Aircraft operating leasing: a legal and practical analysis in the context of public and private international air law

Hanley, D.P.

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PART 3:

THE AIRCRAFT OPERATING LEASE

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3.1 Parties

The preliminary steps identified in 2 (Overview) *supra* should have clarified who should be the parties to the lease – that is, whether a head lease/sub-lease structure, owner trust or other structure which may cause a change in the parties is required.

If so, whether or not there should be a guarantee of the obligations of either or both parties under the lease should be clear by this stage.

If the lessor is, for whatever reason, not the leasing company itself, but an intermediary vehicle of the leasing company or an owner trust under which the leasing company is the beneficiary,[147] the lessee should consider obtaining a guarantee of the lessor's obligations from the leasing company itself. Although the lessee is primarily the debtor under the lease and the lessor is primarily the creditor (and the parties are respectively seen as such under Article 1 of the Cape Town Convention), the lessee is a creditor in respect of refund of any security deposit and maintenance reserves it pays as well as for other contractual obligations and thus has a legitimate interest in the creditworthiness of the lessor.

If the lessee's credit is such that a guarantee of its obligations is required by the lessor, this should be demanded and reflected where appropriate in the drafting.

In particular, any representations and warranties given by a party in the lease should also be given by that party's guarantor, and any events of default relating to the creditworthiness of the lessee should be extended to such events in the context of the guarantor also since the lessor will in such instance be looking to the credit of the guarantor.

[147] Since invariably in such case, the owner trustee will insist on undertaking obligations in the lease "not in its individual capacity but solely as owner trustee."

3.2 Recitals

Although not legally required, the recitals can be a useful introduction to the lease for the reader. See also 2.6.2 *supra*. They help put the lease in context but, under English law, are only used as an aid to construction in case of ambiguity.[148]

They can set out the context to the lease, which may be particularly useful, for example, where there is a complicated ownership structure, where the owner, the head lease from the owner as head lessor to the lessor as head lessee, and the intention of the lessor to lease the aircraft as sub-lessor to the airline as sub-lessee can be made clear.

Recitals are typically set out following the word "Whereas" to indicate that they set out the background to the lease, and are then followed by such words as "Now therefore, it is agreed between the parties as follows", and the actual agreement of the parties is set out.

Thus, the argument may be raised that the recitals do not form part of the contract itself.

It is typical, therefore, to include a provision whereby not only the recitals, but also any schedules, annexes and appendices to the lease are deemed to form part of the lease – this avoids any argument, for example, as to whether terms defined in the recitals and used elsewhere in the lease form part of the lease and as to whether any representation, warranties or undertakings set out therein are representations, warranties or undertakings under the lease such that the remedies for breach thereof under the lease are not lost simply because they appeared in the recitals, that is, before the words "Now therefore, it is agreed between the parties as follows."

[148] Clark T (editor), *Leasing Finance*, Euromoney, 1985, at 52.

3.3 Definitions

The definitions used are vital to the interpretation of the lease. They may be set out for ease of reference either at a particular place in the lease or as a separate schedule attached to the lease but it is desirable that they be set out in one place.[149]

One advantage of setting the definitions in a separate schedule is that technical staff for the lessor and the airline may request that technical provisions, particularly as to delivery and redelivery condition, also be set out in separate schedules. If the definitions are also set out in a separate schedule, they can simply extract the relevant schedules, including that for definitions, and refer to that. This is not a legal consideration, but is a practical one where cross border aircraft dry operating leases typically run up from one to two hundred pages in length.

One reason to use definitions is consistency, which will help in the correct construction of the contract.

For example, in the context of insurance, one may refer to agreed value[150] or to stipulated loss value but one should be consistent in one's choice of words to make sure that it is clear that the same concept is being referred to each time.

Likewise, one may refer either to security deposit or commitment fee[151] and one may refer either to maintenance reserves or supplemental rent[152] but one should be aware of the possible implications of one's choice of terminology (for example, different treatment in the case of bankruptcy of the lessee)[153] and use the same words consistently when referring to the same concept.
Maintenance reserves may be defined by reference to the number of hours utilised by the aircraft. In this case, the draftsman should be clear whether flight hours or block hours are the relevant unit of reference and the relevant term defined clearly and used consistently to avoid confusion.

For example, a "Flight Hour" means:

> "each hour or part thereof elapsing from the moment at which the wheels of the Aircraft leave the ground on the take-off of the Aircraft until the wheels of the Aircraft touch the ground on the landing of the Aircraft following such take-off"[154]

whereas a "Block Hour" means:

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[149] *Vide* Section 1 of the Supplement *infra.*
[150] *Vide* 3.12.2.1 *infra.*
[151] *Vide* 3.7.2 *infra.*
[152] *Vide* 3.7.3 *infra.*
[153] *Vide* 3.7.2 & 3.7.3 *infra.*
[154] Bunker D H, *International Aircraft Financing: Volume 2: Specific Documents*, IATA, 2005 at 52.

> "[t]he number of hours incurred by an aircraft from the moment it first moves for a flight until it comes to rest at its intended blocks at its next point of landing…"[155]

If, therefore, only the term "hours" were used, it would not be clear how to calculate the number of hours desired – hours in the air or hours in motion, whether on the ground or in the air.

Likewise, if "Block Hours" were used where "Flight Hours" was intended, or *vice versa*, or they were wrongly defined, the lessee could end up paying either too much or too little by way of maintenance reserves calculated based on hourly usage of the aircraft.

How terms are defined in leases will be looked at under the heading of the relevant part of the lease where they are most relevant. See also 2.6.3 *supra*.

[155] *Ibid.*

3.4 Representations and Warranties

Each party will give each other representations and warranties, which may be repeated periodically, breach of which gives rise to remedies[156] for breach of contract.[157] Typical representations and warranties of a lessee include those set out at Annex 7.

3.4.1 Representations as to present and past facts

Representations are made by each party to the other to induce the other to enter into the lease. They should be made with respect to present and past only. Representations as to the future are not possible and should be covered as covenants or events of default, which will be examined at 3.10 and 3.14 *infra*.

3.4.2 Repetition of representations

That said, it is not uncommon for a lessor to request that a lessee repeat its representations and warranties (with respect to facts and circumstances then existing) at delivery of the aircraft under the lease and possibly also periodically throughout the term of the lease – typically, throughout the lease term or at least on each rent payment date.

It is debatable as to whether there is much need to insist on this or much risk in acceding to such a demand since breach of a given repeated warranty will most likely be caught by one or other of the events of default anyway but the drafter should check rather than assume that such is indeed the case.

A stronger objection to automatic repetition of representation and warranties is that it may force a lessee into making a false representation and warranty. For example, the lease may provide that the representation and warranties will automatically be deemed to be repeated (with respect to facts and circumstances then existing) on each rent payment date. The lease may further provide a representation and warranty on the part of the lessee there are no withholding taxes payable on the rental payments and that such statement was correct when the lease was signed but subsequently the law is changed and a withholding tax is introduced. The lessor should be protected by the gross up clause in the taxation section (as to which see 3.8 *infra*) requiring the lessee to pay a sufficient amount in rent such that, after making the requisite withholding, the lessor still receives the same net payment of rent as if there had been no withholding. With an automatic repetition of representations and warranties, however, on the next rent payment date after the change in law, the lessee will be deemed to have made a representation and warranty that is untrue, thus entitling the lessor to terminate the lease.

The one time when a lessor will have a strong need for repetition of representations and warranties will be if it decides to sell the aircraft to another party with the benefit of the

[156] *Vide* 3.15 *infra.*
[157] *Vide* Section 2 of the Supplement *infra.*

lease attached. The purchaser will invariably want the lessee to repeat in its favour the representations and warranties set out in the lease before entering into a contractual relationship with the lessee. Lessees often refuse this on the basis that they are not so obliged under the lease – one possible compromise would be for the lessor to agree that the only repetition of representations and warranties by the lessee would be upon an assignment or novation of the lease to a purchaser of the aircraft and that even then, if the lessee could not truthfully repeat such representations and warranties with respect to facts and circumstances then existing, it could then qualify such representations and warranties accordingly.

3.4.3 Representations of law

A representation must be a statement of fact, not of opinion or (with some exceptions) of law.[158]

The fact that representations generally cannot be given as to law is sometimes relied upon be lessees who wish to limit their representations and warranties strictly to factual matters only and who wish to deal with representations as to law only in the legal opinion to be provided to the lessor by their lawyers as one of the conditions precedent to the lessor's obligations under the lease. This argument ignores two points.

The first is that representations as to foreign law, with which the lessor is not expected to be familiar itself, may be binding.[159] Most leases are cross border leases where the lessor and lessee are based in different jurisdictions.

The other is that if a particular representation as to foreign law is incorrect, if it is only in the legal opinion, the lessor's only remedy is for damages against the lawyer giving the incorrect legal opinion whereas if it is in the lease, the lessor will have the full range of remedies as set out in the lease available to it, including the right not only to seek damages but to terminate the leasing of the aircraft and to recover possession of the aircraft.

If a representation misrepresented a relevant fact, under English common law, unless such representation were incorporated into the contract, no remedy for damages lay, although the party to whom such misrepresentation was made could seek to rescind the contract.[160]

3.4.4 Warranties

A warranty does form part of the contract but is contrasted with a condition. Under the English Sale of Goods Act 1893, a condition was defined as a provision of a contract the "breach of which may give rise to a right to treat the contract as repudiated"[161] whereas a

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[158] Furmston M P, *Cheshire & Fifoot's Law of Contract*, 10th edition, Butterworths (1981) at 235-240.
[159] *Ibid.* and Bunker D H, *International Aircraft Financing, Volume 2: Specific Documents*, IATA (2005) at 67.
[160] Furmston, *op. cit.*, at 235-240.
[161] Section 11(1)(b).

warranty was a provision of a contract the "breach of which may give rise to a claim for damages but not to a right to… treat the contract as repudiated".[162] Such dichotomy between condition and warranty has since become "a general but not a universal feature" of English contract law.[163]

To avoid the issues of whether a particular representation was made at all, whether it induced the lessor to enter into the contract, whether it forms part of the contract, whether, as part of the contract, it is, even if described as a warranty, a condition or a warranty for the purposes of English contract law, common drafting practice is to set out the relevant facts relied upon in the lease itself as both representations and warranties together and to provide for the lessor's remedies for their breach in the lease itself, such remedies invariably including the right to terminate the leasing of the aircraft and to demand repossession thereof.

It should not be thought, however, that in aircraft operating leases, representations and warranties have thus fallen together for all purposes. In *Sabena Technics SA v Singapore Airlines Limited,*[164] Colman J of the English High Court held on the facts that an incorrect statement with respect to the condition of the aircraft in question on the part of the lessor constituted a breach of warranty[165] even thought it did not constitute a misrepresentation under Section 2(1) of the English Misrepresentation Act 1967[166] or negligent misrepresentation.[167]

3.4.5 Conclusions

In the context of representations and warranties, on the basis of which the parties enter into the aircraft operating lease, thus far, no particularities relating to public or private international air law have been disclosed. As seen in 3.4.4 *supra*, the governing law of the lease contract may have statutory provisions but these are of the sort which may be expected in the context of any contract, regardless of whether or not related to international aviation. The lease contract having been entered into on foot of those representations and warranties, the review turns next to conditions precedent which must be fulfilled before the respective obligations of the parties thereunder take effect.

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[162] *Ibid.*
[163] Furmston at 132.
[164] [2003] EWHC 1318 (Comm).
[165] At 94.
[166] At 111.
[167] At 114.

3.5 *Conditions precedent*

Conditions precedent of a party are those conditions which must be satisfied before the obligations of that party under the lease become effective.[168] The major conditions will be examined in detail. Typical conditions precedent to be satisfied by a lessee in order for the obligations of the lessor under the lease to become effective include those set out at Annex 8.

It is important to define what is meant by conditions precedent, which in Roman law was treated not as part of the contract itself but an external fact on which the existence of the obligation depends.[169] It may be that the whole existence of a contract is suspended until the happening of a stated event, that is, until satisfaction of a condition precedent.[170] On the other hand, it may be that such a condition may operate:

> "not to negate the very existence of a contract but, to suspend, until it is satisfied, some right or duty or consequence which would otherwise spring from the contract."[171]

In the case of the aircraft operating lease, the latter is the more likely since it will typically provide that, if the lessor does not satisfy the conditions to be satisfied by it within the time specified, the lessee shall not be bound to accept delivery of the aircraft and, if the lessee does not satisfy the conditions to be satisfied by it within the time specified, the lessor shall not be bound to tender delivery of or to deliver the aircraft to the lessee. However, even in such event, the parties will want the lease agreement itself to survive since they will want such matters as representation and warranties, waivers of liability, and perhaps certain other matters to survive notwithstanding non-delivery of the aircraft. Commercially, the parties will wish to be clear as to the return or forfeiture of any deposits paid.
Further, the lessee generally will want to ensure that it is a condition precedent to its being obligated to take delivery of the aircraft under the lease that the aircraft meet the agreed delivery conditions.

3.5.1 General conditions precedent

Certain conditions precedent (as set out below) should be satisfied by both parties, and generally the language required of each party will mirror that required of the other.

3.5.1.1 Payments

For example, it is normally a condition precedent to the lessor's obligations under the lease that the lessor should have received in full payment of the security deposit and the rent in

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[168] *Vide* Section 3 of the Supplement *infra*.
[169] Furmston M P, *Cheshire & Fifoot's Law of Contract*, 10th edition, Butterworths, 1981 at 129.
[170] *Ibid.*
[171] *Ibid*. at 130.

respect of the first rent period, usually one month payable in advance or as otherwise provided for in the lease.[172]

Although the lessor will not normally have payment obligations to the lessee, occasionally these do arise such as where a lessor agrees to make a payment to the lessee in lieu of a certain non-compliance with delivery condition or in order for certain work to be undertaken on the aircraft. Such obligations may, however, take the form of a credit against future rent.

3.5.1.2 Constitutional documents

Both parties should provide copies of their constitutional documents to the other, showing their legal capacity to enter into the aircraft operating lease. These will normally be outside the ability of the other party to interpret; hence, they should be read in conjunction with the legal opinions referred to in 3.5.1.5 *infra.*

3.5.1.3 Corporate approvals

Likewise, both parties should provide copies of their corporate approvals, whether board resolutions or otherwise, to the other, showing that all necessary internal corporate approvals have been obtained to enter into the aircraft operating lease. These will normally be outside the ability of the other party to interpret, at least in the case of cross border leases; hence, they also should be read in conjunction with the legal opinions referred to in 3.5.1.5 *infra.*

3.5.1.4 Filings and consents

Proof that any filings or external consents necessary for the lessor or the lessee to meet its obligations under the lease have been made or obtained as appropriate should be required by the other party.

For example, under Commission Regulation (EC) No 859/2008, OPS 1.165(c)(1)(i) a European Union operator shall not dry lease-in[173] an aeroplane from an entity other than another such operator, unless approved by its authority. Any conditions which are part of this approval must be included in the lease agreement. See also 3.5.2.5 *infra*.

[172] See Bunker D H, *International Aircraft Financing, Volume 2: Specific Documents*, IATA, 2005, at 69.

[173] A dry lease is described as "a lease of an aircraft where the aircraft is operated under the AOC of the lessee. It is normally a lease of an aircraft without crew, operated under the commercial control of the lessee and using the lessee's airline designator code and traffic rights" in ECAC Recommendation on Leasing of Aircraft, Recommendation ECAC/21-1 in *Study on Aircraft Leasing*, Air Transport Committee, 156th Session of the Council, ICAO, 1999, at Appendix B.

Bilateral air transport agreements between countries may come into play.[174] According to the Air Transport Committee of ICAO, out of 41 bilateral air service agreements found to contain provisions on leasing, three had clauses dealing with safety aspects requiring the aviation authority of the operator to be satisfied that airworthiness standards will be maintained.

Greater concern is shown therein for leases from one airline to another airline, with a desire to make clear that no additional traffic rights are granted being evident, and, importantly, in the context of the present work, a distinction being made in certain cases between leases from other airlines, on the one hand, and leases from non-airline lessor, on the other hand. For example, in certain cases, notification only rather than approval is required in the case of leases from non-airline lessors.[175]

Again, these should be read in conjunction with the legal opinions referred to in 3.5.1.5 *infra.*

3.5.1.5 Legal opinions

The lessee should provide a legal opinion, from its qualified legal counsel[176] acceptable to the lessor, confirming the overall legal viability of the structure from a legal point of view. Where the governing law of the lease, the jurisdiction of registration of the aircraft, and the jurisdiction of incorporation and residence of the lessee differ, multiple legal opinion may be necessary, one from each relevant jurisdiction.

As the lessor will also owe certain obligations to the lessee, such as return of the security deposit, return of maintenance reserves and the covenant of quiet enjoyment during the lease term, a legal opinion or opinions from its qualified legal counsel acceptable to the lessee may also be appropriate.

See also 2.5 *supra* and Annex 6 *infra*.

3.5.1.6 Process agent letter

Unless the lessee is domiciled in the jurisdiction (or otherwise subject to the jurisdiction of its courts) chosen as a venue for resolution of disputes (such as an English airline where the courts of England are chosen in the lease as having jurisdiction over any disputes that arise under the lease), a letter from an agent for the lessee agreeing to act as its agent for service of process within such jurisdiction should be obtained.

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[174] Article 6 of the Chicago Convention requires permission or authorization of a state for scheduled international service over or into its territory. Accordingly, the majority of international scheduled fights are regulated by international bilateral or multilateral air transport agreements. *Vide* Bunker D H, *International Aircraft Financing, Volume 1: General Principles*, IATA, 2005, at 367.

[175] *Study on Aircraft Leasing*, Air Transport Committee, 156th Session of the Council, ICAO, 1999, 4.3-4.14.

[176] This need not necessarily be from an independent law firm retained by the lessee but may, if the lessor agrees, be from in-house legal counsel in the employment of the lessee.

The lessee should likewise require a similar letter from the lessor.

Without such a letter, a party seeking to sue the other may be subject to cumbersome procedures to serve a party outside the relevant court's jurisdiction.

Even with such a letter, without substantial assets in such jurisdiction, the value of any favorable judgment will depend on the ability of the victorious plaintiff to enforce such judgment in a jurisdiction where the other party has indeed substantial assets.

3.5.2 Airline specific conditions precedent

Certain documentary conditions precedent must be satisfied by the lessee before the lessor will agree to deliver the aircraft. These are necessary for various reasons: the lessor will want to ensure that the lessee has all necessary approvals and is competent to operate the aircraft. Even if the lessor does not ask for them, the lessee must have them in order to satisfy its legal requirements.

These documents include the certificate of insurance, certificate of registration, certificate of airworthiness, radio station license, air transport license, air operator's certificate, and Eurocontrol letter. There may be others, which should be determined by the lessor's local counsel, and which should have been identified pursuant to the jurisdictional questionnaire discussed at 2.4 *supra*.

Article 19 of the Paris Convention, required that an aircraft covered by it be "provided with", *inter alia*, certificate of registration, airworthiness, crew licenses, and a license for any equipped radio[177] apparatus but did not expressly require that these be carried on board the aircraft – under Article 29 of the Chicago Convention, the aircraft must, *inter alia*, "carry" such documents. Under Article 80 of the Chicago Convention, the Chicago Convention superseded the Paris Convention. Within the European Union, these documents together with the certificate of insurance, *inter alia*, must, be carried on each flight pursuant to OPS 1.125 of Commission Regulation (EC) No 859/2008.

Each will be examined in further detail below.

3.5.2.1 Certificate of insurance and broker's letter of undertaking

The lessor will want to know that the aircraft is adequately insured,[178] and that it, and any of its financiers, are covered adequately as to liability, as required by the lease (see 3.12

[177] Termed "wireless" in the Paris Convention.

[178] Typically, in accordance with the standard Lloyd's market endorsement for lessors and financiers AVN 67B or its replacement AVN 67C – http://www.awg.aero/insuranceandliability.htm on 8 February 2011. As the separation between aircraft owner and operator has developed, aircraft financiers had to become familiar with nuances of insurance in an effort to avoid last minute pressure to approve insurance provisions. AVN 67B was developed to standardise policy endorsements for finance and lease contracts in the London market

infra) and will also want to receive a broker's letter of undertaking whereby, if the insurances should be cancelled, for example, due to non-payment of premium by the lessee, the broker will give a certain minimum notice first to the lessor to enable it to ensure continuation of coverage.

The certificate of insurance need not necessarily be kept on board the aircraft.

In an English Court of Appeal case, *First Security Bank National Association (acting as owner trustee for the benefit of Leopard Leasing No 2 Ltd) v Compagnie Nationale Air Gabon,*[179] May LJ upheld a refusal on discretionary grounds by Timothy Walker J in the English High Court to grant an injunction to lessor preventing lessee from flying the leased aircraft (which in this case had already been delivered) from France to Gabon where the proof of insurance was incomplete and not fully legible and the broker's opinion was missing. The judgment was without prejudice to the issue of damages.

3.5.2.2 Certificate of registration

The aircraft is required to carry its certificate of registration issued in compliance with Articles 17 and 18 of the Chicago Convention,[180] superseding Article 7 of the Paris Convention.

In practice, this may not always issue in time for delivery of the aircraft to the lessee and it is customary, where necessary, to allow a copy of such certificate to be forwarded to the lessor within a few days of delivery.

Traditionally, a certified copy of the certificate of registration was simply collected pursuant to the conditions precedent around the time of delivery and forgotten about unless, pursuant to a sub-lease or some other development, a change in the state of registration was required during the lease term. This may change, certainly for aircraft registered in the United States, and for other countries which may follow its approach in introducing new regulations requiring re-registration of aircraft every three years pursuant to particular procedures which, if not followed, will lead to the aircraft being removed from its register.

Prior to such new regulations, registration was indefinite[181] - the purpose of the new regulations[182] is to clean up the register, burdened by thousands of outdated and inaccurate

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which insurers elsewhere generally follow: Margo R D and Houghton A T, *The Role of Insurance in Aviation Finance Transactions* in Butler G F and Keller M R, executive editors, *Handbook of Airline Finance*, 1st edition, Aviation Week:McGraw-Hill, 1999, at 279 *et seq.*

[179] Royal Courts of Justice, 10 May 1999.

[180] *Vide* 3.10.2.3 *infra*.

[181] Gerber D N, *Aircraft Finance Issues: The Blue Sky Ruling; The New ASU and the "Home Country Rule"; and Recent Developments at the FAA Registry*, a paper presented at the American Bar Association Air and Space Law Forum 2010 Annual Meeting in Seattle, Washington on 26 October 2010.

[182] 14 C.F.R. Section 47.40(a)(1).

registrations.[183] Henceforth, certificates of registration issued by the United States Federal Aviation Administration will contain an expiry date dated three years later. 180 days prior to such expiration, a reminder will be sent to owners, as befits an ownership based system.[184]

The owner should beware that, if it fails to renew the registration of the aircraft, the registration of the aircraft will lapse, and the lessee will be unable to operate the aircraft – this would leave the owner/lessor open to a claim by the airline lessee for breach of its covenant of quiet enjoyment.[185]

Lessors should thus be careful to have systems in place to ensure renewal of such registration.

If similar requirements are brought in by jurisdictions with operator based registries,[186] lessor should build in systems to ensure the lessee is required to show timely proof of such renewal.

3.5.2.3 Certificate of airworthiness

The aircraft is required to carry a certificate of airworthiness issued in compliance with under Article 31 of the Chicago Convention (superseding Article 11 of the Paris Convention). It is the responsibility of the aviation authority where the aircraft will be registered during the term to inspect the aircraft and to issue the certificate of airworthiness (except in the case of an Article 83 *bis* delegation, as to which, see 3.15.8 *infra*).

3.5.2.4 Radio station license

The aircraft is required to carry a license for any radio apparatus with which it is equipped issued in compliance with under Article 30 of the Chicago Convention (superseding Article 14 of the Paris Convention).

3.5.2.5 Air transport license

Council Regulation (EC) 1008/2008,[187] Article 3.1, provides that no undertaking established in the European Union shall be permitted to carry by air passengers, mail and/or cargo for remuneration and/or hire unless it has been granted the appropriate operating licence, commonly known as an air transport license.

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[183] *Ibid.*
[184] *Vide* 3.10.2.3 *infra.*
[185] *Vide* 3.10.1 *infra.*
[186] *Vide* 3.10.2.3 *infra.*
[187] Regulation (EC) No 1008/2008 of the European Parliament and of the Council of 24 September 2008 on common rules for the operation of air services in the Community.

Article 4 sets out the conditions for granting such a license and it is worth setting them out here in full:

> "An undertaking shall be granted an operating licence by the competent licensing authority of a Member State provided that:
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> (a) its principal place of business is located in that Member State;
>
> (b) it holds a valid AOC issued by a national authority of the same Member State whose competent licensing authority is responsible for granting, refusing, revoking or suspending the operating licence of the Community air carrier;
>
> (c) it has one or more aircraft at its disposal through ownership or a dry lease agreement;
>
> (d) its main occupation is to operate air services in isolation or combined with any other commercial operation of aircraft or the repair and maintenance of aircraft;
>
> (e) its company structure allows the competent licensing authority to implement the provisions of this Chapter;
>
> (f) Member States and/or nationals of Member States own more than 50% of the undertaking and effectively control it, whether directly or indirectly through one or more intermediate undertakings, except as provided for in an agreement with a third country to which the Community is a party;
>
> (g) it meets the financial conditions specified in Article 5;
>
> (h) it complies with the insurance requirements specified in Article 11 and in Council Regulation (EC) No 785/2004; and
>
> (i) it complies with the provisions on good repute as specified in Article 7."

A practical issue here is that the airline must have one or more aircraft at its disposal. For a start up airline, the lessor can sign up a lease for the first aircraft, and, indeed may have to in order for the lessee to be able to obtain an air transport license, but it should require confirmation that such license has been obtained before it delivers the aircraft – the lessee in any event will need such license in order to put the aircraft into service.

Under Article 13.2, a dry or wet lease agreement[188] to which a European Union air carrier is a party shall be subject to "prior approval in accordance with applicable Community or national law on aviation safety."

Under Article 13.3, in the case of an aircraft registered in a third country, a wet lease agreement to a European Union air carrier is, unlike a dry lease, additionally subject to prior approval for the operation from the competent licensing authority which may, *inter alia*, require one of the following conditions to be fulfilled:[189]

> "(i) the Community air carrier justifies such leasing on the basis of exceptional needs, in which case an approval may be granted for a period of up to seven months that may be renewed once for a further period of up to seven months;
>
> (ii) the Community air carrier demonstrates that the leasing is necessary to satisfy seasonal capacity needs, which cannot reasonably be satisfied through leasing aircraft registered within the Community, in which case the approval may be renewed; or
>
> (iii) the Community air carrier demonstrates that the leasing is necessary to overcome operational difficulties and it is not possible or reasonable to lease aircraft registered within the Community, in which case the approval shall be of limited duration strictly."

The above requirements are not expressly extended to dry leases, but it is not clear whether or not similar requirements for dry leases could be invoked anyway pursuant to the more general language of Article 13.2, particularly where it is proposed to keep the aircraft on the register of a third country whether pursuant to Article 83 *bis* of the Chicago Convention or otherwise.[190]

The license may be suspended or revoked pursuant to Article 9.

3.5.2.6 Air operator's certificate

Commission Regulation (EC) No. 859/2008, Subpart C, OPS 1.175 et seq., deals with rules for the issuance of an air operator's certificate (commonly known as an "AOC") to a European Union carrier and certifies that the operator has the professional ability and organisation to ensure the safety of operations specified in the certificate.

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[188] A wet lease is described as "a lease of an aircraft where the aircraft is operated under the AOC of the lessor. It is normally a lease of an aircraft without crew, operated under the commercial control of the lessee and using the lessee's airline designator code and traffic rights" in ECAC Recommendation on Leasing of Aircraft, Recommendation ECAC/21-1 in *Study on Aircraft Leasing*, Air Transport Committee, 156th Session of the Council, ICAO, 1999, at Appendix B.

[189] Article 13.3(b).

[190] *Vide* 3.15.8 *infra.*

Whereas the air transport license then is concerned with the overall viability of the proposed enterprise, the air operator's certificate is concerned with safety. Indeed, as we have seen in 3.5.2.5 *supra*, in the European Union it is a requirement[191] that an enterprise seeking an air transport license demonstrate that it already holds an air operator's certificate.

3.5.2.7 Eurocontrol letter

For leases of aircraft which are, or are likely to be, operated into the European Union or any other territory in respect of which Eurocontrol provides air navigation services, it is, in this author's experience, standard practice for lessors to require that the lessee first supply it with a letter, in form satisfactory to it and to Eurocontrol, authorizing it to obtain information from time to time concerning the status of the lessee's account with Eurocontrol in respect of air navigation charges.

Without such a letter, Eurocontrol is not free to divulge what are otherwise private matters between it and the lessee airline. Having obtained such a letter,[192] it is then up to the lessor to check such status regularly with Eurocontrol so as to monitor any airlines whose overdue debts may become of concern, especially given the extent of Eurocontrol's *in rem* lien over the aircraft for unpaid charges.[193]

3.5.3 Waivers and conditions subsequent

With the exception of insurances and, usually, payments, sometimes a lessor will agree to deliver an aircraft to a lessee notwithstanding that the lessee has not then satisfied all conditions to be satisfied by it. Such unsatisfied conditions will, in such event, be waived permanently or temporarily by lessor.

In particular, quite often, the certificate of registration may not be available until some short time after delivery, allowing for processing time.

In such circumstances, the parties should agree a short letter setting out which conditions precedent have not yet been satisfied by the lessee, agreeing that delivery may nevertheless proceed, but providing that such unsatisfied conditions, if not permanently waived, are temporarily waived by being converted into conditions subsequent to be satisfied within a mutually agreed period after delivery.

Such a letter will only be of real value to the lessor if it also provides that failure to satisfy any relevant condition subsequent within such agreed time period shall constitute an event

[191] Article 4(b) of European Commission Regulation 1008/2008.
[192] This assumes, of course, that Eurocontrol abides by its provisions. It is submitted that this letter, which is the lessor's primary means of monitoring a situation which could result in loss of title to its aircraft for reasons outside its control, be put on a legal footing which clearly obliges Eurocontrol to abide by it.
[193] *Vide* 3.10.2.2.2 *infra.*

of default under the lease, thus allowing the lessor to exercise its remedies for breach under the lease.

This can be seen from Cheshire & Fifoot's definition of a condition subsequent as follows:

> "If a contract has come into existence but is to terminate upon the occurrence of some event, it is said to be subject to a condition subsequent." [194]

Such a definition encompasses also events of default the occurrence of which entitle the lessor to terminate the leasing of the aircraft to the lessee under the lease agreement.

3.5.4 Conclusions

The conditions precedent reviewed in 3.5.1 *supra* are of the type which are to be expected in any commercial cross-border contract and are not, of themselves, specific to international aviation, even if some of the specific examples are.

The conditions precedent set out at 3.5.2 *supra,* however, disclose for the first time the relevance of public and private international air law to the aircraft operating lease contract.

The conditions examined at 3.5.2 *supra* may, in turn, be divided into those which the lessor simply requires to see simply as a matter of due diligence and those which it contractually imposes on the lessee before it is willing to part with possession of its aircraft in favour of the lessee.

Examples of the former, which the lessor requires as a matter of due diligence but which the lessee is required as a matter of law to have anyway in order to operate the aircraft, whether they are set out contractually as conditions precedent in the lease or not, are that the lessee holds an air transport license and an air operator's certificate.

An example of the latter is the requirement that the lessee provide the lessor with a letter authorizing Eurocontrol to disclose details of its account with Eurocontrol to lessor. This is a purely contractual requirement of the lessor: the lessee is required to pay Eurocontrol fees for navigation services but disclosing details of its account to a lessor is not a legal requirement of Eurocontrol or any other entity.

A hybrid example is the requirement that the lessee provide the lessor with an insurance certificate – liability coverage is legally required anyway but the lessor may impose higher contractual requirements as to liability insurance and will require hull insurance.[195]

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[194] Furmston M P, *Cheshire & Fifoot's Law of Contract*, 10th edition, Butterworths, 1981, at 131.
[195] *Vide 3.*12 *infra.*

In the case of these latter types of conditions precedent, therefore, the provisions of public and private international air law come into play in the aircraft operating lease, with particular concerns for the lessor in the case of non-compliance therewith by the lessee, and these are examined in detail as they arise throughout Part 3 of this study.

Having satisfied the conditions to the obligations of the parties under the lease, the examination turns next to the delivery of the aircraft by the lessor to the lessee thereunder.

3.6 Term and delivery

3.6.1 Term

The term of the lease together with any early termination or extension options should be set out with certainty.[196] Any minimum time period notice provision to terminate early or to extend should be clear and should be irrevocable once given.

The term must be ascertainable but need not necessarily be a fixed date: for example, it could be stated to be a given date, or a given period from the delivery date, or even something not fixed (but ascertainable) such as completion of the first scheduled heavy check (suitably defined) to occur before or after a certain date.

Once all conditions precedent to delivery are satisfied or waived, the aircraft may be tendered for delivery at the agreed delivery location, which should be specified in the lease since this will have cost implications in terms of fuel, crew, and insurance. Also, as the lessee will generally bear the tax risk of any taxes being imposed by virtue of the delivery in the jurisdiction of the delivery location (as to which, *vide* 2.6.8 *supra*), the lessee should satisfy itself beforehand that it will not face any untoward tax consequences by agreeing to accept delivery in a particular location.

3.6.2 Delivery

The agreement to lease is typically set out here and constitutes the core of the contract between the parties whereby the lessor agrees to lease the aircraft to the lessee and the lessee agrees to lease the aircraft from the lessor on and subject to the terms set out in the lease agreement.

Passing of risk on delivery, the requirement that the aircraft be in delivery condition, and delay in delivery are also issues to deal with here.

3.6.2.1 Delay in or failure of delivery

The lease should provide for what happens in the case of delay or failure to deliver the aircraft in the delivery condition set out in the lease within the timeframe set out in the lease as well as the effect of accepting delivery of the aircraft by the lessee.

If the lessee fails to accept delivery when properly tendered, the lease will normally give the lessor the right to keep the security deposit.[197] Normally, some delay in delivery is contemplated but typically a final date for delivery will be set out, failing which, the security deposit will be returnable to the lessee, if failure is not attributable to the lessee, or the security deposit may be retained by the lessor, if failure is attributable to the lessee.

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[196] *Vide* Section 4 of the Supplement *infra.*

[197] See Bunker D H, *International Aircraft Financing, Volume 2: Specific Documents*, IATA, 2005, at 93.

See also 3.7.2 (Security Deposit) and 3.19.1 (Time of the Essence), *infra.*

3.6.2.2 Failure to meet delivery condition prior to delivery

An aircraft operating lease will typically set out a delivery condition which must be met in order for the airline to be obliged to take delivery of the lease. If it does not, the lessee should be free to reject the aircraft and demand the return of its deposit.

Lessors often worry that a lessee may find a minor non-conformity in delivery condition and use that as an excuse to refuse delivery in circumstances where the lessee's real reason is that it no longer wants the aircraft, or markets rents have dropped since it signed the lease agreement.

A recent New York case involving the sale of an aircraft which failed to meet the contractually stipulated delivery condition will not give such lessor much comfort. In *Austrian Airlines Oesterreichische Luftverkehrs AG v UT Finance Corporation*,[198] Kaplan DJ was asked to rule on a contract which provided for the sale of an aircraft where the aircraft, as was stipulated by both parties, did not meet the required delivery condition in certain important respects. The airline sought to enforce the contract on the grounds that the contract provided for a reduction in price in case of non-conformity, and argued that industry practice meant that the defendant was acting unreasonably in refusing such reduction, its real grounds for refusal being the collapse in aircraft values after the terrorist incidents in the United States of America of 11 September 2001 involving aircraft.

Kaplan J was firm in disposing of the claim: the contract provided that the defendant "may" but did not have to accept a reduction in price in lieu of precise conformity to the delivery condition. He held that any contrary industry practice does not apply in the case of clear contrary language in the contract. He also held that the defendant did not act in bad faith: it was entitled to take account of the decline in aircraft values "to insist upon getting everything it bargained for".[199]

Finally, in this case, the contract was governed by New York law, under which, pursuant to Section 2-508(2) of the Uniform Commercial Code:

> "[w]here the buyer rejects a non-conforming tender which the seller had reasonable grounds to believe would be acceptable with or without money allowance the seller may if he seasonably notifies the buyer have a further reasonable time to substitute a conforming tender."

Kaplan DJ held in *Austrian*[200] that the seller in the case had no such reasonable grounds.

[198] 04 Civ 3854 (LAK) (2008).
[199] *Id.*, at 36.
[200] *Op. cit.*

In the context of a lease, not only does the above statute, dealing with sales, not apply, but, pursuant to the judgment in *Austrian*, a lessee may well be justified, if the wording of the lease so permits it, in demanding precise conformity of the aircraft to the delivery condition set out in the lease even if its main reason is that it no longer wants the aircraft or that lease rents have indeed dropped since it first signed the lease. Lessors should beware!

3.6.2.3 Effect of acceptance of delivery

In *ACG Acquisition XX LLV v Olympic Airways,*[201] there was a dispute between the lessor and the lessee where the lessee had accepted delivery of an aircraft under lease after due inspection and signing an acceptance certificate (execution of which was stated in the lease to be conclusive proof of the lessee's examination and acceptance of the aircraft condition) but where the aircraft was soon after delivery declared unairworthy by the lessee's aviation authority.

The lease also contained an exclusion that the lessee accepted the aircraft "as is, where is" and that lessor would have no liability and had given no representations as to condition, airworthiness, fitness for any use or purpose, or otherwise.[202]

On the facts, Hamblen J refused to grant summary judgment, holding that the lessee had a sufficiently arguable case of total failure of consideration. Although there is much to criticize in his judgment, and although the case was later settled, it is instructive to note that he laid much emphasis on the fact that, regardless of all the above provisions, in addition to its being a condition precedent to the lessee's obligation to accept the aircraft that the aircraft be in the agreed delivery condition, the lease also provided that, on the delivery date:

> "Lessor shall deliver the Lease Property "as is, where is" and in the condition required by Schedule 2[203]…."[204]

This clause made the lessee's obligation to lease the aircraft conditional on the lessor's delivering the aircraft in a condition meeting the contractually required condition. This is not an unusual provision[205] – normally execution of the acceptance certificate by lessee is proof of satisfaction of such requirement.

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[201] [2010] EWHC 923 (Comm). This author hereby discloses that the claimant, ACG Acquisition XX LLC is a related party to and managed by his employer, Aviation Capital Group Corp.
[202] *Id.*, at paragraph 37.
[203] Schedule 2 set out the agreed delivery condition of the aircraft, including that the aircraft be airworthy.
[204] *Id.*, at page 3.

[205] See, *e.g.*, Bunker D H, *International Aircraft Financing, Volume 2: Specific Documents*, IATA, 2005, at 74.

This problem could be avoided in future by removing from the clause of the lease setting out the lessor's obligation to deliver the aircraft any reference to the aircraft's being in a particular condition: this cuts across the exclusion and the conclusivity of the acceptance certificate whereas the lessee's interests would be adequately protected by ensuring it is a condition precedent to its obligation to accept delivery of the aircraft that it meet the delivery condition without imposing a contractual obligation on the lessor to deliver in the delivery condition.[206]

The lessor is not an operator: it either delivers the aircraft new from the manufacturer to the airline or delivers to it at the end of the lease from the previous operator at the end of that operator's lease. Even if the aircraft is off lease for a period, the lessor relies on a third party authorized maintenance provider for any maintenance work performed on the aircraft. The lessor is not in a position to assure any particular condition other than the extent to which it can protect itself contractually as against its lessees and its maintenance providers.

All it can reasonably do, it is submitted, is to afford the lessee a sufficient right of examination for the lessee to decide for itself whether the aircraft meets delivery condition or not. If it does, the lessee should sign the acceptance certificate, and take responsibility for its inspection of the aircraft. If it does not, it should reject the aircraft and demand its deposit back.

A lessee should be careful in what inspection rights it wants, for the broader its inspection rights on delivery, the broader shall the lessor's inspections rights be correspondingly upon redelivery, since these are usually negotiated fairly as to match. It is thus more than a bit disingenuous for an airline to complain that freely negotiated inspection rights on delivery are unfair.

Further, in arguing against the enforceability of the conclusivity language in the acceptance certificate provided for in the lease, the airline sets itself up for the possibility that the similar conclusivity language in the redelivery certificate given to it by the lessor upon completion if its corresponding redelivery inspection at the end of the lease may not be upheld.

Airlines would be wise to consider whether they want to be able to ignore agreed contractual limits on inspection rights of the lessee at delivery and to ignore conclusivity language in the acceptance certificate[207] signed by the lessee at delivery for, should such arguments prevail, lessors would have the ability to claim correspondingly broader rights of inspection at redelivery and to sue lessees post-delivery for defects found after completion of the redelivery inspection notwithstanding conclusivity language in the redelivery certificate signed by the lessor at redelivery.

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[206] *Vide* 3.5 *supra.*

[207] Whereby the lessee confirms to the lessor that it accepts delivery of the aircraft in the contractually agreed delivery condition, or waives any non-compliance therewith.

This brings out an important fact: the lessor is never the operator or maintenance provider. It buys the aircraft, typically new from the manufacturer, leasing it first to one airline, then to another, until it sells the aircraft or the aircraft reaches the end of its economic life. The airline taking delivery of a used aircraft will inspect the aircraft before accepting delivery – this is typically the same as the redelivery inspection from the previous lessee. Thus, it seems inequitable[208] that a subsequent airline lessee could hold a lessor liable for defects without allowing the lessor similar recourse to the previous airline lessee on whose maintenance both the lessor and the subsequent airline lessee have relied. Any airline wishing to make aggressive claims as the subsequent airline lessee should bear in mind that it will, at the end of the lease, be in the shoes of the previous airline lessee.

It is submitted that *Olympic*, being only a judgment on an interlocutory hearing, without a full hearing of the facts or of the reasons (summarized above) why the standard operating lease practice should be given effect to both for contractual certainty and for the protection not only of lessors generally but of lessees as well, and in any event being a judgment peculiar to the particular drafting of the lease in question, it is not a good precedent and should not be followed at a full trial.

If it should be followed, it is submitted that lessors will refuse to grant redelivery certificates[209] to lessees at the end of the lease, as they will need to preserve their ability to sue the previous lessee after redelivery where a subsequent lessee is able to sue the lessor or to escape its obligations under its lease by reason of the condition (for which the previous lessee was responsible) of the aircraft being discovered to be totally unairworthy after delivery.

One final point is that, as noted above, in the *Olympic* case, the lease contained a provision that the lessee accepted the aircraft "as is, where is" and that lessor would have no liability and had given no representations as to condition, airworthiness, fitness for any use or purpose, or otherwise of the aircraft.

In the European Union, Council Directive 85/374/EEC of 25 July 1985, dealing with product liability, provides, under Article 1, that a producer shall be liable for damage caused by defects in his product, which is defined to mean all movables.[210] Under Article

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[208] It is conceded that there is not a perfect symmetry between a subsequent lessee's claims against a lessor after delivery and a lessor's claim against a previous lessee after redelivery. With the former, Hamblen J in *Olympic* considered the possibility that, notwithstanding the conclusivity language of the acceptance certificate, a lessee may not be bound in case of total failure of consideration, which could occur with delivery of an unworthy aircraft.
By contrast, where a lessor has accepted redelivery from a lessee which performed its obligations during the lease, and only after redelivery discovered that the aircraft was unairworthy, it would be much more difficult for the lessor to establish total failure of consideration on the part of the lessee, since some consideration at least would have passed (e.g. rent during the lease term), and thus that could not be used as a ground to defeat or to ignore the conclusivity language in the redelivery certificate, if any, given to the previous lessee.

[209] Whereby the lessor confirms to the lessee that it accepts redelivery of the aircraft in the contractually agreed redelivery condition, or waives any non-compliance therewith.

[210] With the exception of primary agricultural products and game: Article 2.

3(1), any person who imports into the European Union a product for leasing shall be deemed to be a producer. The liability of the producer arising from this Directive may not, in relation to the injured person, be limited or excluded by a provision limiting his liability or exempting him from liability.[211] Thus, in theory, any provision in a lease, such as that in the *Olympic* case, relieving a lessor of liability may be void under this Directive.[212]

In practice, however, a lessor is unlikely to face liability pursuant thereto since damage under Article 1 is limited to mean damage by death, personal injury or damage to certain property (other than the movable complained of) used by the injured person mainly for his own private use or consumption.[213] The lessee itself is more likely to face economic loss than such personal injury or physical property damage.

3.6.3 Conclusions

The term of the lease should normally be sufficiently clear as not to raise legal issues but the consequences of acceptance or non-acceptance of delivery may give rise to dispute, as seen above.

Neither public nor private international air law appears to have much of a role, if any, in respect of disputes concerning the term of or delivery under a lease. As seen above, these are dealt with, rather, under the governing law of the lease, which is a national law, and the main legal challenge in this respect has been to the conclusivity of the acceptance certificates required by lessors of lessees. For the reasons given above, this author favours recognizing the conclusive nature of such acceptance certificates as stated in the terms thereof.

Once the aircraft has been delivered to the lessee under the lease, the lessee's obligations commence, including the obligation to pay rent and other amount due under the lease, which are examined next.

[211] Article 12.
[212] See also the discussion at 3.11.2.4 *infra* with respect to third parties.
[213] Article 9.

3.7 Payments

The net payment obligation of the lessee together with its gross up obligation in the case of withholding tax will be examined. As well as rent, the security deposit (and its recasting as a commitment fee) and maintenance reserves (and their recasting as supplemental rent) will be examined.[214]

3.7.1 Rent

Rent is the principal consideration paid by the lessee to the lessor for the use of its asset.

It may be fixed throughout the lease term. It may be "float to fix" whereby there is an assumed rent amount which then varies according to fluctuation in a reference interest rate between the time of signing the lease and the time of delivery, when it is then adjusted to reflect such fluctuation and fixed from that point. It may also be a floating rate rent, where the adjustment for interest rate fluctuations does not stop at delivery, but continues through the lease term.

Rent is typically paid monthly in advance, but sometimes other rental periods are encountered, such as quarterly rent payments.[215]

The airline's obligation to pay rent for the lease term is typically stated to be an absolute obligation – this is the so called "hell or high water" clause (to the effect that, come "hell or high water" the lease rent must be paid). The lease rent is stated to be a net amount so that it must be grossed up such that, if any withholdings are imposed, the net amount must still be received by the lessor. Rent is payable periodically (typically monthly) in advance.

Further, any rights of set off on the part of the lessee (but not the lessor) are generally given up such that, even if the airline has a claim against the lessor, it must bring a legal action while continuing to pay rent.

In addition, there will normally be statements in the lease that the airline accepts the aircraft "as is, where is" and that no representations or warranties, express or implied, are given by lessor as to the condition or suitability of the aircraft.[216] The airline's sole right is thus to inspect the aircraft before delivery and to refuse the aircraft if it does not meet the required delivery condition.

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[214] *Vide* Section 5 of the Supplement *infra.*

[215] Indeed, Beatson J refused to characterize a lease as a sham where no rent was paid where evidence was adduced that no payments were made in return for set off of amounts owed under a loan from lessee to lessor: *Blue Sky One Limited and others v Blue Airways LLC and others,* [2009] EWHC 3314 (Comm) at paragraph 130.

[216] See Bunker D H, *International Aircraft Financing, Volume 2: Specific Documents*, IATA, 2005, at 84-86.

Bunker has argued[217] that, while "hell or high water" clauses may be acceptable in the context of a finance lease, they may be unfair to lessees in operating leases. He argues[218] that a finance lease is akin to a secured financing[219] where it is reasonable for the finance lessor to assure repayment of what is essentially a loan. By contrast, he points out that an operating lessor has real obligations to the lessee, such as repayment of security deposit and reimbursements from maintenance reserves.

Insofar as reimbursements from maintenance reserves goes, he makes a fair point: the lessee is an unsecured creditor of the lessor with respect to them. This author, however, would not agree that the "hell or high water" clause has no just application at all in the case of operating leases. The security deposit is not due to be refunded until then end of the lease term, by which time the lessee should already have paid all its rent, thus having nothing to set off anyway, and, by definition, as from delivery, the lessee has already accepted the condition of the aircraft pursuant to the terms of the lease and the acceptance certificate.

Notwithstanding Bunker's argument in favour of not applying the "hell or high water" clause at least to claims for reimbursement of maintenance reserves, the practice for operating leases and operating leases alike[220] is indeed to apply it without restriction – and the courts have tended to uphold it. In such circumstances, lessee should at least consider the credit of their lessors before entering into an operating lease.

For example, in *Celestial Aviation Trading 71 Limited v Paramount Airways Private Limited*,[221] before the English High Court, Teare J held that a lessee could not set off an obligation to pay lessor against an obligation on the part of lessor[222] to reduce a deposit held pursuant to a letter of credit rather than in cash but that, even if the deposit had been held in cash, he would have upheld the clause in the lease requiring the lessee to make all payments thereunder to the lessor regardless of any "defence, set-off, counterclaim…or other circumstance".[223]

Further, a recent English case, *Trident Turboprop (Dublin) Ltd -v- First Flight Couriers Ltd.*,[224] has upheld certain such protections for the lessor, but on narrow grounds. In that case, the airline refused to continue to pay rent and justified this citing the poor performance of the aircraft and that it had been induced to enter into the leases in question in reliance on non-fraudulent misrepresentation on the part of the lessor.

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[217] Bunker D H, *International Aircraft Financing, Volume 1: General Principles*, IATA, 2005, at 194-199, and *International Aircraft Financing, Volume 2: Specific Documents*, IATA, 2005, at 102.
[218] *Op. cit.*
[219] *Vide* 2.1 *supra.*
[220] *Vide* Clark T (editor), *Leasing Finance*, Euromoney, 1985, at 55 and Bunker, *op. cit.*
[221] [2009] EWHC 3142 (Comm).
[222] An obligation which the judge held the lessee had not in any event established on the facts.
[223] *Id.*, at paragraph 7.
[224] [2009] 1 All ER (Comm) 16.

In this case, English law applied, and the lessor relied on a provision of the leases which contained an acknowledgement by the airline that the lessor had not and would not be deemed to have made any warranties or representations about the aircraft and under which the lessee gave up any rights it would otherwise have had in respect of any warranty or representation other than those set out in the leases.[225]

The airline successfully argued that such provisions were covered by the United Kingdom Unfair Contract Terms Act 1977 (UCTA) and, as such, because they both purported to exclude or restrict liability, would be subject to the UCTA reasonableness test unless they were outside UCTA for some other reason.

UCTA does not apply to international supply contracts. The court considered that the leases were international sale contracts because the parties' places of business were in different territories and possession of the aircraft was being transferred between the parties, thus satisfying Section 26(3) of UCTA. However, the court held that even where this is not the case, Section 26(4)(a) is satisfied if goods are carried from the territory of one state to the territory of another state on conclusion of the contract.[226]

In other cases, the reasonableness test for any exclusion of representations would apply and this may add uncertainty to the airline's absolute liability to pay rent "come hell or high water".

If the test applies, under Section 11(1) of UCTA, the party seeking to uphold the limitation on liability must show that:

> "the term shall have been a fair and reasonable one to be included having regard to the circumstances which were, or ought reasonably to have been, known to or in the contemplation of the parties when the contract was made."

If UCTA had applied here, it would have been open to the lessor to show that, in the circumstances, the limitation was fair and reasonable by reference not only to industry practice but to the fact that the airline was afforded a full opportunity to inspect the aircraft prior to taking delivery with the right to refuse to take delivery if the aircraft did not meet the contractually stipulated legal condition.

In the United States, the US Court of Appeals for the Eighth Circuit recently held[227] that a contractual acceptance provision in respect of a tower for installation on a skyscraper could not, despite its conclusivity language, override Section 2-608 of the Uniform Commercial Code which allows for revocation of acceptance where non-conformity substantially

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[225] *Vide* http://www.ashurst.com/publication-item.aspx?id_Content=4203 on 21 March 2009.

[226] *Vide* http://www.internationallawoffice.com/Newsletters/Detail.aspx?g=9e128cdc-22c9-4b74-ba7c-1a1e014d8903 on 21 March 2009.

[227] *Trinity Products, Inc v Burgess Steel, LLC*, 486 F 3d 325, 329 (8th Cir 2007).

impairs its value to the buyer if the buyer has accepted it (i) on the reasonable assumption that its non-conformity would be cured and it has not been seasonably cured, or (ii) without discovery of such non-conformity, if the buyer's acceptance was reasonably induced by the seller's assurances.

In the context of operating leases (and sales) of commercial aircraft, it is submitted that lack of representations or other assurances in the lease (or otherwise) coupled with full pre-delivery inspection rights should adequately protect a lessor. However, if the acceptance certificate sets out defects and an agreed course of dealing with such defects, based on which a lessee agreed to accept delivery, revocation should the lessor fail to proceed as agreed with regard to rectification of such defects may indeed allow a lessee to refuse to accept delivery.

3.7.2 Security deposit

3.7.2.1 Security deposit rationale

Assuming that the airline has no valid argument to the "hell or high water" provisions of the lease, the lessor can, of course, sue the airline for failure to pay rent, or invoke other dispute resolution provisions of the lease. Litigation and arbitration are uncertain, however, and cost time as well as money.

In order to protect the lessor against the airline's failure to pay rent, the lease will normally include a requirement that the airline pay a security deposit to lessor, which the lessor may apply to remedy any failure by the airline to pay rent, or indeed to remedy any other failure by the airline to perform its obligations under the lease.[228]

The amount of the security deposit is commercially negotiated and will normally be calculated by reference to a number of months' rent, typically (in this author's experience) two or three. Sometimes the airline will want the deposit to bear interest at an agreed rate.

The lease will oblige the airline to replenish any amount spent by the lessor from the security deposit in rectifying any failure to perform on the part of the airline.

The greatest concern which the lessor has is that, if the airline goes bankrupt, the trustee in bankruptcy or the liquidator may demand the security deposit back, as being funds belonging to the estate in bankruptcy, and that it may claim that the lessor is merely an unsecured creditor in respect of any claims for failure to perform on the part of the airline (a likely situation where the airline is bankrupt).

[228] See Bunker D H, *International Aircraft Financing, Volume 2: Specific Documents*, IATA, 2005, at 93.

3.7.2.2 Charge over the security deposit

Thus, it is prudent for a lessor to include a provision in the lease that a first priority charge is granted by the airline to the lessor as security for performance by the airline of its lease obligations.

Care must be taken by the lessor to comply with any laws governing the creation of charges by a company over any of its assets. These laws will be the laws of the jurisdiction of the lessee in the case of an aircraft operating lease. For example, in the United Kingdom, under Section 860(1) of the United Kingdom Companies Act 2006, "a company that creates a charge to which this section applies must deliver the prescribed particulars of the charge, together with the instrument (if any) by which the charge is created or evidenced, to the registrar for registration before the end of the period[229] allowed for registration."

It is surprising how often this requirement to perfect the charge is overlooked in practice given that, under Section 874(1) of the Act, failure to register particulars in time render the charge void as against a liquidator or creditors of the company.

In re Charge Card Services Ltd., the English High Court[230] and later the Court of Appeal[231] held it conceptually impossible for a company to be granted a charge over its own indebtedness to the chargor insomuch as

> "a man cannot have a proprietary interest in a debt or other obligation which he owes another."[232]

That this case has effectively been overruled and is no longer a binding precedent is clear from the House of Lords in *Morris and others v Rayners Enterprises Incorporated and Another*[233] where Hoffmann LJ held *per curiam* that:

> "[i]n a case in which there is no threat to the consistency of the law or objection of public policy, I think that the courts should be very slow to declare a practice of the commercial community to be conceptually impossible."[234]

Nevertheless, *In re Charge Card* cast a long shadow on creditors and some lessors continue to take additional steps to protect their interest, to which we shall next turn.

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[229] In this instance, 21 days – see Section 870(1).
[230] [1987] Ch. 150 (High Court).
[231] [1996] Ch. 245 (Court of Appeal).
[232] *Id.*, at 258.
[233] [1997] UKHL 44.
[234] *Id.*, at paragraph 6.

3.7.2.3 Commitment fee

A further innovation used by some lessors to protect its ability to retain the security deposit even in the case of the lessee's bankruptcy is to provide in the lease that the sum is referred to not as a security deposit but as a commitment fee paid as consideration for the lessor's taking the aircraft off the market. The commitment fee is stated to be the absolute property of the lessor. Thus, upon an airline's bankruptcy, the lessor would argue that this does not form part of the estate in bankruptcy.

In such instances, it is important to provide that, upon the redelivery of the aircraft in accordance with the lease, and satisfaction of the airline's obligations under the lease, an amount equal to the commitment fee (or better still an amount not referencing the commitment fee but calculated so as to be the same as it) will be paid to the lessee.

As a precaution, such provisions as to commitment fees generally go on to state that if, contrary to the intent of the parties, the commitment fee is held to be a security deposit, then a first priority charge is granted over it.

3.7.2.4 Market reality

Of course, the ability of a lessor to require such stringent language depends on the state of the market at the time of lease negotiation. At the time of writing, many lessees are raising concerns as to potential lessor bankruptcy with the consequent risk that the security deposit may not be returned to them. To the extent that the market favours lessees, it would not be surprising to see lessees require such security deposits to be placed in a pledged account or to have the lessor's obligation to return the security deposit, assuming of course that the lessee discharges its obligations under the lease, supported by a letter of credit.

3.7.3 Maintenance reserves

3.7.3.1 Maintenance reserves rationale

Just as the lessor will rely on having a security deposit available to it in case the airline fails to pay rent, a lessor will typically want reserves paid to it to cover the cost of scheduled maintenance to the aircraft in the event that the airline fails properly to maintain the aircraft.[235] Depending on the creditworthiness or bargaining position of the airline, this may be negotiable.

Typically, these reserves are split out by airframe, engines, landing gear, auxiliary power unit, and life limited parts and are calculated by reference to expected usage of each and expected heavy maintenance charges based on such usage.[236] The reserves are then paid

[235] *Vide* 3.10.2.1 *infra.*

[236] Careful drafting is needed here. Note, for example, the English Court of Appeal case of *Sunrock Aircraft Corporation Limited v Scandinavian Airline Systems Denmark-Norway-Sweden*, [2007] EWHC Civ 882,

periodically (typically monthly[237]) in arrears based on actual usage during the preceding month. For example, the cost of an airframe C Check will typically be spread out over the cost of an expected C Check interval.

Once scheduled heavy maintenance (not all maintenance is reimbursable and the precise parameters of what is reimbursable are heavily negotiated) is performed, an airline will typically want prompt reimbursement of that expenditure.

The lessor will agree, upon being satisfied that the work was properly carried out, to reimburse an amount equal to the lesser of the actual cost of such heavy maintenance and the amount currently in the account for such reimbursement event (in other words, the airline can, for example, only claim reimbursement up to the amount of airframe reserves paid by it against the cost of an airframe C Check and reimbursement up to the amount of engine reserves paid by it against the cost of an engine shop visit).[238]

On the other hand, the lessor will be concerned as to any claims for liens imposed by the party performing the maintenance in respect of work owed by the airline in respect of other aircraft which are not related to the lessor. The last thing a lessor wants is to reimburse the maintenance payment and then find that its asset is not released because the repair shop is asserting a lien in respect of such other unrelated work.

3.7.3.2 Charge over maintenance reserves

Just as with the security deposit,[239] a lessor should ensure that the airline grants it a first priority charge over such maintenance reserves and should ensure that such charge is perfected in accordance with the laws of the jurisdiction of the lessee.

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where Thomas LJ held, *per curiam*, that an obligation to pay at the end of the lease an amount by reference to the "maintenance status" of life limited parts at the end of the lease by comparing them with such status as of delivery did not mean that one looked to their condition (as in, how close to replacement they were at the end of the lease bearing in mind their life limited nature) but rather whether or not they needed replacement at such points in time.

Thomas LJ held (at paragraph 23) that :

> "the obligation of the parties in respect of the…[life limited parts] was to make an adjustment for the difference in maintenance status by reference to a comparison between what was required at the next overhaul as at delivery and redelivery and the difference in the length of time as delivery and redelivery to that overhaul. The clause plainly did not oblige SAS to pay Sunrock a sum calculated by reference to the proportion of the [life limited parts] used during the period of the lease".

[237] Bunker D H, *International Aircraft Financing, Volume 2: Specific Documents*, IATA, 2005, at 98.

[238] Lessees should also argue for return of all maintenance reserves held by lessors in the case of total loss where the lessor has been paid the stipulated loss value of the aircraft under the insurances.

[239] *Vide* 3.7.2.2 *supra.*

3.7.3.3 Supplemental rent

Likewise, the maintenance reserves may be stated to be supplemental or additional rent which are the sole property of the lessor. In such event, the amount paid to the lessee upon carrying out certain heavy maintenance is not stated to be reimbursement of maintenance reserves or supplemental or additional rent but rather payment or contribution by the lessor of an amount equal to the lesser of the actual cost of the relevant heavy maintenance and the sum of all amounts of relevant supplemental rent (airframe, engine, etc) minus all such sums previously paid by lessor to the airline.

Again, in such event, it may be advisable to provide that if, contrary to the intent of the parties, the supplemental or additional rent is held to be maintenance reserves, then a first priority charge is granted over it. On the other hand, such a statement may be seen by a court as defensive and effectively as an admission that, notwithstanding the language of the lease, the sums involved are reserves. Much here will depend on what view the judge in question takes, something which is not readily predictable, particularly in the absence of case law on the point.

3.7.3.4 Limited reimbursement obligation

As operational risk of the aircraft is the sole obligation of the lessee under an operating lease, the lessor will only want to reimburse the lessee from the maintenance reserves[240] for scheduled[241] heavy checks or maintenance work (as carefully negotiated in the lease) in respect of the airframe, engines, life limited parts, landing gear, auxiliary power unit and (if applicable) thrust reversers.

The reserves collected will normally, in this author's experience, be calculated by the lessor's and lessee's technical staff to be sufficient to cover the expected costs of such work and thus the lessor's counsel will need to be careful to make clear in the lease that the lessor will expect the lessee to bear the cost of any other repairs or work, including foreign object damage, operational misuse, mishandling, faulty maintenance, accidental or intentional damage, abuse, modification or alteration for whatever reason or requirements of airworthiness directives, service bulletins, regulatory revisions, mandatory orders and instructions issued by such aviation authorities as are referenced in the lease.

Failure to do so will risk unnecessary depletion of the maintenance reserves, possibly leaving the lessor with insufficient reserves to pay a contribution to the follow on lessee for the first scheduled heavy checks or maintenance work during the term of the follow on

[240] Or, in the case of supplemental rent, pay an amount equal to relevant supplemental rent paid in to the extent such payments have not already been made.

[241] The lessor will not reimburse from reserves for unscheduled maintenance (such as to repair, for example, foreign object damage) since the quantum of the reserves will have been calculated according to an agreed estimate of scheduled maintenance costs which by definition cannot include unscheduled maintenance. For unscheduled maintenance, lessee may be able to claim on its insurances but will otherwise have to fund it itself.

lease where the follow on lessee will expect the lessor to contribute for that portion of the work that reflects operation of the aircraft prior to its taking delivery of it.

In a tight economic environment, cash flow is a major concern for lessors and lessees alike. Many lessees are now asking that lessors pay in advance part of the estimated fees for performing maintenance work, to save the lessees from having to pay that portion themselves in advance and then await reimbursement from the lessors. Again, lessors' reactions to this will depend on the then prevailing environment. If the market favours the lessees, the lessors will have little choice but to work with the lessees on a solution here.

A lessor, who does work with a lessee to agree to pay directly to a maintenance performer, will want to approve the workscope in advance (sometimes, the lessor will not insist on advance approval but may decline reimbursement if the workscope is unsatisfactory) and will want even more than usual to be satisfied in advance with the identity of the maintenance performer. It will also want to approve the maintenance contract and ensure that, if it pays in advance, such sums will only be applied to its property, and (if it can) it will want the maintenance performer to agree to limit its mechanics' lien (as to which, see 3.10.2.2 *infra*).

While this may help the lessor to limit its financial risk, the lessor will need to bear in mind that, much though it needs to retain the ability to approve maintenance work and the identity of any proposed maintenance performer on its aircraft, the more closely it becomes involved in this regard, the more likely that it will be sued in the case of a later accident involving its aircraft under the controversial theory of negligent entrustment (see 3.11.3 *infra*).

3.7.4 Standby letters of credit and guarantees

3.7.4.1 Standby letters of credit

A lessor will sometimes accept, in lieu of a security deposit or maintenance reserves, a standby letter of credit or bank guarantee issued by a bank acceptable[242] to it.

A standby letter of credit is a particular type of letter of credit which:

> "commits the issuer to honor the credit not upon evidence of performance by the beneficiary, as by presenting evidence of shipment of goods to the customer, but upon evidence or a mere declaration of the customer's default in the underlying transaction with the beneficiary."[243]

There are advantages and disadvantages for both lessor and lessee to using a standby letter of credit.

[242] Credit rating and reputation of the issuing bank will be keys here.
[243] *Black's Law Dictionary*, 6th edition, 1990.

The advantage to the lessee in using a letter of credit instead of a cash security deposit or maintenance reserves is that it frees up cash for the lessee. It will typically pay a fee to the issuer (dependent on its credit standing) which may be lower to it than the cost of foregone cash flow associated with a cash security deposit or maintenance reserves.

The disadvantage to the lessee is that, if the lessor draws on the letter of credit, it may damage the lessee's creditworthiness whereas resolution of disputes involving application by the lessor of a cash security deposit or maintenance reserves can often be resolved *inter partes* without impacting the lessee's creditworthiness.

The advantage to the lessor in accepting a letter of credit is that it is accepting the creditworthiness of the issuing bank and, as the issuing bank is a separate entity from the airline, if the airline goes bankrupt, this should not in principle affect the obligation of the bank to pay the lessor. The bank takes the risk that it may not recover the amounts paid out by it under the letter of credit from the estate of the bankrupt airline. The general rule is thus that the letter of credit is not affected by the bankruptcy of the airline (which will be the applicant to the issuing bank) but there are exceptions[244] to this general rule which can limit the usefulness of accepting a standby letter of credit in lieu of cash.

In *re Metrobility Optical Systems, Inc.,*[245] a U.S. court held that a tenant of real estate who had secured its obligations under the lease with a letter of credit could prevent a lessor from drawing on the letter of credit where the tenant was current in rent but the bankruptcy filing itself constituted an event of default under the lease. Section 365(e)(1) of the United States Bankruptcy Code invalidating such *ipso facto* clauses in executory contracts.

Wunnicke *et al.* discuss[246] the many exceptions to the general rule, noting in particular that courts may set aside as an indirect preferential transfer a letter of credit where the applicant for the letter of credit has provided collateral to the issuing bank as security.[247]

In addition to the risk of falling within such exceptions, another disadvantage to the lessor is that it foregoes the ability to apply the cash security deposit and maintenance deposit to enhance its cash flow (bearing in mind that a lessor will not see much advantage to having such deposits and reserves if it is required to keep them in separate accounts). Further, bank creditworthiness is not what it once was and banks may delay in accepting demands for payment even if all the paperwork is in order.

A lot depends on the facts of each case to determine whether cash or a letter of credit is better – the economics of the deal will usually dictate the outcome.

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[244] B Wunnicke, DB Wunnicke, PS Turner, *Standby and Commercial Letters of Credit*, Wolters Kluwer, 3rd edition, 2009, 9.04.
[245] 268 B.R. 326 (D.N.H) 2001.
[246] *Vide* footnote [19].
[247] *Kellogg v Blue Quail Energy, Inc. (In re Compton Corp.),* 831 F.2d 586 (5th Cir. 1987).

3.7.4.2 Guarantees

Occasionally, a lessor may accept a bank guarantee[248] in place of a standby letter of credit but should take care to review the language to ensure that it constitutes an indemnity and not merely a guarantee. With a guarantee, the guarantor has the same range of defences available to it as the lessee has[249] whereas with a standby letter of credit, the bank is the primary obligor and must pay upon the happening of a stated event (usually a certificate from the lessor that an event of default has occurred) and:

> "[f]or this reason, a lessor will often agree to accept an LC[250] instead of a cash deposit, but may be less willing to accept a bank guarantee."[251]

While a bank guarantee may be an acceptable substitute for a standby letter of credit, which is itself a substitute for a security deposit paid in cash, depending on the credit and the corporate structure of the lessee, the lessor may require a guarantee from the parent company of the lessee, which (unlike a standby letter of credit and a bank guarantee) is not necessarily limited in amount and should cover all obligations of the lessee under the lease and its related documents. This is, in effect, a performance guarantee. It should also contain language clarifying that it is an indemnity and not merely a guarantee so that the guarantor is primary obligor. (If the lessor itself is a special purpose or pass through entity, the lessee may require such a guarantee from its parent for the same reasons.)

3.7.5 Late payment

The lease will normally set out a default rate of interest for late payment of obligations – this interest typically accrues as soon as the payment is late, even if a default has not yet been triggered due to the presence of a grace period.[252]

The default interest rate should not be so low as to provide an attractive form of financing to the lessee, or so high as to risk being unenforceable due to its being deemed to be a penalty or to its being held to transgress any applicable usury law.

In *BAE Systems Management Service (Two) Limited & Another v Trident Aviation Leasing Services (Jersey) Limited and AS Enimex,*[253] the English Court of Appeal upheld a decision to award interest on damages at a rate of 8% where the lease itself did not provide for interest on damages and the default interest provisions of the lease (setting default interest at 3% above the Bank of England base rate) applied only to rent and other amounts payable

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[248] As with letters of credit, credit rating and reputation of the issuing bank will be keys here.
[249] See Bunker D H, *International Aircraft Financing*, IATA, 2005, Volume 1 at 401 and 415.
[250] Letter of credit.
[251] Bunker D H, *Securing Aircraft Financing*, Annals of Air and Space Law, Volume XXIX, 2004, 147-174, at 168.
[252] See Bunker D H, *International Aircraft Financing, Volume 2: Specific Documents*, IATA, 2005, at 107.
[253] [2010] EWCA Civ 107.

under the lease. The courts have a broad discretion in England to award interest on damages.

3.7.6 Conclusions

Disputes as to payment obligations under contracts are not uncommon and aircraft operating leases are no exception. The foregoing provisions of 3.7 do not reveal any particular provisions of public and private air law and the disputes reviewed were generally governed by the governing law of the lease.

The cases reviewed reveal a willingness by the courts to uphold contractual restrictions on a lessee's right to set off its payment obligations against claims it has against the lessor and a willingness to uphold requirements to continue to pay rent after acceptance of delivery of the aircraft despite claims as to its poor performance.

With respect to characterization of maintenance reserves and security deposits as supplemental rent and commitment fees, and to payment thereof by way of letter of credit or bank guarantee rather than cash, these are efforts, of course, to provide in a manner suitable to the parties under the governing law of the lease against the bankruptcy of the lessee, which bankruptcy will be governed by the laws of the jurisdiction of the lessee.

If the lease provides that, should the security deposit or maintenance reserves be held to be assets of the lessee, a claim likely to be brought by a liquidator in the case of bankruptcy of the lessee, then, that bankruptcy will be administered according to the laws of the jurisdiction of the lessee and the lessor, in order to enforce such clause, will have to show that the charge was perfected in accordance with the provisions of the laws of that same jurisdiction.[254]

Allied to payments is always the issue of taxes thereon and on the transaction generally, which are examined briefly next.

[254] *Vide* 3.7.2.2 *supra*.

3.8 Taxes

A detailed examination of taxes is beyond the scope of this study but it should at least be mentioned that the standard practice is for the lessee to bear the entire tax risk relating to the transaction, and to indemnify the lessor such risk, with the exception of those taxes for which the lessor would have been liable anyway even in the absence of the transaction in question.[255]

Thus, the lessor should remain liable for taxes on its corporate income in its home jurisdiction and in any other jurisdiction in which it would have been liable even if it had not entered into the lease in question. Subject to that exception, the lessee should be liable for all other taxes to which the lessor may be liable as a result of the operation and possession of the aircraft by the lessee.

The lessee will want to make further exception to its indemnity obligation clear, such as that it will not be liable for any taxes arising prior to the term of the lease, or as a result of the lessor's financing arrangements with respect to the aircraft.

Typically, tax indemnities take the form of an unlimited indemnification obligation from which exceptions are then made.

One point which the lessor should take care never to forget is that the lessee's tax indemnity is only as good as the lessee's credit: if the tax is one which as a matter of law falls on the lessor, it is no defence to the lessor's liability at law to pay such tax that, as a contractual matter *inter partes* under the lease, the lessee is obliged to indemnify the lessor: with or without performance of such indemnity obligation by the lessee, the lessor remains liable to the tax authority as a matter of law.

As for taxes which as a matter of law the lessee should pay, the lessor should take steps to ensure they are paid, particularly where non-payment may give rise to a tax lien[256] over the aircraft. This may be a particular risk in the case of a flag carrier or other airline supported by its government where the government may well be willing to allow taxes to go uncollected from the airline but which may then intervene and impose a lien on the aircraft which the lessor must be paid if it acts to repossess the aircraft.

Having thus examined the provisions of the lease involving payments, including taxes, in respect of the aircraft, the examination turns to operational issues in respect of the aircraft itself.

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[255] *Vide* Section 5 of the Supplement *infra.*
[256] *Vide* 3.10.2.24 *infra.*

3.9 Manufacturer's warranties

Typically, the airframe and engine manufacturers will grant warranties to the initial buyer of the aircraft as a means of supporting their product for an initial period following purchase.[257] The lessor, where it is the buyer, will normally be the recipient of such warranties, as are set out in the purchase agreement pursuant to which it acquires title.

Where the lessor leases the aircraft to an airline, the airline will typically want the benefit of such warranties by means of an assignment of warranties for the term of the lease so that it can, if it encounters difficulties with the aircraft, cause the manufacturer to rectify any defects covered by the warranties.[258]

The lessor may wish to retain such warranties in itself but agree with the lessee to extend the benefit of such warranties to the lessee. That is, if the lessee encounters a problem with the aircraft, it should report it to the lessor which will then make a claim under the appropriate warranty.

More often, however, both lessor and lessee agree that the lessor will assign the benefit of such warranties to the lessee so that the lessee can make a claim directly against the manufacturer during the term of the lease. In such cases, care should be taken to ensure that the lessee assigns the benefit of such warranties back to the lessor upon termination or expiration of the lease term.[259]

Invariably, the manufacturer will require that its consent be given in order to recognize such assignment. In part, this is because the manufacturer will want to ensure that the terms set out in the warranties governing assignment are observed and so that it is aware at any given time which is the party entitled to the benefit of the warranties which it has granted.

Typically, the warranties will set out a form of warranty assignment[260] which must be used, which will involve notifying the manufacturer of the assignment and obtaining the manufacturer's consent.

In English common law, legal *choses in action*[261] were not enforceable directly by an assignee against a debtor. In time, the courts of equity allowed assignment of equitable *choses in action.*[262] Absolute assignments of equitable *choses in action* allow an assignee to sue in its own name. Non-absolute assignments of equitable *choses in action* as well as

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[257] *Vide* Bunker D H, *International Aircraft Financing, Volume 2: Specific Documents*, IATA, 2005, at 352.
[258] *Vide* Section 6 of the Supplement *infra.*
[259] Upon such termination or expiration, the lessor should also require that the lessee assign to it the benefit of any warranties which the lessee has obtained from parties carrying out maintenance and repair work on the aircraft during the term of the lease.
[260] Also, *vide* discussion on assignment at 3.16 *infra.*
[261] Such as enforcement of a debt claim.
[262] Such as seeking an injunction or an order for specific performance.

assignments (whether absolute or partial) of legal *choses in action* allow an assignee to sue but require the assignor to be joined to the action.[263]

In terms of assignments in commercial transactions, such as assignments of rights under warranties (or indeed lease agreements), English statute law provided for absolute assignments of legal *choses in action* to be enforceable directly by an assignee against a debtor if the statutory provisions were met: such provisions required the assignment to be absolute (not partial), in writing and with notice to the debtor.[264]

An assignment stated to be only for the term of the lease will be a partial, not an absolute, assignment. Care should be taken that the assignment itself be absolute with a covenant for reassignment to the lessor upon expiration or termination of the lease.

Regardless of the form of the assignment of manufacturer's warranties, it should be noted that the Cape Town Convention and Aircraft Protocol, while they do provide for registration of interests in respect of assignments, only do so in respect of assignments related to an "international interest".[265] As an "international interest" is defined[266] as one granted under a security agreement, title reservation agreement, leasing agreement and contracts of sale, assignments of manufacturer's warranties fall outside the scope of the Cape Town Convention.[267]

A lessee should inquire as to whether, under the terms of its purchase agreement, the lessor also has a right to certain training support from the manufacturer from which, as a non-operator, the lessor cannot benefit. The lessor should have no reason not to pass on the benefit of such training to the lessee.

The lessee, in turn, will owe certain covenants to the lessor in respect of the operation of the aircraft in its possession, and these will next be examined.

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[263] Furmston M P, *Cheshire &Ffifoot's Law of Contract*, 10th edition, Butterworths, 1981, at 455 *et seq.*

[264] First introduced into England by Section 25(6) of the Judicature Act 1873 as initially replaced by Section 136 of the Law of Real Property Act 1925.

[265] Article 1(b) of the Cape Town Convention.

[266] Article 2 of the Cape Town Convention and Article III of the Aircraft Protocol.

[267] Unlike assignments of the lessor's interest in the leasing agreement, which, accordingly, may be registrable under the Cape Town Convention. *Vide* 3.16 *infra.*

3.10 Covenants

3.10.1 Lessor's covenants

The lessor's covenants in favour of the lessee are limited in number but important in kind – quiet enjoyment of the aircraft by the lessee for the term (while it is meeting its obligations) and, where and as appropriate, reimbursement from maintenance reserves (and payment of any other contractually agreed maintenance or other contributions).[268]

3.10.1.1 Quiet enjoyment

The lessor typically grants the lessee a covenant of quiet enjoyment on its own behalf and on behalf of anyone claiming through it, in the absence of a default on the part of lessee under the lease.[269] Thus, for example, a lessee will want the ability to sue the lessor for breach of covenant in the event that, despite adhering to its obligations under the lease, it is dispossessed of possession of the aircraft during the lease term due, for example, to repossession of the aircraft by a secured creditor of the lessor.

Typically, the lessee will seek a letter granting quiet enjoyment in similar terms from secured lenders of the lessor but, for example, it will have to take the credit risk of lessor in respect of certain other creditors of lessor, such as Eurocontrol.[270]

Where the Cape Town Convention applies,[271] even in the absence of such a covenant on the part of the lessor, and so long as it has not otherwise agreed in the lease,[272] the lessee shall, in the absence of a default within the meaning of Article 11 of the Cape Town Convention, be entitled to quiet possession and use of the aircraft in accordance with the lease agreement as against the lessor.[273] However, this is so only so long as the lease in which it is contained remains registered as an international interest under the Convention:[274] that can be deregistered at any time by the lessor although the lessor would be most unlikely to have any motivation to do so while the aircraft remains on lease to the lessee thereunder.

A classic example of the type of situation which may constitute a breach of lessor's covenant of quiet enjoyment to the lessee in the lease may be where a leased aircraft is

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[268] *Vide* Section 7 of the Supplement *infra.*
[269] See, for example, Bunker D H, *International Aircraft Financing, Volume 2: Specific Documents*, IATA, 2005, at 81.
[270] *Vide* 3.10.2.2.2 *infra.*
[271] *Vide* 2.5 *supra*.
[272] Express subordination clauses are sometimes seen in leases, especially where a lessee airline subleases to an affiliate – the alternative approach being to grant quiet enjoyment but also for the owner to be granted an assignment of the lessee's airline's rights as sublessor under the sublease as security for performance of its obligations under the head lease.
[273] Article XVI(1) of the Aircraft Protocol.
[274] Legal Advisory Panel of the Aviation Working Group, *Practitioner's Handbook to the Cape Town Convention and Aircraft Protocol*, Cape Town Paper Series, Volume 3, Unidroit, 2010, at 59.

detained due to no fault of the lessee but due to the existence of sanctions against the lessor - for example, see the European Court of Human Rights case of *Bosphorus Airways v Ireland*,[275] discussed further at 3.10.2.2.3 *infra,* or due to the exercise of an *in rem* right over the aircraft, such as by Eurocontrol, discussed further at 3.10.2.2.2 *infra*.

3.10.1.2 Reimbursement from reserves and other payments

Where the lessee pays maintenance reserves,[276] howsoever described, the lessor should, so long as there is no default on the part of lessee, agree to pay the lessee for the cost of scheduled maintenance work from (or calculated by reference to) those reserves. The lessor will normally want to ensure that the work has been satisfactorily performed and paid for before so doing but lessees may request the lessor to pay the maintenance performer directly.[277] These matters are negotiable.

Likewise, depending on the commercial terms agreed between the party, which should be identified in the letter of intent,[278] if the lessor will make an additional contribution for the first covered maintenance event during the lease term (to reflect that part of the period between that and the previous such event would predate possession of the aircraft by the lessee) or if the lessor will make a contribution towards the cost to lessee of complying with airworthiness directives which will benefit the lessor after the end of the lease term, these should likewise be set out here.

The obligation to return the security deposit[279] at the end of the lease term, assuming there is no default, may be set out here, or, depending on the drafting of the lease in question, in the provisions dealing with payments or return of the aircraft.

3.10.2 Lessee's covenants

The lessee's covenants are much more extensive than those of the lessor[280] – to maintain the aircraft as required by the lease, not to part with possession except as agreed, swapping of engines, registration, etc. are all areas which typically take up the bulk of a lease negotiation, especially for non-lawyers. Typical operational covenants by the lessee are set out at Annex 9.

[275] Grand Chamber Judgment of the European Court of Human Rights, 362 30.6.2005.
[276] *Vide* 3.7.3 *supra*.
[277] See Bunker D H, *International Aircraft Financing, Volume 2: Specific Documents*, IATA, 2005, at 128-131 and 142-146.
[278] *Vide* 2.3 *supra.*
[279] *Vide* 3.7.2 *supra.*
[280] *Vide* Section 8 of the Supplement *infra.*

3.10.2.1 Maintenance

The airline will be required by the laws of its jurisdiction to maintain the aircraft or to cause the aircraft to be maintained in accordance with the requirements of the aviation authority of that jurisdiction.

Under Article 31 of the Chicago Convention, every aircraft engaged in international navigation must have a certificate of airworthiness issued or rendered valid by its state of registration. Annex 6 to Chicago Convention dealing with operation of aircraft, sets out standards and recommended practices (SARP's) in respect of airworthiness of aircraft. The essence of Annex 6, according to ICAO, is that "the operation of aircraft engaged in international air transport must be as standardized as possible to ensure the highest levels of safety and efficiency", recognizing that the SARPs are "operating minima" which "do not preclude the development of national standards which may be more stringent than those contained in the Annex."[281]

Under Article 37 of the Chicago Convention, ICAO shall "adopt and amend from time to time, as may be necessary", SARP's. This allows for the operating minima provided for in to be kept up to date. Under Article 38 thereof, a state "which finds it impracticable to comply" with SARP's must give notice thereof to ICAO, and any failure to comply therewith must be endorsed on the relevant license or certificate.[282]

Under Article 40 of the Chicago Convention:

> "No aircraft or personnel having certificates or licenses so endorsed shall participate in international navigation, except with the permission of the State or States whose territory is entered."

In the United States, under Section 44713 (Inspection and Maintenance) of Chapter 447 (Safety Regulation) of Subtitle VII (Aviation Programs) of the Title 49 (Transportation) of the US Code, maintenance is clearly the obligation of the airline:

> "An air carrier shall make, or cause to be made, any inspection, repair, or maintenance of equipment used in air transportation as required by this part or regulations prescribed or orders issued by the Administrator of the Federal Aviation Administration under this part."

The key phrase here is "cause to be made". If the airline is not itself licensed to perform the required maintenance, it should contract with a licensed performer. Section 43.3 (Persons authorized to perform maintenance, preventive maintenance, rebuilding, and alterations) of Part 43 (Maintenance, Preventive Maintenance, Rebuilding and Alteration) of Chapter I (Federal Aviation Administration, Department of Transportation) of Title 124 (Aeronautics

[281] http://www.icao.int/eshop/annexes_list.htm on 18 April 2011.
[282] Article 39 of the Chicago Convention.

and Space) of the Code of Federal Regulations set out the requirements for licensing in the United States.

In the European Union, the European Aviation Safety Agency oversees aircraft maintenance pursuant to Council Regulation (EC) No 216/2008, Part M whereof deals with Continuing Airworthiness[283] and Part 145 whereof deals with maintenance organizations approvals.

The lessor does not operate the aircraft itself: further, under the lease, the lessee has exclusive possession and control of the aircraft for the term of the lease. The lessor thus requires the lessee to be responsible for maintenance under the terms of the lease.[284]

Thus, if the airline itself does not possess the requisite approvals to perform required maintenance, it must contract with a Maintenance, Repair and Overhaul organization (MRO) that does. The lease itself as a contractual matter may require the airline as lessee only to use a licensed and approved MRO and may provide further that the identity of the MRO is, in addition, subject to its approval.

Further, a lessor will typically also require in the lease a higher standard of maintenance than the legal minimum required pursuant to applicable law, in order to preserve the value of its asset, and also, as a contractual matter, may also require compliance with any stricter requirements of the US FAA or EASA than those of the state of registration. In particular, the lease may have restrictions on the age and status of components installed on the aircraft and contractual requirements as to timing of compliance with airworthiness directives and manufacturer's service bulletins.[285]

This is partly because these are considered to be strict and should enhance the value of the aircraft but also because, at the time of signing the lease, the lessor probably does not know to which jurisdiction the aircraft will be next leased, and so wishes to maximize its chances that the aircraft will be acceptable to the aviation authority of the follow on lessee.

The lessor needs to ensure that other provisions of the lease do not unintentionally cut across this requirement. For example, although it was an interlocutory hearing rather than a full trial, the English Court of Appeal refused in *Air Mauritius v Caribjet Inc*.[286] for technical reasons leave to appeal by an airline where the lessor terminated the lease by reason of the airline's repeated failure to maintain the aircraft in an airworthy and safe condition as required by the lease. The airline had sought to avail of a force majeure clause in the lease relieving the parties of liability resulting, *inter alia*, from unserviceability of the aircraft owing to unscheduled failure.

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[283] *Vide* Articles 3 and 4 thereof.
[284] Bunker D H, *International Aircraft Financing, Volume 2: Specific Documents*, IATA, 2005, at 123.
[285] See Bunker, *op. cit.*, at 123-141, 185-188, and 233-234.
[286] Royal Courts of Justice, 18 September 2007.

3.10.2.2 Liens

The lessee will generally not be allowed to place the aircraft in a position where liens are imposed on the aircraft. Clearly, some exceptions to this are needed: permitted liens should include liens created by or through the lessor itself, since this is within the lessor's, not the lessee's control. Likewise, some liens arise by operation of law or will be insisted on contractually by third parties providing maintenance services on the aircraft. The principle liens of concern in the context of aircraft operating leasing will be examined here.

Liens are naturally a major concern for lessor since they give rise to an *in rem* right to seize the aircraft and to sell it:[287] this is not something covered by the insurances on the aircraft, so an aircraft lessor could lose its aircraft, without compensation, upon enforcement of a lien. Of course, if it was not a lien permitted under the lease, the lessor has a contractual right to sue the lessee but this is an *in personam* right which is likely to be of cold comfort since, having already suffered enforcement of a lien, it is likely that in such a situation the lessee will not have sufficient assets to pay on such a claim.

In addition to requiring the lessee not to allow unpermitted liens on the aircraft, the lessor should require the lessee to covenant only to use the aircraft lawfully.[288] Although it may be able to assert an "innocent owner defence" if it can establish that it took "all reasonable precautions to prevent illegal use of the aircraft",[289] a lessor may be subject to having its aircraft seized and declared forfeit[290] if the lessee uses it for an illegal purpose such as drug running. Inclusion of a covenant will not likely deter a lessee which is willing to engage in criminal activity, and Bunker wisely advises lessor to be "on guard against placing aircraft in the control of operators of questionable character."[291]

3.10.2.2.1 Mechanics' liens

A mechanic's lien is "a claim…for the purpose of securing priority of payment of the price or value of work performed and materials furnished"[292] and may, for these purposes, be treated as being essentially synonymous with an artisan's lien. An artisan's lien is:

> "a possessory lien given to a person who has made improvements and added value to another person's personal property as security for payment of the services performed"[293]

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[287] *Vide e.g.* 3.10.2.2.2 *infra.*
[288] *Vide* Annex 9 *infra*.
[289] Bunker D H, *Aircraft Financing and Drugs*, Annals of Air and Space Law, Volume XVI, 1991, at 37.
[290] Under *e.g.* Section 141 of the English Customs and Excise Management Act 1979.
[291] *Id.*, at 39.

[292] Nolan J R and Nolan-Haley J M, *Black's Law Dictionary*, West Publishing co., 6th edition, 1990.

[293] *Ibid.*

and may further defined as being the:

> "statutory right of an artisan to keep possession of the object that he has worked on until he has been paid for such labor."[294]

As the airline is responsible for maintenance of the aircraft while it is in the airline's possession, the airline may, if it is qualified to do so and permitted to do so under the lease, perform the maintenance itself or, if not, it may arrange for a qualified Maintenance, Repair and Overhaul organization (MRO) to perform such maintenance work.[295] Lessors will typically require that such MRO's be approved by it.

The MRO will generally have a mechanics' lien in respect of work undertaken by it in the event that it is not paid – simply put, it typically is not required to release the aircraft or aircraft engine or other part until it has been paid. Such mechanics' lien arises under applicable local statutory law and may differ in its details by jurisdiction.

Mindful of the need for the aircraft to be properly maintained, leases typically provide that, although the airline is generally forbidden from allowing liens to arise over the aircraft to arise, exception are made for "permitted liens" which include mechanics' liens.

Great care must be taken with regard to the drafting of language in the lease dealing with permitted liens.

For example, if a lessee submits an aircraft engine to an MRO for maintenance, it may do so under the terms of a General Terms Agreement (GTA) between the airline and the MRO. Such GTA may provide for a contractual lien going beyond that provided for by the mechanics' lien which arises by operation of law. The MRO may provide, for example, in the GTA, that it shall have a lien over the engine until all sums due to it by the airline have been paid in full, whether or not relating to the engine in question.

The problem for the lessor is that, if the airline goes into bankruptcy or is otherwise unable or unwilling to pay the MRO, while the lessor understands that it will have to pay the MRO in respect of its engine, it will not want to have to pay the MRO for bills unpaid by the airline to the MRO which do not relate to its engine.

Such bills may relate to engines owned by the airline itself or by other lessors in respect of which the MRO cannot assert a lien since they are no longer in its possession. Thus, the MRO may try to assert, relying on the contractual language of the GTA, a lien over the lessor's engine in its possession covering the entire indebtedness of the airline.

Good local legal advice is crucial here. For example, depending on the jurisdiction, the MRO may only have a detention right without a sale right or it may have both or even

294 *Ibid.*

295 *Vide* 3.10.2.1 *supra.*

neither. Generally speaking, it is advisable to put the MRO on notice early on, even before any dispute arises, that the engine belongs to the lessor and not to the airline. This may be sufficient to disapply the contractual lien provisions of the GTA (since the lessor is not a party to it) to the extent that they go beyond the statutory mechanics' lien.

Further, as the lessor is not a party to the GTA and thus not bound by its terms, the MRO may, depending on the jurisdiction, only be entitled to the value added by it to the engine in question – thus, it may not be entitled to seek the profit element of the contract price set out in the GTA. Of course, its ability to seek payment for other engines and for the profit element in respect of the engine in question is not extinguished, but it has only an unsecured claim for this against the airline (which may not be very valuable if the airline is in bankruptcy) and at least, in being reimbursed its cost in adding value to the engine in question, should not incur a loss in respect of that engine in having to release the engine to the lessor.

Naturally, this becomes a matter of discussion between the lessor and the MRO. Generally, the MRO will initially assert the widest lien possible, with the lessor advising it of the correct limits of such lien as against a non-contractual owner, having obtained local legal advice.

It is not unusual for the MRO then to point out that its contract is with the airline, not the lessor, and thus even if it releases the engine, it should release it back to the airline, not to the lessor, in the absence of proof of termination of the lease or a court order. Typically, however these scenarios are provoked by the bankruptcy of the airline and thus a pragmatic solution is found.

Taking the example of an aircraft engine MRO based in Germany, in a situation where German law applies, the mechanics' lien (*Werkunternehmerpfandrecht*) provided for pursuant to section 647 of the German Civil Code (*Bürgerliches Gesetzbuch* or *BGB*) only arises with respect to claims under a GTA or other contract between the MRO and the owner of the engine. Section 647 BGB provides:

> "For its claims under the contract, the workman acquires a lien over the movable assets of the customer that he has produced or repaired if they have come into its possession during the production or for the purpose of repair."

The mechanics' lien pursuant to section 647 BGB lapses after return of the asset by the MRO to its contractual partner. The important point here, however, is that, where the airline, as a lessee, delivers an aircraft engine to a German MRO pursuant to its GTA with the MRO, the engine are not "assets of the customer" but assets of the customer's lessor.

The German Supreme Court (*Bundesgerichtshof*) has held that where an MRO performs work with respect to an asset that is not owned by the customer a *bona fide* acquisition of a workman's lien is thus precluded under German law. However, Dr Dirk Schmalenbach of Freshfields in Germany has advised that this position is disputed in legal literature and thus

strongly recommends notification by a lessor to the MRO to the effect that the engine in question is owned by lessor and only leased to the MRO's customer, thereby eliminating the risk that the MRO could argue to have acted in good faith and justifiably believed that the lessee was the owner of the engine when the engine came into the MRO´s possession.[296]

Dr Schmalenbach has pointed out that, while pursuant to the foregoing it is unlikely that the MRO would have a lien in such a situation (which would allow the MRO to seek the forced sale of the engine at auction[297] to cover unpaid fees) the MRO may assert a retention right (*Zurückbehaltungsrecht*) pursuant to section 1000 BGB against both the lessor and the airline with respect to the engine if the airline does not pay for the maintenance work undertaken by the MRO with respect to that engine. Section 1000 BGB provides:

> "The possessor may refuse the return of the asset until he is reimbursed the outlays due to him. He is not entitled to the right of retention if he obtained the asset by an intentionally committed tort."

According to Dr Schmalenbach, the retention right pursuant to section 1000 applies only to outlays with respect to the engine in question, not other amounts. Thus, the retention right does not entitle the MRO to refuse to return the engine until it has been reimbursed for amounts owed by lessee for work on unrelated property.

An interesting point of law arose in an interim judgment of the Scottish courts in *Wilmington Trust Company, Orix Aviation Systems Limited v Rolls Royce PLC, IAE International Aero Engines PLC*[298] where the lessor argued that IAE as MRO did not have possession of aircraft engines sufficient to claim a lien for work unpaid by the lessee, Mexicana, as the MRO had entered into a subcontract with Rolls Royce and had passed possession of the engines to Rolls Royce. The court held that as Rolls Royce held the engines to the order of IAE, IAE still had civil possession sufficient to assert a lien.

Particularly in situations where the MRO only has a detention right, and not a sale right, which covers only amounts due on the engine, both lessor and MRO will be motivated to reach a commercial agreement. The lessor will want its engine back and the MRO will want to receive at least some payment and to free up storage space. Typically, then, the resolution will be found within the range of the value added to that engine and the contractual price agreed in the GTA between the airline and the MRO with respect to that engine.

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[296] Electronic mail correspondence between Dr Schmalenbach and the author between 1 and 4 May 2009.

[297] McBain G, *Aircraft Liens & Detention Rights*, General Editor, Sweet & Maxwell, 2007, Chapter on Germany, Section 1.1.

[298] [2010] CSOH 157.

3.10.2.2.2 Eurocontrol and similar liens

Eurocontrol[299] was established by the Eurocontrol Convention[300] which came into force on 1 March 1963. The Eurocontrol Convention established Eurocontrol as having international legal personality with the intention of creating a single European upper airspace.[301] Eurocontrol at the time of writing has 39 members.[302]

Eurocontrol describes itself as supporting:

> "its Member States to achieve safe, efficient and environmentally-friendly air traffic operations across the whole of the European region. Our organization is committed to building, together with its partners, a Single European Sky, that will deliver the air traffic management (ATM) performance for the twenty-first century and beyond."[303]

Indeed, Eurocontrol is active in all areas of air traffic management safety, safety research, planning, management, operations and regulation.[304]

In November 1971, Eurocontrol introduced a route charges system. It set up the Central Route Charges Office (CRCO) which collects charges for flights on behalf of Eurocontrol members, the amount of the charges varying based on the distance flown and the weight of the aircraft. The proceeds are used to finance the safety activities of Eurocontrol. Such services are also offered to non-members by way of bilateral agreement.

One of the controversial aspects of CRCO's powers has been its reliance on broad powers of the United Kingdom Civil Aviation Authority to act on its behalf with respect to unpaid charges. Under Regulation 11 of the United Kingdom Civil Aviation (Navigation Services Charges) Regulations 2000, where there is a default in payment of charges due thereunder, which includes charges due to Eurocontrol, the United Kingdom Civil Aviation Authority may detain:

> "(a) the aircraft in respect of which the charges were incurred (whether or not they were incurred by the person who is the operator of the aircraft at the time the detention begins); or
>
> (b) any other aircraft of which the person in default is the operator at the time when the detention begins".

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[299] The European Organisation for the Safety of Air Navigation.
[300] The Eurocontrol International Convention relating to Cooperation for the Safety of Air Navigation signed in Brussels on 13 December 1960.
[301] http://www.eurocontrol.int/faq/corporate on 6 April 2011.
[302] http://www.eurocontrol.int/articles/members on 6 April 2011.
[303] http://www.eurocontrol.int/faq/corporate on 6 April 2011.
[304] *Ibid.*

There are a couple of points to note here. Under Regulation 11, no court order is needed but a court order for sale is required under Regulation 13. Further, the effect of this combined right of detention and sale is to provide an *in rem* lien over the aircraft. The operator, being the airline, remains liable *in personam* for the debt, but the owner is not liable *in personam*.

If the aircraft is detained while in the possession of the operator, the aircraft may be sold to cover the entire fleet debt of the operator to Eurocontrol, not just the debt on that aircraft, even though the operator does not own the aircraft.

If the owner has recovered possession of the aircraft from the operator prior to enforcement by Eurocontrol of its lien, then the lien may be enforced in respect of all debt on that aircraft to Eurocontrol, regardless of by whomever incurred.

The potential effect of this on a non-operator is apparent – it may easily stand to have nothing left after its aircraft is sold pursuant to exercise of this lien.

This scheme has been the subject of legal challenges on the grounds that it exceeds Eurocontrol's powers under the Eurocontrol Convention and breaches the human rights of aircraft owners (where the debts are incurred by their lessees) under the European Convention on Human Rights[305] (ECHR). Article 1 of the First Protocol[306] to the ECHR provides:

> "Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law.
>
> The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties."

It is the view of the Aviation Working Group (AWG), which represents major aircraft and engine manufacturers and lessors that it "will be difficult for the state to justify a sale of property belonging to an innocent party who is not aware of outstanding Charges incurred by an aircraft owned by a third party".[307] MacCarthy[308] has described this power as "oppressive and arbitrary".

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[305] Convention for the Protection of Human Rights and Fundamental Freedoms signed at Rome on 4th November, 1950.
[306] Done at Paris on 20th March 1952.
[307] AWG Position on Eurocontrol and Air Navigation Charges, August 2004, at http://www.awg.aero/pdf/AWGEurocontrol.pdf on 18 April 2011.
[308] MacCarthy R J, *The Problem of Unpaid Eurocontrol Charges*, in Butler G F and Keller M R, executive editors, *Handbook of Airline Finance*, 1st edition, Aviation Week:McGraw-Hill, 1999, at 400.

The situation is different in other countries covered by Eurocontrol and the AWG has complained of this lack of common policy.[309] For example, it points out[310] that in *Société Outremer Finance Limited,*[311] the highest administrative court in France held that a right of detention came to an end upon termination of the lease and is unenforceable against a non-operator owner of the aircraft. Likewise, it points out[312] that, under Dutch law, a court order allowing detention and sale of an aircraft may only be granted where the debtor is the owner of the aircraft.[313]

Nevertheless, a challenge, arising out of the bankruptcy of Zoom Airlines Incorporated, to the fleet lien of Eurocontrol on the grounds that it breached Article 1 of the First Protocol to the ECHR failed in the English Court of Appeal in *Global Knafaim Leasing Ltd* and another) *v Civil Aviation Authority and others,*[314] despite Collins J expressing some sympathy for the lessor's case that the fleet lien under English law is unfair. He held that, since the power to exercise the fleet lien was discretionary, not mandatory, it could not be said that its exercise was disproportionate without examining the given fact of a case.[315]

Collins J cited[316] as authority the case of *Air Canada v UK,*[317] where the European Court of Human Rights upheld as consistent with Article 1 of the First Protocol to ECHR the seizure of an aircraft when cannabis resin was found on board and its release only upon payment by the airline of a large fine. As with the Eurocontrol fleet lien, there is detention but no transfer of title. Of course, the power of sale pursuant to the Eurocontrol fleet lien goes further.

Collins J rejected an argument that the fleet lien breached Article 1(2) of the Geneva Convention[318] whereby contracting states undertook not to admit or recognise any right as taking priority over property and other rights recognised in Article 1(1) thereof, holding that it did not restrict seizure of property for unpaid taxes and the like but rather was aimed at restricting priority of other private rights.[319]

In relation to the Cape Town Convention, Collins J noted[320] that Article 39(1) allows contracting states to declare categories of non-consensual rights and interests having priority over international interests registered and thus protected thereunder and to declare that nothing therein shall affect its right or that of an:

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[309] Op. cit., at 11.
[310] *Id*., at 12.
[311] Counseil d'Etat, 2 juillet 2003, No. 254536.
[312] *Ibid.*
[313] Section 5/20 of the Dutch Act of Air Navigation (*Wet luchtvaart*) and Article 276 of Book 3 of the Dutch Civil Code (*Burgerlijk Wetboek*).
[314] [2010] EWHC 1348 (Admin).
[315] At 25.
[316] At 47.
[317] (1995) 20 EHRR 150.
[318] Convention on the International Recognition of Rights in Aircraft, signed at Geneva on 19 June 1948.
[319] At 20.
[320] At 21.

> "intergovernmental organisation or other private provider of public services to arrest or detain an object under the laws of that State for payment of amounts owed to such entity, organisation or provider directly relating to those services in respect of that object or another object."

The Eurocontrol Convention was extensively revised pursuant to a Protocol thereto signed on 27 June 1997.[321] It has not yet come into force as it has been ratified by most but not yet quite all of the requisite number of states.[322]

According to Eurocontrol, the Protocol was:

> "first conceived in 1992 as a response to the growing changes in the air traffic management environment, one of its most significant elements allowed for the expansion of Eurocontrol's authority to include the airport taxiway and runway as well as the en-route, research and coordination aspects of air traffic management…."[323]

By its own admission, disagreement among member states has slowed down ratification. It is the understanding of this author that one of the areas of disagreement had been the concern of certain members as to revisions to the provisions on charges but it appears that these have been mostly overcome now as the Protocol is only a few ratifications short of coming into effect.

Aware of the legal challenges to the *in rem* debt system referred to above, the Protocol proposes to extend the United Kingdom system throughout the territory of all member states,[324] subject only to the proviso that local law should so permit, and for the first time provides that owners should have also have *in personam* liability for the unpaid route charges of their lessees.[325]

The only realistic tool which the lessor has at present to manage this risk is to obtain the Eurocontrol letter discussed above at 3.5.2.8 *supra* and to have a system in place for regularly checking the status of the lessee's account with Eurocontrol.

Although the Eurocontrol lien is unusually broad in its scope, other similar liens may exist of which lessor should be aware, such as unpaid airport charges or navigation charges outside the Eurocontrol area.

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[321] For a discussion of the Protocol, *vide* Van Antwerpen N, *Cross-border provision of Air Navigation Services with specific reference to Europe: Safeguarding transparent lines of responsibility and liability.* PhD Thesis, Leiden University, 2007, at 48 *et seq.*

[322] Aviation Working Group, *AWG Position on Eurocontrol and Air Navigation Route Charges*, August 2004, at 6, http://www.awg.aero/euro_rules.htm on 16 June 2011.

[323] www.eurocontrol.int on 16 June 2011.

[324] Article 5(1) of Annex IV to the Protocol.

[325] Article 5(4) of Annex IV to the Protocol.

An interesting Canadian case, like *Global Knafaim Leasing* arising in the aftermath of the collapse of Zoom Airlines Incorporated, is *Calgary Airport Authority v AerCap Group Services Inc.,*[326] which came before the Alberta Court of Appeal. In that case, the relevant legislation[327] allowed for the seizure and detention of aircraft for unpaid landing and airport charges, etc. owed by the owner or operator of the aircraft.

In this case, the airport authority obtained a seizure and detention order not knowing that the lessor had already taken possession of the aircraft. A few minutes after such order was obtained, the lessor notified the aviation authority of the lease termination and had the aircraft registered in the name of its nominee. The airline was not in possession of the aircraft when the airport authority sought to enforce its order. Accordingly, the lessor was held not to be liable for the debts of the airline as the airline was not then the owner or operator of the aircraft, notwithstanding that the owner had not yet been changed on the aircraft register of the aviation authority.

The court denied that this would lead to a "race to repossess the aircraft"[328] but the fact is that there is always a race in such a situation.

Indeed, in the related case of *Calgary Airport Authority and Others v Zoom Airlines Incorporated,*[329] Kent J of the Alberta Queen's Bench, held that where the lessor had repossessed the aircraft prior to the court order allowing seizure of the aircraft, the aircraft should be released. In this, he expressly followed the Supreme Court of Canada's decision in *Canada 3000 Inc.; Re: Inter-Canadian (1991) Inc. (Trustee of*),[330] where the court excepted from detention aircraft already repossessed by the titleholder.

In *Canada 3000 Inc.*, Binnie J made the observation, cited with approval by Collins J in *Global Knafaim Leasing Ltd*,[331] that:

> "[i]t is difficult to endorse the indignation of the legal titleholders with respect to detention of their aircraft until payment is made for debts due to the service providers. They are sophisticated corporate players well versed in the industry in which they have chosen to invest. The detention remedies do not affect their ultimate title. Investors who have done their due diligence will recognise that detention remedies have deep roots in the transport business….As long as the aircraft is owned or operated by a person liable to pay the outstanding charges, it may be the subject of an application to seize and detain it. The fact that there may be other persons,

[326] 2009 ABCA 306.
[327] Airport Transfer (Miscellaneous Matters) Act, S.C. 1992, c.5, section 9.
[328] *Calgary Airport Authority, op. cit.* at paragraph 37.
[329] Unreported, Court of Queen's Bench of Alberta, Judicial District of Calgary, Case No. 0801-10295, 5 September 2008.
[330] 2006 SCC 24 (CanLII).
[331] At 42.

> who are not liable to pay the outstanding charges but have property interests in the aircraft, is of no consequence.**"**[332]

Binnie J cited as evidence of such deep roots of detention rights in the transport business the 1905 case of *The Emilie Millon*[333] where the English Court of Appeal upheld the power of the Mersey Docks and Harbour Board to detain a ship owned by one party for harbour and tonnage payments incurred in respect thereof by the operator, a different party.

Thus, clearly, in Canada and in the United Kingdom, the lessor is motivated to repossess the aircraft before a court order is issued in favour of third party creditors of the lessee allowing seizure of its aircraft.

3.10.2.2.3 Emissions lien

Pursuant to Council Directive 2008/101/EC, the European Union has amended Council Directive 2003/87/EC (the "EU ETS Directive") so as to include aviation activities in the scheme for greenhouse gas emission allowance trading within the European Union.

Accordingly to the AWG,[334] it has been proposed in various member states that a regulator may, in respect of breaches of the EU ETS directive, exercise a fleet lien in respect of aircraft in a manner similar to the Eurocontrol right discussed *supra*.

In such event, the appropriate regulator would have, in addition to having the power to ban aircraft operators which failed to do so, the right to detain and sell any and all aircraft that are operated by an operator (regardless of whether or not it owns such aircraft) which has failed to pay civil penalties imposed on it for failing to submit an emissions plan or failure to report as to emissions or to provide requested information as set out in the proposal.

AWG contends that any such "right of sale and detention is unlawful and ambiguous and fails to adequately address the rights of parties who are property holders in an aircraft (or any part thereof) and who are not also operators of such aircraft."[335] It sets out the same arguments *mutatis mutandis* as it did in relation to the Eurocontrol right.

It is difficult at this stage to determine the effect, if any, on any such new lien right of the case of *Bosphorus Airways v Ireland.*[336] In that case, pursuant to EC Council Regulation 990/93 imposing sanctions on Yugoslavia, the Irish government seized an aircraft which was leased by a Yugoslav owner to a Turkish airline and which had been sent by the airline

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[332] At 71-74.
[333] [1905] 2 K.B. 817
[334] Aviation Working Group, *Position Paper Objecting to Liens to Securing Airline Obligations under Rules Implementing the EU ETS*, February 2011, at 6, at http://www.awg.aero/Environmental_Issues.htm on 16 June 2011.
[335] http://www.awg.aero/pdf/Env.Annex1.pdf on 4 May 2009.
[336] Grand Chamber Judgment of the European Court of Human Rights, 362 30.6.2005.

to an Irish MRO for maintenance.[337] The airline claimed this was a breach of discretion by the Irish government under Article 1 of ECHR. The court held however, that it was not, given that the Irish government had no discretion in the matter, being obliged to impound any aircraft to which Article 8 of EC Regulation 990/93 applied. The court held that there was a presumption that the European Union *régime* offered equivalent protection to the one that state parties should offer under the ECHR, and that, as the protection of the airline's rights was not manifestly deficient, the presumption that ECHR had been complied with was not rebutted.

Perhaps not surprisingly, there has already been legislative action in the United Kingdom[338] whereby regulations extend the sale and detention rights to the case of emissions breaches by aircraft operators. Even bearing in mind that the United Kingdom has particular restrictions in setting aside legislation under British law as discussed in 3.10.2.2.2 *supra)*, it is still surprising that this new lien right was passed without some amendment to take account of the fact of leased aircraft (as opposed to aircraft owned by the operator) due to the likelihood that it would breach the ECHR.[339]

Under these United Kingdom regulations, where an operator has not paid a penalty incurred by it for breach thereof within six months, or where it has had an operating ban imposed on it under Article 16(1) of the EU ETS Directive, the regulator may detain and then sell the aircraft[340] with the leave of the court.[341] Upon a sale of the aircraft, the proceeds are to be paid by first paying any customs dues, then, in order, expenses of the regulator, airport charges in respect of the sold aircraft, the unpaid penalties in respect of which the aircraft was detained, any other unpaid penalties of the aircraft operator.[342]

Having done all that, the regulator must pay any residue left over from the proceeds of sale to "the person or persons whose interests have been divested by reason of the sale",[343] which, in the case of a leased aircraft will be the lessor (or other owner)[344] or, in the case of an owned aircraft, will be the aircraft operator.

A court case has already been brought in English High Court (Administrative Court) challenging the EU ETS Directive. In *The Queen on the application of Air Transport Association of America, Inc., and Others v The Secretary of State for Energy and Climate Change*,[345] the plaintiffs allege that it violates, *inter alia*, Articles 1,[346] 15[347] and 24[348] of

[337] *Vide* 3.10.2.1 *supra.*
[338] Aviation Greenhouse Gas Emissions Trading Scheme Regulations 2010 (SI 2010/1996), as amended by Aviation Greenhouse Gas Emissions Trading Scheme (Amendment) Regulations 2011 (SI 2011/765).
[339] Notwithstanding the English judgment in *Global Knafaim* discussed at 3.10.2.2.2 *supra*.
[340] Regulation 42.
[341] Regulation 44.
[342] Regulation 45(1).
[343] Regulation 45(2).
[344] *Vide* 2.2 *supra*.
[345] Claim Co/15376/2009
[346] Dealing with each state's sovereignty with respect to its airspace.

the Chicago Convention, Articles 3(4)[349] and 11(2)(c)[350] of the EU-United States Open Skies Agreement,[351] and Article 2(2) [352] of the Kyoto Protocol.[353] The English High Court referred the case to the European Court of Justice[354] for a preliminary ruling, which is not expected before 2012. Bartlik[355] has expressed "serious doubts"[356] as to whether "some regulations contained in the Emissions Directive are compatible with the Chicago Convention"[357] and no doubt this case will be followed with great interest.

3.10.2.2.4 Tax liens

Certain jurisdictions may impose tax liens in respect of unpaid taxes on an aircraft.

For example, if an aircraft is sold while within that jurisdiction, a sales tax may be imposed, with a lien being imposed *in rem* over the aircraft in the event that the sales tax is not paid.

In order to avoid this, or the risk that there might be a liability to pay a stamp duty on the bill of sale transferring title, without payment of which the seller may be unable to record its ownership in the aircraft, lessors are typically careful when selling or buying aircraft to ensure the lessee's co-operation.

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[347] Article 15 sets out limits on airport and air navigation charges and provides that no charges shall be imposed simply for transit over the territory of a contracting state.

[348] Article 24 provides an exemption for aircraft fuel from customs duties or other charges in international air transport.

[349] Article 3(4) only allows certain restrictions on frequency and capacity including for environmental reasons but only to the extent consistent with Article 15 of the Chicago Convention.

[350] Article 11(2)(c) provides an exemption for aircraft fuel from customs duties or other charges in international air transport.

[351] Done at Brussels on the twenty-fifth day of April 2007 and at Washington on the thirtieth day of April 2007, in duplicate. *Vide* Official Journal of the European Union, L 134/4, 25.5.2007.

[352] Article 2(2) provides that the parties thereto shall "pursue limitation or reduction of emissions of greenhouse gases… from aviation… fuels, working through the International Civil Aviation Organization…"

[353] Kyoto Protocol to the United Nations Framework Convention on Climate Change, done at Kyoto on 11 December 1997.

[354] Case C-366/10, 2010/C 260/12.

[355] Bartlik M, *The extension of the European Union's emissions trading scheme to aviation activities,* Annals of Air and Space Law, Volume XXXIV, 2009, 151-172, at 171.

[356] *Ibid.*

[357] *Ibid.*

For example, the seller and the buyer may, having investigated the legal situation in the lessee's jurisdiction, and having agreed which of them ultimately takes the tax risk, ask the lessee to co-operate either in confirming when the aircraft is over international waters or in a jurisdiction agreed by the seller and buyer as not giving rise to a sales tax or tax lien.

Thus, at the time of closing of the sale, the parties will typically pay attention to the exact time of the transfer of ownership of the aircraft and its location at that time. Such evidence can then be submitted to a tax authority subsequently seeking to impose a sales tax or assert a tax lien over the aircraft.

A similar risk may exist with respect to customs issues. In Russia, for example, there is a scheme for paying import duty in respect of temporarily imported aircraft on terms preferable to those applying for permanently imported aircraft. Violation of the temporary import régime may result in a fine for the airline of up to 200% of the customs value of the aircraft. In addition, however, the aircraft may be confiscated by court order, despite the fact that the importing airline is not the owner of the aircraft.[358]

A very disquieting recent development, particularly in the context of the lien over a lessor's aircraft for unpaid Eurocontrol charges on the part of the lessee[359] or breaches of emissions limits on the part of the lessee[360] is the recent German legislation providing that a lessor may in certain circumstances be liable for the non-payment of an air travel tax in Germany on the part of its lessee.

The German Air Travel Tax Act[361] of 2010 provides[362] for an air travel tax based on number of passengers departing from a domestic German point of departure. Under Section 6(1), the airline's tax representative is jointly and severally liable with the airline for payment of the tax.

Under Section 6(2) of the German Air Travel Tax Act, if a non-German airline fails to appoint such a tax representative, the owner of the aircraft is liable for the taxes owed in addition to the operator.

Further, Section 6(2) makes an exception to Section 219 of the German Fiscal Code[363] which restricts recourse to a person liable to a tax to a situation where enforcement action against the movable property in question is unsuccessful or is not likely to lead to payment of the tax. By removing this restriction, Section 6(2) of the German Air Travel Tax Act

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[358] Muriel A & Yanboukhtin A**,** *Confiscation of Leased Aircraft by Customs*, International Law Office, Aviation – Russia, May 20, 2009 at http://www.internationallawoffice.com/Newsletters/Detail.aspx?g=143720a3-4ebf-43e0-9f89-98796faf313c on 21 May 2009.
[359] *Vide* 3.10.2.2.2 *supra*.
[360] *Vide* 3.10.2.2.3 *supra.*
[361] *Luftverkehrsteuergesetz.*
[362] At Section 4.
[363] *Abgabenordnung. Fundstelle*: 2002, S. 3866.

leaves open immediate action not only *in rem* against the aircraft operated in Germany but also *in personam* against the owner of the aircraft itself in a situation where a foreign airline fails to appoint a German tax representative and fails to pay the air travel tax.

Even if the tax is not yet due, in a situation where a foreign lessee has not appointed a German tax representative, the relevant customs office:

> "may require security from the tax debtors up to the amount of the tax likely to accrue for two calendar months in the event there is reason to believe the tax will not be collected."[364]

In other words, the lessor may be required to make a payment on behalf of the airline even where the tax is not yet due. Of course, the lessor can, at least in theory, seek to recover this from the lessee pursuant to the tax indemnity provisions[365] of the lease, but such recovery right will be of least use when it is most likely to be needed – when the airline is insolvent and the German tax authority seeks payment of the tax from the lessor having failed to recover from the airline or having concluded that recovery is unlikely.

According to Steppler,

> "[i]t is likely that several German carriers will challenge their tax assessments, because the financial repercussions will be unacceptable. The act is poorly designed and the concept behind the tax is badly suited to a global industry such as aviation."[366]

Not only German carriers are likely to find this unacceptable: the legislation is still new as of the time of writing but it is possible that lessors may react to this new *régime* by requiring foreign airlines which are their lessees to pay to them as lessors, on the analogy of maintenance reserves,[367] reserves against payment of the air travel tax or by requiring them not to operate into or out of Germany without first satisfying the lessors that tax representatives have been duly appointed in accordance with this legislation.

This author's objections to the above legislation are the same as those discussed *supra* in relation to Eurocontrol and emissions liens and indeed go beyond those: not only does this legislation extend a lien over a lessor's aircraft to pay unpaid air travel tax on the part of a non-German lessee, which is objectionable enough *per se*, it actually goes further by making the lessor, as owner, primarily liable along with the lessee, as operator.

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[364] Article 9.
[365] *Vide* 3.8 *supra.*
[366] Steppler U, *Air travel tax and aircraft lease agreements*. International Law Office: Aviation – Germany. 1 December 2010, at http://www.internationallawoffice.com/newsletters/Detail.aspx?g=a390e5a7-dee8-43f7-9288-dfc7b86a5232 on 11 April 2011.
[367] Discussed at 3.7.3 *supra.*

It is difficult to escape the conclusion that, at least in Europe, legislators are making lessors stand, in effect, as surety for the credit of airlines in an increasingly wide range of areas, none of which falls within the control of the lessor.

Under Section 8(3) of the German Air Travel Tax Act, the tax representative must inform the relevant customs office of its details, including its contact details, and, under Section 8(4) must inform that authority of any change in its details. At the very least, therefore, as long as this legislation is in place, lessors would be well advised to require any of its lessees to covenant not to fly into or out of Germany without having such a tax representative in place and should, *ex abundanti cautela*, require that the tax representative likewise undertake to inform the lessor of any change in its details or if it ceases to act as the airline's tax representative in Germany.

In this author's opinion,[368] this German legislation may be subject to challenge as being contrary to Article 15 of the Chicago Convention.[369] Article 1 of the German air Travel Tax Act states as the object of taxation the following:

> "The authorized carriage of a passenger from a domestic departure point in an aircraft or helicopter by an aviation enterprise to a destination is a taxable legal transaction under the Air Travel Tax Act."

Article 15 of the Chicago Convention requires states to charge the same for use of its airports to aircraft of other contracting states as to its own national aircraft, and indeed the German Air Travel Tax Act does not distinguish in terms of *quantum* as between national and non-national aircraft.

Where the problem may arise is rather in the first paragraph of Article 15 of the Chicago Convention, which requires as follows:

> "Every airport in a contracting State which is open to public use by its national aircraft shall likewise, subject to the provisions of Article 68, be open under uniform conditions to the aircraft of all the other contracting States….."

The German Air Travel distinguishes among national and non-national airlines in requiring only the latter to appoint German tax representatives who, as explained above, also become debtors. Although from a tax collection point of view, this may make sense, as otherwise they may not have a person resident in Germany who may be sued in Germany for non-payment, this puts a burden on the non-German airline not put on the German airline. It may be difficult for a non-German airline to find a German resident willing to be its tax representative. Further, if it fails to find one, its aircraft are subject to seizure even if they

[368] And in that of Steppler, *op. cit.*

[369] And indeed it may well also be open to challenge as being contrary to Article 1 of the ECHR discussed at 3.10.2.2.2 *supra.*

are leased: thus they may be subject to particular scrutiny or terms by lessors who do not face the same risk with respect to German airlines.

Although the Chicago Convention speaks of national aircraft rather than national airlines, it is this author's view that this legislation *prima facie* risks conflicting with Germany's obligations under the Chicago Convention.

3.10.2.3 Chicago Convention and registration

The Chicago Convention 1944 provides that aircraft shall have the nationality of their state of registration[370] and allows for such registration to be changed from the register of one state to another, while only allowing an aircraft to be registered in one state at a time.[371]

Beyond that, and the requirement for aircraft engaged in international traffic to bear their appropriate nationality and registration marks,[372] and certain reporting requirements to ICAO and other state parties as to such registration,[373] the Chicago Convention does not lay out rules for eligibility for or form of such registration, but rather provides, at Article 19:

> "The registration or transfer of registration of aircraft in any contracting State shall be made in accordance with its laws and regulations."

This was a change from the Paris Convention 1919 which laid out more detailed requirements for eligibility for aircraft registration:

> "No aircraft shall be entered on the register of one of the contracting states unless it belongs wholly to nationals of such State.
>
> No incorporated company can be registered as the owner of an aircraft unless it possess the nationality of the State in which the aircraft is registered, unless the president or chairman of the company and at least two-thirds of the directors possess such nationality, and unless the company fulfills all other conditions which may be prescribed by the laws of the said State."[374]

As noted *passim*, the Chicago Convention superseded the Paris Convention pursuant to Article 80 of the former.

For the most part, the decision to be made by a state is whether to implement an aircraft register by the owner of the aircraft and/or by the operator of such aircraft, with regulations

[370] Article 17.
[371] Article 18.
[372] Article 20.
[373] Article 21.
[374] Article 7.

in each case as to nationality criteria to be met in order for the aircraft to be eligible for registration.

In the context of the European Union, the provisions of EC Regulation 1008/2008 provide in respect of its member states that:

> "1. Without prejudice to Article 13(3),[375] aircraft used by a Community air carrier shall be registered, at the option of the Member State whose competent authority issues the operating licence, in its national register or within the Community.
>
> 2. In accordance with paragraph 1, the competent authority shall, subject to applicable laws and regulations, accept on its national register, without any discriminatory fee and without delay, aircraft owned by nationals of other Member States and transfers from aircraft registers of other Member States. No fee shall be applied to transfers of aircraft in addition to the normal registration fee."

For his part, Gillick[376] refers to certain countries, such as Aruba, Bermuda, Ireland and Mauritius as examples of the establishment of "aircraft registries of convenience". Stating that restrictive citizenship requirements for aircraft registration have impeded the free flow of airline and aircraft financing and have precluded cross-border mergers, he continues, in relation to those countries mentioned by him that:

> "[i]n these countries, an owner or a lessee may, for a fee, place an aircraft on that country's registry and in so doing accomplish a particular objective that would not be possible if the aircraft were registered, for example, in the home country of the lessee."

Huang discusses whether an aircraft need have a "genuine link" with the state of registration but correctly concludes that Article 19 of the Chicago Convention reserves the right to fix conditions for registration of aircraft "exclusively to sovereign States".[377] Without conceding any need under the Chicago Convention itself for a "genuine link", this author also agrees with Huang's conclusion that:

> "the fact that an aircraft is not owned by a national of the State of registry does not necessarily deprive it of a genuine link with that State."[378]

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[375] Article 13(3) deals with leasing of aircraft by a European Union airline which are registered in a third country. *Vide* 3.5.2.5 *supra*.
[376] Gillick J E, *The Impact of Citizenship Considerations on Aviation Financing*, in Butler G F and Keller M R (executive editors), *Handbook of Airline Finance*, 1st edition, Aviation Week: McGraw-Hill, 1999, at 41 *et seq*.
[377] Huang J, *Aviation Safety and ICAO*, Leiden University, PhD Thesis, 2008, at 34.
[378] *Ibid*.

He continues that:

> "the practice of ICAO has been not to focus on foreign ownership of aircraft but, rather, on the safety oversight capabilities of the States which register foreign-owned aircraft"[379]

Article 83 *bis* discussed at 3.15.8 *infra* should be seen in this light. However, this author disagrees with Huang that Article 83 *bis*:

> "may be regarded as one of the few lawful exceptions to the requirement of a "genuine link" between an aircraft and its State of registry",[380]

at least insofar as he may be implying such requirement under the Chicago Convention itself. Nevertheless, Huang is correct that such requirements do indeed exist, albeit outside of the Chicago Convention itself.

190 states[381] are party to the Chicago Convention which, under Article 5, gives each contracting state the right to have its aircraft, not being engaged in scheduled international air services, the right, subject as set out therein, to make flights into, or in transit non-stop across, or to make stops for non-traffic purposes in, the territory of the other contracting states, as well as (subject to Article 7 on cabotage) to take on and to discharge passengers, cargo and mail without need for prior permission. Under Article 6, special permission of a contracting state is needed to operate any scheduled international air service over or into the territory of another contracting state.

129[382] states are party to the International Air Services Transit Agreement which extends, among the states party thereto, to scheduled as well as to non-scheduled international air services the provisions of Article 5 of the Chicago Convention relating to making flights into, or in transit non-stop across, or to make stops for non-traffic purposes in, the territory of each contracting state.

Only 11[383] states are party to the International Air Transport Agreement 1944 which, *inter alia*, extends to scheduled as well as to non-scheduled international air services, as well as (subject to Article 7 on cabotage) to take on and to discharge passengers, cargo and mail without need for prior permission.

The International Air Services Transport Agreement, at Article 1(3) and 1(6) , and the International Air Services Transport Agreement, at Article 1(3) and 1(5), refer to "substantial ownership and effective control" of "the airlines of another contracting State"

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[379] *Id.*, at 37.
[380] *Id.*, at 42.
[381] http://www2.icao.int/en/leb/Lists/Current%20lists%20of%20parties/AllItems.aspx on 25 April 2011.
[382] *Ditto.*
[383] *Ditto.*

by citizens of that other state. Likewise, many bilateral agreements have similar requirements.[384]

However, both of the above agreements refer to the ownership of the airline and not to the ownership of the aircraft: once the airline meets the ownership requirements thereunder, it does not matter whether the airline possesses the aircraft pursuant to ownership or pursuant to a lease.

As to whether use of a "flag of convenience" in connection with aircraft is or should be a concern with respect to safety, Abeyratne[385] makes a useful distinction:

> "There are two broad groups of foreign registered aircraft that can be deemed to be operated under a flag of convenience: those done for fiscal purposes; and those done to take advantage of a system with no or minimal economic or technical oversight. The first group may not pose a problem if arrangements are made between concerned States to ensure proper oversight, for example through bilateral agreements under Article 83 *bis*….It is the second group that creates a major security problem that needs to be addressed."

If "fiscal purposes" can be taken to mean a lessor's or financier's preference for a particular registry based on its ability better to protect its interests there, this author agrees with Abeyratne.

Verhaegen[386] has expressed the concern that a state could offer to the state of the operator to act, in effect, as a flag of convenience, while transferring functions back to the state of the operator. This author fails to see the concern: under Article 83 *bis*, the state of the operator will still have the responsibilities under the Chicago Convention in respect of those transferred functions just as if it were the state of registration all along.

3.10.2.3.1 Owner only registration

In the United States, for example, an aircraft may be registered only by and in the legal name of its owner[387]. The operator of the aircraft is not, therefore, relevant.

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[384] Bunker D H, *International Aircraft Financing, Volume 1: General Principles*, IATA, 2005, at 366-367.
[385] Abeyratne R, *Registration of Aircraft: Legal and Regulatory Issues*, *Annals* of Air and Space Law, Volume XXXIV, 2009, 173-206, at 189.
[386] Verhaegen B M, *The Entry into Force of Article 83 bis: Legal Perspectives in Terms of Safety Oversight*, Annals of Air and Space Law, Volume XXII, Part II, 1997, at 273-274.
[387] http://www.faa.gov/licenses_certificates/aircraft_certification/aircraft_registry/register_aircraft/ on 23 March 2009. There are certain exceptions for aircraft primarily based in the United States where the owner or lessee certifies that 60 per cent. or more of the aircraft's flight hours within each six month period were between two points in the United States – see Balfour J (ed.), *Air Transport in 34 Jurisdictions Worldwide 2009*, at 190.

This is, however, an oversimplification. Preston G Gaddis II points out that the term "owner" is not defined in the Federal Aviation Act and that the definition on the Federal Aviation Regulations is unhelpful and confusing. Although non-binding, persuasive legal opinions issued by counsel to the FAA set out certain guidelines whereby an aircraft subject to a lease may be registered in the name of a lessee (in other words, the lessee is treated as the owner for registration purposes) in certain circumstances.[388]

It is beyond the scope of this study to go into such leases in detail as they are not pure operating leases but, in essence, such leases are full pay out leases, finance leases, conditional sales contracts, leases with lessee purchase options under certain conditions (for example, the option amount is not to exceed 10% of lessor's cost (if a new aircraft) or 10% of current value (if previously acquired by lessor) or in excess of 10% if non-refundably prefunded prior to lease expiry).

Pre-filing opinions of counsel to the FAA, although not binding, are advisable.

To be registered as an owner, under the Transportation Code and applicable Federal Aviation Regulations, an aircraft is only eligible for US registration if it is owned by either[389]:

(a) a citizen of the United States or a resident alien; or

(b) a United States Corporation (which does not meet the requirements of a citizen of the United States) if the aircraft is based and primarily used in the United States.[390]

One means of registering an owner who does not qualify as a United States citizen is for the owner of an aircraft to transfer title to that aircraft to an owner trust, typically a large United States bank under the terms of an owner trust agreement whereby the owner trustee holds title to the aircraft in trust for such non-US citizen as beneficiary. The owner trustee is simply a *nominee* and all rights and obligations are pass through for all legal accounting and tax purposes to the beneficiary.

Accordingly, the owner trustee will act as lessor in any leases and words will appear in the lease to the effect that the lessor is acting "*not in its individual capacity but solely as Owner Trustee*". It is for this reason that a lessee may reasonably require the beneficiary to grant to it a guarantee of the lessor's obligations under the lease.

One advantage for the lessor in being registered as the owner is that, should it come to a hostile repossession of the aircraft, it need only worry about physical repossession of the

[388] Gaddis II P G, *Registering lease aircraft in the US*, Airfinance Journal, May 1988, No. 90, 48-49. This author is grateful to Dr Donald H Bunker for drawing his attention to this article.
[389] McBain G, *Aircraft Finance: Registration, Security and Enforcement*, General Editor, Sweet & Maxwell, 2000, Volume-3 at United States of America-3 (paragraph 1.2).
[390] 49 USC 44102(a)(1).

aircraft (including its records) and will not need to worry about a lessee wrongly refusing to deregister the aircraft. This is discussed further *infra* at 3.15.9 in the context of the IDERA and at 3.15.8 in the context of Article 83 *bis* of the Chicago Convention.

Please see above[391] the discussion of the requirement to renew aircraft registration in the United States every three years.

3.10.2.3.2 Owner or operator registration

In Ireland, an aircraft may only be registered in Ireland if it is owned by a citizen or company[392] of Ireland or other European Union member state[393] but, even if the aircraft is not owned by such a citizen, if it is chartered by demise, leased or on hire to, or in course of being acquired under a lease-purchase or a hire-purchase agreement by such a citizen or company, then the aircraft may be registered in the State but such registration shall be subject to any conditions the Irish Aviation Authority may deem fit.[394]

In Belgium, the rule is similar, with aircraft on an operating lease of at least 6 months being registrable in Belgium so long as the lessee would be qualified as an owner if it owned the aircraft.[395]

McBain[396] notes that the aircraft register and certificate may contain a brief note identifying the lessor or owner which, while having no legal effect provides a form of comfort to lessors. He goes on to note[397] that the Belgian Civil Aviation Administration sometimes registers an aircraft in the name of the lessor but that:

> "the preference of lessor is generally to leave the registration in the name of the lessee in order to avoid a possible exposure to operational liabilities".

What remains unclear is the effect of identifying the lessor or owner by means of a note for potential liability as owner of the aircraft under, for example, as discussed at 3.11.2 *infra.*

[391] At 3.5.2.2.
[392] Such company having a place of business in Ireland and having its principal place of business in Ireland other European Union member state and of which not less than two thirds of the directors are citizens of Ireland or other European Union member state.
[393] Section 7(1) of the Irish Aviation Authority (Nationality and Registration of Aircraft) Order, 2005 (S.I. 634 of 2005).
[394] *Ibid*, Section 7(4).
[395] McBain G, *Aircraft Finance: Registration, Security and Enforcement*, General Editor, Sweet & Maxwell, 2000 at Belgium, 1.2.2.
[396] *Ibid*., at Belgium, 1,4.
[397] *Ibid.*, Belgium, at 1.2.4.

3.10.2.3.3 Owner and operator registration

Under Japanese law, even if the operator of the aircraft is a Japanese airline, the aircraft may not be registered in Japan unless it is also owned by a Japanese citizen.[398]

In principle, for a foreign lessor, this poses a problem, but there are ways of dealing with it. One typical structure is as follows. A non-Japanese leasing company ("**Servicer**") has a purchase agreement with the aircraft manufacturer. Under it, the Servicer can nominate affiliates or subsidiaries to acquire title to the aircraft.

The Servicer may wish to use a subsidiary entity ("**Beneficiary**") to acquire title. This Beneficiary will be consolidated in the Servicer's accounts.

In fact, the Beneficiary will not acquire title directly. Instead, the Servicer will use an owner trustee ("**Lessor**") whereby Lessor holds title to the aircraft in trust for the Beneficiary. This means that the Owner Trustee is simply a *nominee* and all rights and obligations are pass through for all legal accounting and tax purposes to the Beneficiary (hence words will appear in the lease to the effect that Lessor is acting "*not in its individual capacity but solely as Owner Trustee*"). This is a very common structure for holding title to aircraft in the United States, as discussed at 2.5.1.1 *supra*.

In order for an aircraft owned by the non-Japanese Lessor to be registrable in Japan, therefore, it is common for a Japanese special purpose company ("**Owner**"), set up by an established Japanese company ("**Manager**"), to buy the aircraft from the Lessor. The Owner will then agree to sell the aircraft back to the Lessor under a conditional sale agreement ("**CSA**") for the same price. Under the CSA, the Owner retains title until payment of US$1 by the Lessor to the Owner (all other amounts being netted off). Because of this nominal amount, the Lessor is treated as owner for tax and accounting and most legal purposes but the Owner is treated as owner for purposes of registering the aircraft in Japan.

Thus, the Owner passes through all rights and obligations to Lessor, which passes through all rights and obligations to Beneficiary, which is ultimately controlled by Servicer.

Servicer manages the Beneficiary (which has no staff of its own). Manager manages the Owner (which has no staff of its own). Lessee should usually only need to deal directly with Servicer, as all the other parties are in the structure for legal and accounting reasons only.

Annex 2 sets out this basic structure.

[398] Advice of Katsu Sengoku, Esq, of Nishimura & Partners, Tokyo, Japan. See also Hames & McBain, A*ircraft Finance: Registration, Security and Enforcement*, Volume I, Longman (1 February 2000): Japan: Section 1.2.

Annex 4 sets out a complication to this structure for leases of aircraft to be registered in Japan where there is a lender who requires title to the aircraft to be placed in an entity controlled by it, as is the case in financing guaranteed by the Export Import Bank of the United States of America. This entity (the "**Head Lessor**") enters into the structure set out in Annex 2 between the Owner and the Lessor, by entering into the CSA in place of the Lessor and by then finance leasing the aircraft to the Lessor which continues to lease the aircraft under an operating lease to the lessee.

What is interesting here is that there are four entities which may be considered the owner of the aircraft:

(1) the Owner, the Japanese special purpose company, as registered owner on the aircraft registered maintained by Japan pursuant to the Chicago Convention;

(2) the Head Lessor, the special purpose vehicle controlled by the lender which may be considered the owner for all accounting and tax purposes by virtue of its rights as conditional purchaser under the CSA between it and the Owner, the Japanese special purpose company;

(3) the Lessor (as owner trustee) as lessee from the lenders' special purpose vehicle under a finance lease; and

(4) the Beneficiary, as beneficiary of the owner trust pursuant to which the Lessor has its interest in the aircraft.

3.10.2.3.4 Operator only registration

Finally, the aviation authority may look to the identity of the operator of the aircraft, not the owner. For example, Austria requires for Austrian registration that the operator be an Austrian or European Union citizen.[399]

3.10.2.4 Possession and replacement of parts and engines

The lessor will want to ensure that the lessee does not part with possession the aircraft or of parts or engines of the aircraft without good reason – removal may only be for maintenance, repair or (in the case of parts) required replacement (due to time expiry etc.). Typically, the lessee will not be allowed to replace the engines on a permanent basis for any reason short of replacement of a destroyed engine.

Temporary replacement or pooling (or interchange) with other airlines of engines[400] and parts may be allowed as being reasonably required for airline operation but even then the

[399] Hames & McBain, A*ircraft Finance: Registration, Security and Enforcement*, Volume I, Longman (1 February 2000): Austria: Section 1.2.

lessor will have a legitimate interest in ensuring that in so doing the value of the aircraft is not reduced, even during the term. A lessor cannot assume that the lease will run its full term – if the lessee defaults, it will have to repossess its aircraft at short notice and thus will need to ensure the aircraft is in reasonable condition.

3.10.2.4.1 Possession

The lessee should covenant not to part with possession of the aircraft or any engine or part thereof during the lease term except for authorized maintenance to an authorized maintenance provider[401] or to a sub-lessee pursuant to a sub-lease[402] permitted pursuant to the terms of the lease or consented to by the lessor.

3.10.2.4.2 Replacement of parts

Parts may, typically under a lease, only be replaced if they are worn out or expired and need of replacement or repair – typically they will have to be repaired in accordance with the standards set out in the lease, being of a type at least as good as that replaced, and having at least the same value and utility as it.

If replaced, there is quite often an argument during the negotiations over whether replacement parts must be original manufacturer (OEM) parts or may be parts manufacturer approval[403] (PMA) parts, parts made by manufacturer's other than the original manufacturer and typically cheaper.[404]

In case from the United States, *U.S. Bank National Association v Southwest Airlines Co.*[405], brought in the southern District of New York, the airline was held to have:

> "stripped the Aircraft of their valuable Engines and Parts, and replaced them with comparatively inferior Engines and Parts thereby constructing three substantially degraded airplanes"[406]

despite provisions in the lease requiring substitute engines and parts having at least the same value and utility as those replaced and despite a provision that the lessee not discriminate against the leased aircraft as compared with other aircraft in the airline's fleet.

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[400] Pooling of engines by lessees can be a contentious issue for lessor. Industry practice is such that, no matter what the lease may provide, engines will be pooled as needed by operators: vide Bunker D H, *International Aircraft Financing*, Volume 2, IATA, 2005, at 133.
[401] *Vide* 3.10.2.1 *supra*.
[402] *Vide* 3.15.5 *infra.*
[403] An approval granted by the United States Federal Aviation Administration under 14 C.F.R. 2.303.
[404] Thus saving the airline money but potentially reducing the value of the aircraft.
[405] 2009 WL 2163594 (S.D.N.Y. July 20, 2009).
[406] *Id.*, at 10.

As most leases do not allow substitution of engines except in case of destruction, this is typically a concern as to parts rather than engines. The court did not define "value and utility" since the airline admitted the reduction in value of the aircraft due to its conduct, arguing only over quantum, but it does illustrate the importance of having requirements as to value and utility and to non-discrimination in the context of replacement parts.

Usually there is not the debate, seen in connection with engines,[407] over title being retained regardless of their installation on other aircraft – leases typically provide that ownership of parts does pass on installation even though they also claim not to relinquish ownership to removed parts unless and until they are replaced with parts permitted under the terms of the lease. However, title to such a removed part would probably pass to the owner of the aircraft on which it is installed regardless of the lease language, leaving only a contractual claim against the lessee – this issue is more fully discussed in the next section, 3.10.2.4.3.

3.10.2.4.3 Replacement of engines

Unlike other parts, engines are considered such a valuable part of the aircraft that, barring a total loss of the engine, the aircraft should be returned in principle at the end of the lease term with the same engines with which it was delivered.

Permanent replacement of engines typically does not, in this author's experience, typically cause a problem in engine leasing – if an engine is destroyed, for example, it will be replaced permanently by an engine and typically the lessor will want the lessee, even if the lease provides for automatic vesting of title upon installation, to provide a bill of sale establishing title. Permanent replacement of engines is not otherwise typically allowed.

Temporary replacement of engines is where, heretofore, problems have been faced by this author in practice, and owners of engines worry that, should their engine temporarily be installed on another airframe, the owner of that other airframe may acquire title to that engine by operation of law pursuant to an applicable rule of national property law.[408]

Thus, making clear in drafting legal documentation that title to temporarily replaced or temporary replacement engines *does* not pass may be more important than making clear that title to permanently replaced or permanent replacement engines *does* pass.

Leaving aside the issue of the distinction of permanent and temporary replacement of engines, and turning to the broader issue in hand of the ability of the parties to determine

[407] *Vide* 3.10.2.4.3 *infra*.

[408] Engine owners often request the airframe owner to sign a letter recognising the former's ownership rights in the installed engine. If the letter is so limited, this should not cause a problem. Issues arise where the requested letters go beyond this, requiring notification or consent to the former before the latter may exercise repossession rights over the aircraft so long as the engine is installed. This is interference in the airframe owner's ownership rights in the aircraft and contractual rights under the lease and should be resisted.

transfer of title of engine ownership, we need to examine not only applicable national law but also its effect at global level.

Drafting the contract so as to reflect the will of the parties is important, and, by having a governing law clause, the parties can ensure that the *lex loci contractus*, being the law governing the contract, either because the contract was concluded in a particular jurisdiction or in the contract the parties chose the laws of a particular jurisdiction to govern it, will recognize and enforce the contractual provision on engine title.[409]

Thus, Releaux and Tonnaer[410] suggest that contractual provisions can suffice and, to a limited extent they are correct. Typically, a legal opinion will be obtained by the lessor that the contract, including this provision, constitutes the legal, valid and binding obligation of the lessee.

However, although this contractual drafting may suffice as a matter of contractual rights *inter partes*, it may not suffice as a matter of proprietary rights where we are dealing with involuntary transfers by operation of law and possibly with third party rights. As Honnebier points out,

> "[t]his is particularly the situation where one of the interested parties becomes a bankrupt. Only the validly created proprietary rights of the other party will be recognized and enforced in other states."[411]

In other words, the contractual rights may suffice where the lessee is solvent as it, in effect, compels them to maintain the lessor's proprietary rights or pay the consequences; but, in bankruptcy, the contractual rights may be worthless.

It is therefore necessary to look to the proprietary rights at a national level. The general rule for the governing law relating to the proprietary rights in corporeal movable assets is that the *lex situs* applies – that is, the law of the jurisdiction where the asset was located at the time of the creation of the interest.[412]

The proper law then, determining proprietary rights which may arise upon operation of law, including any accretion rights to engines, will be the *lex situs*, rather than the *lex loci contractus*. If it is in a jurisdiction which is a state party to the Geneva Convention, then, under Article 1(1) of the Geneva Convention,[413] the rights to property in aircraft which

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[409] *Vide* Hanley D P, *Contractual and Property Rights in Leased Aircraft Engines*, in Singamsetty S S P (editor in chief), *Air and Space Law: Contemporary Issues and Future Challenges*, Air and Space Books, 2011.
[410] *Financing Aircraft Engines – Pitfalls and Solutions*, Matthias Reuleaux and Hein Tonnaer, ZLW 56. Jg. 1/2007, at 2.2.
[411] Honnebier B P, *Clarifying the Alleged Issues Concerning the Financing of Aircraft Engines*, ZLW 3/2007, 33-44, at 1.3.
[412] Honnebier, ibid, at 2.3, refers to it as a universal rule.
[413] *Vide* 3.15.4 *infra.*

should be recognized are rights which "have been constituted in accordance with the law of the Contracting State in which the aircraft was registered as to nationality at the time of their constitution".

At the time of delivery, typical practice is that the aircraft will still be on the register of the prior operator. Typically, the new lessee will then quickly file to register the aircraft in its register.

According to Article 3(3) of the Geneva Convention, if the law of a Contracting State provides that the filing of a document for recording has the same effect as actually recording it, it shall (so long as the document is open to the public) have the same effect under the Geneva Convention.

The important point to note is that, to the effect that documentary provisions on title transfer are given effect to not only as a contractual matter but as a matter of proprietary rights, thus covering involuntary transfers and binding third parties, it is not because the governing law of the contract and the contract itself so provide, but because the applicable *lex situs* also so provides.

The *lex loci contractus* is the law of the place of the contract. This can be either the law where the contract is formed or the law which the parties agree should govern the contract.[414] This only governs contractual *in personam* rights between the parties, and thus does not govern proprietary rights *in rem,* which prevail in case of involuntary transfers of title, transfers by operation of law and bankruptcies.

The *lex rei sitae* (more commonly referred to in common law jurisdictions as the *lex situs*) is the law of the jurisdiction where property is situated at the time of creation of a right in it or, more specifically in this context, at time of transfer of title to it.

This is the general rule applicable to determining which substantive law to apply to the transfer of an interest in corporeal moveable property. Only corporeal assets have a fixed *situs*, and the *situs* of immovable property does not change. Moveable property by definition may have more than one *situs*, depending where it is at a given time.

Under the Geneva Convention, Article 1(1), the *lex registrii* applies for these purposes. In other words, the law of the state of registration (for the purposes of the Chicago Convention) of the aircraft applies.

Releaux and Tonnaer interpret this to mean the substantive law only of the *lex registrii* applies. Thus, if under the national property law (looked at in isolation) of the *lex registrii*, accretion of title to engines to the airframes on which they are installed occurs by operation of law, then, under the Geneva Convention, the right of the person claiming title to such engine will be recognised and upheld by the Geneva Convention.

[414] *Black's Law Dictionary*, 8th edition.

Honnebier, however, argues that the Geneva Convention does not refer to the substantive laws only – it refers to laws without qualification and this must be taken to mean all laws of the state of registration, including conflicts of laws rules. Certain laws automatically provide that references to their law include references to their conflicts of law rules, such that parties choosing New York law, for example, to govern a contract, need to take care to exclude its conflicts of law rules if they want to ensure that New York substantive law applies to the contract rather than some other law as a result of New York's determination that the substantive laws of the *lex situs* (where different) apply instead.

As stated above, given the universality of the *lex situs* rules in these cases, the *lex registrii* would apply the *lex situs* with the effect that any accretion rules would have to occur under the *lex situs* rather than purely under the substantive laws of the *lex registri*.

The Geneva Convention thus sets outs procedural, not substantive, law, further proof of which comes in the fact that it "recognizes" rather than "creates" rights.

Complicating the picture is the doctrine of *renvoi*, whereby a court determines that, in this context, when examining the rules of a given jurisdiction, one should examine all its rules, including its rules of private international law. This may result, for example, in a court holding that, under the *lex situs* of one jurisdiction (including its rules of private international law), the laws of another, such as the *lex registrii*, shall apply. The problem is that the rules of that other jurisdiction may, under its private international law rules, provide for the law of the *lex situs* to apply, thereby creating a circular process.

This is not a theoretical concern: in *Blue Sky One Limited and others v Blue Sky Airways LLC and others*,[415] Beatson J of the English High Court held that the validity of aircraft mortgages is "to be determined by the *lex situs*, the law of the place where the aircraft were situated on 21 December 2006, the date the mortgages were executed" and rejected an argument that the *lex registrii* should be used instead so as to conform to the Geneva Convention.

Renvoi was thus rejected and the domestic laws of the *lex situs*, excluding its rules of *renvoi* which would have looked to the *lex registri*. He continued that, in the case of "a transfer of title to tangible moveables, such as the aircraft in this case, the reference to the *lex situs* is to the domestic law of the place where the aircraft are situated on the relevant date, and not to its entire law including its choice of law rules; that is the doctrine of *renvoi* does not apply". Gerber[416] has commented that this judgment, harsh in its effect:[417]

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[415] [2010] EWHC 631 (Comm), at 200-201.

[416] Gerber D N, *Aircraft Finance Issues: The Blue Sky Ruling; The New ASU and the "Home Country Rule"; and Recent Developments at the FAA Registry*, a paper presented at the American Bar Association Air and Space Law Forum 2010 Annual Meeting in Seattle, Washington on 26 October 2010.

[417] The mortgage had been perfected under the laws of the *lex registri*, which laws, under the private international laws of the *lex situs* applied, but had not been perfected under the laws of the *lex situs*, and thus was held not to have been perfected.

> "could probably be criticized as focusing overly on the hypothetical problems that might occur while ignoring the reasonable justifications of the particular facts of this case."

In order to overcome differing interpretations of, and problems involving *renvoi*, rules of private international law, and the risk of application of national law to what are inherently internationally moveable assets, the Cape Town Convention 2001 and Aircraft Protocol thereto provided for an "international interest" in aircraft objects (defined to include (i) airframes which can carry at least 8 persons including crew or goods in excess of 2,750 kg, (ii) aircraft engines having at least 1,750 lb of lift for jet engines or otherwise at least 550 rated take off shaft horsepower and (iii) helicopters which can carry at least 5 persons including crew or goods in excess of 450 kg).

Sir Roy Goode describes the "international interest" as a creature of the Cape Town which:

> "in principle is not dependent on national law. It is therefore irrelevant that the international interest has no counterpart under the otherwise applicable law or that the latter does not recognise non-possessory security at all. Once the conditions of the Convention have been satisfied an international interest comes into existence, even if fulfillment of those conditions would not suffice to create an interest under national law or would require further formalities in order to be effective. In this sense, the international interest is an autonomous interest. However, it is not wholly independent of national law, which continues to govern the question of whether an agreement exists between the parties at all…."[418]

Sir Roy continues that the creation of interests under national law is not precluded, and that "in most cases" an interest arising under national law under a leasing agreement will constitute both an international interest and a domestic interest, but that "usually" the international interest will give stronger rights than a purely domestic interest, since the former overrides even unregistrable unregistered interests whereas the latter may not.[419]

The Cape Town Convention[420] supersedes, pursuant to Article XXIII of the Protocol, the Geneva Convention for signatories thereto to the extent that the Cape Town Convention applies.[421] International interests may be registered in respect of aircraft objects if the airframe is registered as part of an aircraft in a contracting state, if the engine is registered

[418] Sir Roy Goode, *The International Interest as an Autonomous Property Interest*, European Review of Private Law 1-2004, at 24.
[419] *Ibid*.
[420] Article XXIII of the Aircraft Protocol.
[421] Article XXIII of the Aircraft Protocol goes on to provide: "However, with respect to rights or interests not covered or affected by the present Convention, the Geneva Convention shall not be superseded."

as part of an aircraft in a contracting state or otherwise the engine is located in a contracting state[422] or if the debtor (or lessee) is situated in a contracting state.[423]

Once registered, international interests (pursuant to Article 29(1) of the Cape Town Convention), have "priority over any other interest subsequently registered and over an unregistered interest". An "unregistered interest" is defined in Article 1 to include non-consensual rights or interests.

The Geneva Convention does not create any rights or govern matters such as the transfer of title to engines.[424] It is a conflict of laws treaty that deals with recognition of rights, not a substantive treaty that creates rights.

Honnebier[425] view of the background to this is that, immediately after World War II, a substantive treaty on rights in aircraft was not feasible, so the Geneva Convention was entered into as a provisional body of rules. Likewise, according to Rosales, the drafters of the Geneva Convention initially hoped to establish a substantive treaty mortgage or charge on aircraft, or at least a uniform recordation system, but found that would be too radical a departure in the face of great divergence in national conceptions.[426]

The Geneva Convention only deals with four types of consensually created rights and does not deal with non-consensual rights such as accretion or accession of title to aircraft engines by operation of law at all. Both Honnebier, on the one hand, and Releaux and Tonnaer, on the other hand, agree, albeit for different reasons, as to the inadequacy of the Geneva Convention in this regard and the need for the solution set out in the Cape Town Convention.

The Cape Town Convention creates an international interest which can be registered in respect of aircraft engines over a certain size (see above). This international interest under Article 29(1) has "priority over any other interest subsequently registered and over an unregistered interest".[427] An "unregistered interest" is defined to include non-consensual rights or interests,

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[422] Article IV(1) of the Aircraft Protocol.
[423] Article 3(1) of the Convention.
[424] As Honnebier puts it: "the Convention takes no account of new developments in international financing practice, such as the fact that at present aircraft engines are financed and registered separately": *The Convention on International Interests in Mobile Equipment and the Aircraft Equipment Protocol will encourage European property law reform*, 1 (2004) Edinburgh Law, *Review* 115.
[425] Honnebier B P, *The European air transport sector requires an international solid regime facilitating aircraft financing: The Cape Town Convention*, Tijdschrift Vervoer + Recht, 2007-5, at 4.2 and 4.3.
[426] Rosales R, *Recordation of Rights in Aircraft and International Recognition: A Comparison between the American and Canadian Situations*, Annals of Air and Space Law, Volume XVI, 1991, at 209-210.
[427] Registration ensures that application of the principle of title preservation and overrides any contrary local law of contracting states. *Vide* French D, *Legal considerations for aircraft engine financiers*, Airfinance Journal, July 2008 Supplement, at 23.

Thus, a duly registered international interest in an aircraft engine under the Cape Town Convention prevails over a non-consensual right or interest such as a transfer of title to an aircraft engine by operation of law by reason of its installation on another aircraft even if, under some applicable national property law, such installation would otherwise vest title to the engine in the owner of the aircraft.

There is some difference of legal opinion as to whether, for example, under the law of the Kingdom of the Netherlands[428] title to engines passes to the airframe owner upon installation thereon. Honnebier[429] argues that under such law there is no accession of title engines to the title of the aircraft on which it is installed. He cites two cases which decided against such accession: *AAR Aircraft & Engine Group v Aerowings*[430] and *Volvo Aero Leasing v AVIA Air*,[431] decided on the basis of the prevailing industry view.

The argument in favour of engine accession is based on Article 8:3a(2) of the Civil Code of the Netherlands, which provides that:

> "[t]he airframe, engines, propellers, radio apparatus, and all other goods intended for use in or on the machine "(toestel)", regardless whether installed therein or temporarily separated there from, are a component part "(bestanddeel)" of the aircraft."[432]

Nevertheless, even those who argue that it does agree that this will no longer be the case once the Netherlands ratifies the Cape Town Convention. [433]

Finally, in this regard, it should be noted that the Cape Town Convention[434] has not yet been as widely adopted as the Geneva Convention[435] even though, for those states bound by it, the Cape Town Convention supersedes[436] the Geneva Convention to the extent of rights or interests covered by the Cape Town Convention. As noted above, the Geneva Convention was only intended as provisional in nature given the inability of states to agree substantive rules at that time. The Cape Town Convention is proof that agreement on

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[428] Bearing in mind that within the Kingdom of the Netherlands there are three separate jurisdictions, the Netherlands, the Netherlands Antilles and Aruba, each with its own Civil Code and that, accordingly, jurisprudential results in one jurisdiction may not necessarily be followed in the others.

[429] Honnebier B P, *Clarifying the Alleged Issues Concerning the Financing of Aircraft Engines: Some Comments to the Alleged Pitfalls Arising Under Dutch, German and International Law as Proposed*, ZLW 3/2007, at 33-44.

[430] Court of Appeal, Den Bosch, The Netherlands, 15 August 2002.

[431] Summary Proceedings, Court of First Instance of Aruba, 25 June 2003.

[432] http://lincolngomez.com/2010/02/11/aviation-engines-doctrine-accession-gomez-bikker-arub on 18 April 2011.

[433] *Vide e.g.* Crans B, *Aircraft finance below sea level*, Airfinance Journal Supplement, July 2008, at 39.

[434] At the time of writing, 36 states are party thereto – *vide* http://www2.icao.int/en/leb/List%20of%20Parties/capetown-prot_en.pdf on 6 April 2011.

[435] At the time of writing, 89 states are party thereto – *vide* http://www2.icao.int/en/leb/List%20of%20Parties/Genev_en.pdf on 6 April 2011.

[436] Pursuant to Article XXIII of the Aircraft Protocol.

substantive rules could be reached, thus obviating the need for the provisional solution set out in the Geneva Convention.

In summary, it could be said that neither the Cape Town Convention nor the Geneva Convention deals explicitly with transfer of title to engines by operation of law but that the Geneva Convention had no effect on such transfer whereas the provisions of the Cape Town Convention, which is growing in importance as it is increasingly adopted by more and more states, take precedence over any such transfer under national property law rules so long as the proper registration in respect of the international interest in the engine is made.

As a contractual matter *inter partes*, engine lessors commonly ask aircraft lessors to sign recognition of rights agreements (RORA), particularly as aircraft engine leasing increasingly develops as a commercial field alongside aircraft leasing. The idea behind the RORA is that, if an aircraft lessor repossesses its aircraft at a time when the airline has installed on that aircraft an engine belonging to the engine lessor, the aircraft lessor agrees not to make any ownership claim against the engine even if by operation of law title to the engine automatically passes to the aircraft lessor.

Usually this is not a contentious request, but disagreements over the extent of a RORA can occur where the engine lessor seeks to extend its terms beyond those originally contemplated.

For example, the engine lessor may ask that the provisions of its lease prevail over those of the aircraft lease, or it may ask that the aircraft lessor not take any action with respect to its engine without the engine lessor's consent.

These are unrealistic requests: an airframe lessor has no reason to agree that the engine lease will prevail over the aircraft lease. Further, if it needs to act quickly to repossess its aircraft and remove it to a different jurisdiction, it cannot lose valuable time obtaining consent and negotiating terms for it with the engine lessor.

The most the aircraft lessor can agree to do is to notify the engine lessor where its engine is after an aircraft repossession and invite the engine lessor to collect its engine.

Engine lessors may argue that they may be in breach of their covenant of quiet enjoyment to the airline if the aircraft lessor repossesses their engine while the airline is still complying with the engine lease. Such argument is specious, as the interference in quiet enjoyment would not have been caused by or through the engine lessor.

They may alternatively argue that commercially they may not wish or be able to terminate their engine lease: that is reasonable enough but they must accept and understand that if they allow their engine to be installed on somebody else's aircraft, they must expect that it is subject to being repossessed along with the aircraft by the aircraft owner. If they wish to continue their engine lease, they can collect it from the engine owner and ship it back to the

airline. In most if not all cases, however, the engine lessor will be grateful that its engine was safely removed from the jurisdiction in the event of a major default or collapse on the part of the airline.

3.10.3 Conclusions

The lessee's covenant's examined in 3.10.2 *supra* show a great interplay between, on the one hand, public and private international law as well as of national law (both law of the jurisdiction of the airline and law of the state of registry) and, on the other hand, aircraft operating leases, something reflect in the lengthy of 3.10.2 itself.

Many areas of public international law and national law, in particular involved, covering maintenance (where the lease requires, as seen, compliance as a contractual matter with legal requirements as to maintenance, and indeed imposes higher requirements), liens (which may take the form of an *in rem* lien under the Eurocontrol convention or even result in personal liability on the part of the lessor in the case of breach by the lessee of its obligations), registration (where, as foreseen by the Chicago Convention, registration may take various forms depending on national law), and replacement of parts and engines (where the Geneva Convention and the Cape Town Convention are discussed).

What has to be borne in mind throughout is that the provisions of the law as they apply to third parties apply without reference to the provisions of the lease, which only apply *inter partes*, and yet are most likely to become an issue for the lessor precisely because the lessee is in breach of its covenants under the lease (as well as its obligations at law).

Of course, the lessor will insist on an indemnity claim against the lessee, examined next at 3.13 but the lessee, if it is in breach of its covenants, may well be in breach because it is insolvent and thus in no more a position to indemnify the lessor for the consequences of its breach than it was in a position to avoid the breach in the first place.

3.11 Indemnities

These are some of the most closely negotiated parts of the lease for the lawyers if not for the non-lawyers. Since the lessor will not want to take the credit risk of the lessee in respect of its indemnity obligations, the lessor will insist that such indemnity obligations[437] be covered, insofar as that is possible,[438] by insurance, as discussed further at 3.12 *infra*.

3.11.1 Damage to aircraft or other loss to lessor

The indemnity provisions will require the lessee to indemnify the lessor for damage to or loss of the aircraft and for loss which the lessor suffers as a result of any breach by the lessee of its obligations under the lease.[439] Of course, the lessor can sue the lessee for breach of contract in accordance with applicable law and the dispute settlement provisions of the lease.

This is, however, a heart, a risk assignment among the parties whereby the lessee undertakes such risk, and insures against it.[440] The hull insurances[441] should, subject to deductibles, cover loss or damage to the aircraft.

3.11.2 Liability for damage to third parties

3.11.2.1 Liability to non-passengers

Under the Convention on Damage caused by Foreign Aircraft to Third Parties on the Surface signed at Rome on 7 October 1952 (Rome Convention 1952), the operator shall, pursuant to Articles 1 and 2, be liable for damage to any person on the surface "upon proof only that the damage was caused by an aircraft in flight or by any person or thing falling therefrom". Under Article 2(3) thereof:

> "the registered owner of the aircraft shall be presumed to be the operator and shall be liable as such unless, in the proceedings for the determination of his liability, he proves that some other person was the operator and, in so far as legal procedures permit, takes appropriate measures to make that other person a party in the proceedings."

The problem with this provision is that the Chicago Convention, at Article 17, refers, in fact, to the registration of aircraft, not to the registration of owners.

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[437] *Vide* Section 10 of the Supplement *infra*.
[438] For example, neither hull nor liability insurances will cover the lessor in case an *in rem* lien is imposed against its aircraft in the circumstances discussed at 3.10 *supra*.
[439] Clark T (editor), *Leasing Finance*, Euromoney, 1985, at 55, and Bunker D H, *International Aircraft Financing, Volume 1: Specific Documents*, IATA, 2005, at 158-163.

[440] *Vide* Bunker, *op. cit.*
[441] *Vide* 3.12.2 *infra*.

Article 19 of the Chicago Convention leaves it to the contracting states to determine what laws and regulations apply. As we have seen at 3.10.2.3 *supra*, not all contracting states have an ownership-based register, although some may do. As discussed there, in the case of a Japanese registered aircraft financed by the Export Import Bank of the United States, there may be four different legal entities which may be considered the owner.

In such an instance, it may not be entirely clear which is the owner for the purposes of Article 2(3) of the Rome Convention 1952 if the aircraft registration system concerned does not provide for an ownership-based register. It is conjectured that a court may look to the state of registration and apply the laws of such jurisdiction to determine who is the owner but that party may not be the "registered owner" as required by the words of Article 2(3) of the Rome Convention 1952.

Article 9 of the Rome Convention 1952 goes on to provide:

> "Neither the operator, the owner,… nor their respective servants or agents, shall be liable for damage on the surface caused by an aircraft in flight or any person or thing falling therefrom otherwise than as expressly provided in this Convention. This rule shall not apply to any such person who is guilty of a deliberate act or omission done with intent to cause damage."

The basic premise under the Rome Convention 1952 of holding the operator liable but assuming the owner is the operator unless the owner can rebut this assumption is echoed in various national laws, many of which provide for liability for damage on the part of the owner in the first instance and then go on to provide that, where the owner has leased the aircraft to an operator other than itself, such liability provisions shall be construed as if they referred to that operator rather than to the owner.[442]

The Rome Convention has been reviewed by an International Civil Aviation Organisation (ICAO) Council Special Group on the Modernization of the Rome Convention particularly in light of the risk of terrorist attacks using aircraft and the AWG has made submissions with regard thereto to the effect that the sole remedy of a person suffering damage should be to the operator given that lessors are essentially financial service providers, providing aircraft possession to airlines in return for a use fee without access costs where all operational risk is borne by the airlines.[443]

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[442] See for example, Section 97(7) of the New Zealand Civil Aviation Act 1990 (which requires a hiring out essentially on a dry lease basis of greater than 28 days); Section 64 of the United Kingdom Civil Aviation Act 1982 (which provides in much the same terms except that the period should be greater than 14 days), and Section 10(a) of the Australian Damage by Aircraft Act 1999 (which also provides in much the same terms but does not have any minimum term requirement for a lease).

[443] http://www.awg.aero/pdf/WP%204.pdf on 4 May 2009.

Arising out of such review, the Unlawful Interference Compensation Convention 2009,[444] the rules of which, under Article 44 thereof, prevail over those of the Rome Convention 1952, has not yet come into effect.[445] It provides simply for liability on the part of the operator.[446] Article 27 explicitly provides:

> "No right of recourse shall lie against an owner, lessor, or financier retaining title of or holding security in an aircraft, not being an operator, or against a manufacturer if that manufacturer proves that it has complied with the mandatory requirements in respect of the design of the aircraft, its engines or components."[447]

Further, Article 29.1 sets out an exclusive remedy:

> "Without prejudice to the question as to who are the persons who have the right to bring suit and what are their respective rights, any action for compensation for damage to a third party due to an act of unlawful interference, however founded, whether under this Convention or in tort or otherwise, can only be brought against the operator and, if need be, against the International Fund and subject to the conditions and limits of liability set out in this Convention. No claim by a third party shall lie against any other person for compensation for such damage."

Wool[448] writes that with this approach:

> "for the first time, a major international air law instrument recognizes and advances the integrated industry principle. Previous air law instruments have equated airlines with the industry as a whole. The liability of others was beyond the scope of such instruments, meaning that they were left to applicable law."[449]

Abeyratne agrees with Wool that a:

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[444] Convention on Compensation for Damage to Third Parties, Resulting from Acts of Unlawful Interference Involving Aircraft, signed at Montréal on 2 May 2009.

[445] 8 countries have signed so far at the time of writing - see http://www2.icao.int/en/leb/List%20of%20Parties/2009_UICC_en.pdf on 6 April 2011.

[446] Article 3.

[447] Thus effectively resolving the lack of clarity as to the owner is for the purposes of Article 2(3) of the Rome Convention. An earlier draft had provided that claims against the operator would be an exclusive remedy and shielded all other entities. Germany expressed concerns about exonerating entities involved in the operational process – see International Conference on Air Law (Montreal, 20 April to 2 May 2009), *Draft Convention on Compensation for damage to Third Parties, resulting from Acts of Unlawful interference involving Aircraft*, presented by Germany, ICAO DCCD Doc. No. 7, 13/03/09, at 4.2 and 4.3. Also, *vide* 3.11.2.2 *infra.*

[448] Wool J, *Lessor, Financier, and Manufacturer Perspectives on the New Third-Party Liability Conventions*, The Air & Space Lawyer, Volume 22, Number 4, 2010.

[449] See also the discussion at 3.11.2.2 *infra*.

> "special and unique feature of the Convention is ….that…any action…can only be brought against the operator…."[450]

Similarly, the related General Risks Convention 2009,[451] the rules of which, under Article 25 thereof also prevail over those of the Rome Convention 1952, has not yet come into effect.[452] It likewise provides simply for liability on the part of the operator.[453] Article 13 explicitly provides:

> "Neither the owner, lessor or financier retaining title or holding security of an aircraft, not being an operator, nor their servants or agents, shall be liable for damages under this Convention or the law of any State Party relating to third party damage."

A previous submission by the AWG to ICAO[454] sets out a very useful comparative overview of liability *régimes* under various national laws, dividing them into three groups:

(1) liability only where there is fault on the part of the owner;[455]

(2) strict liability on the part of the owner, except where it was not in possession or control of the aircraft (this exception is often by way of subsequent amendment to a strict liability régime which did not recognize the difference between owners and operators), and

(3) strict liability on the part of the owner, regardless of its possession or control of the aircraft.[456]

As of the time of writing, it is unlikely that either the Unlawful Interference Compensation Convention or the General Risks convention will come into force soon.[457]

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[450] Abeyratne R I R, *The Unlawful Interference Compensation Convention of 2009 and principles of state responsibility*, Annals of Air and Space Law, Volume XXXV, Part I, 2010, 177-211, at 186.

[451] Convention on Compensation for Damage Caused by Aircraft to Third Parties, signed at Montréal on 2 May 2009.

[452] 10 countries have signed so far at the time of writing – see http://www2.icao.int/en/leb/List%20of%20Parties/2009_GRC_en.pdf on 6 April 2011.

[453] Article 3.

[454] http://www.awg.aero/pdf/SPECIAL%20GROUP%20ON%20THE%20MODERNIZATION%20OF%20THE%20ROME%20CONVENTION%20OF%201952.pdf on 4 May 2009.

[455] See for example, Section 146 Para. 1 of the Austrian Aviation Act 1946.

[456] See for example, Section 11-1 of the Norwegian Aviation Act 1993; Articles 117 and 119 of the Greek Civil Aviation Code (making owner and operator jointly and severally liable for damage to persons on the surface); and Article 127 of the Danish Aviation Act 1927.

[457] Lee J W, *The regime of compensable damage in the modernized Rome Conventions: A comparison between Article 3 of the General Risks Convention of 2009 and Article 17 of the Montreal Convention of 1999*, Annals of Air and Space Law, Volume XXXV, Part I, 2010, 213-230, at 229.

3.11.2.2 Liability to passengers

The Warsaw Convention (under Article 1 thereof) or the Montreal Convention 1999 (under Article 1 thereof) may apply to an accident occurring between embarkation and disembarkation during international carriage by aircraft for reward, in each case as defined in the relevant Convention.

If either Convention does apply, then, under Article 24 of the Warsaw Convention, any action for damages "however founded" may only be brought "subject to the conditions and limits set out" in the Convention. Article 29 of the Montreal Convention provides likewise.

The Warsaw and Montreal Conventions refer to "any action", and the references are not limited to any action against the airline as carrier and thus, this author argues, they properly apply to any action against anyone, whether founded in contract or tort.[458]

In *Sidhu v British Airways*,[459] the court held that:

> "…it matters not whether the plaintiff brings his claim in contract…, or in tort, as in the present case…" and that "the plaintiffs have no rights save under the Convention."

The United States Supreme Court concluded similarly in *El Al Israel Airlines Ltd v Tseng*[460] to the effect that:

> "…the Warsaw Convention precludes a passenger from maintaining an action for personal injury damages under local law when her claim does not satisfy the conditions of liability of the Convention."

Thus, if either Convention applies, it is submitted that the passenger's sole recourse is pursuant to the conditions and limits of the applicable Convention. The question which then falls to be considered is whether such recourse, against the carrier, excludes any recourse against a non-carrier, such as a lessor in the case of a leased aircraft.

It may, it is conceded, be argued that Article 24(1) of the Warsaw Convention in providing that:

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[458] Article IX of the Guatemala City Protocol to the Warsaw Convention signed at Guatemala City on 8 March 1971 did not come into force but expressly provided that the Warsaw Convention, as amended, provided an exclusive remedy "for any action for damages, however, founded, whether under this Convention or in contract or tort or otherwise…", language not repeated in Article VIII of the Montreal Additional Protocol No. 4 to the Warsaw Convention signed at Montreal on 25 September 1975 or in Article 29 of the Montreal Convention 1999.

[459] 1 Aviation and Space Law Reports 217-219 (1994).

[460] 525 U.S. 155 (1999).

> "[i]n the cases covered by Articles 18 and 19 action for damages, however founded" may only be brought subject to the conditions and limits set out in the Convention"

and Article 24(2) thereof in providing that:

> "[i]n the cases covered by Article 17 the provisions of the preceding paragraph also apply…"

mean that only actions involving liability of the carrier are covered by this provision, since each of Articles 17, 18 and 19 begin: "The carrier is liable…", thus leaving to be examined the possibility, or otherwise, of actions outside of the terms of the Warsaw Convention against other parties, such as manufacturers and lessors.

Nevertheless, it is submitted that these references to "[i]n the cases covered by…." should be construed as references to the nature of the damage incurred, rather than to mean the plaintiff is nevertheless free to bring a claim against parties other than the carrier airline.

In one case, *In re: Air Crash over the Taiwan Strait on May 25, 2002,*[461] an action was brought in the United States against both the airline, China Airlines, and the manufacturer, Boeing. The defendants brought a motion to have the action dismissed on the grounds of *forum non conveniens*, which was granted.[462]

What is of interest here is that China Airlines had waived the liability limits set out therein *vis-à-vis* plaintiffs whose claims were governed by the Warsaw Convention but the plaintiffs argued that this did not affect their right to proceed against Boeing. Morrow J. held that:

> "The court finds, however, that the pendency of the Warsaw Convention cases, while not mandating retention of the actions in this forum, weighs slightly in favor of such a result".

In other words, there was no discussion that plaintiffs whose cases were governed by the Warsaw Convention could *only* proceed against the airline, without recourse to any other party such as, in this case, the manufacturer.

In *Ellis v AAR Parts Trading, Inc.,*[463] discussed below at 3.11.6, in the context of domestic United States law, the issue was not discussed but it should be noted that the ill-fated flight here was a domestic flight[464] within the Philippines, not an international one.

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[461] 2002, 331 F. Supp. 2d 1176, 1187 (C. D. Cal 2004).
[462] *Vide* 3.11.3.1 and 3.18.2 *infra* for further discussion on *forum non conveniens*.
[463] 828 N.E. 2d 726, 730 (Ill. App. Ct. 2005).
[464] Leaving aside any issue of passengers connecting form or to international flights – an issue not discussed in the case.

Likewise, in a case[465] involving a crash by the Indonesian carrier Adam Air, the Northern District of Illinois granted a motion by defendant lessors and manufacturers to dismiss on grounds of *forum non conveniens* without discussing this issue but, as with Ellis, the flight involved was a domestic flight.

Not only in case law but in the literature, it is remarkable how little discussion there has been on this issue. In an interesting review of *Ellis* and other United States cases involving potential lessor liability, Clark and Richardson[466] do not discuss the effect of the Warsaw Convention or the Montreal Convention at all. Alexander Ho, in his article *Does the Montreal Convention 199 provide an exclusive remedy in the international carriage of good and passenger*s?,[467] does not discuss at all the issue of recourse against parties other than the carrier. Likewise, Tory A Weigand, in his article Accident, *Exclusivity, and Passenger Disturbances under the Warsaw Convention*[468] does not discuss the issue.

Dempsey and Milde[469] do not expressly deal with lessors in this regard, although they do state that:

> "…Warsaw does not regulate the liability of aircraft manufacturers, of the airport authorities or air navigation services providers, or to (sic) domestic travel."[470]

This seems at least somewhat contrary to their discussion of Article 29, where they discussed the United States Supreme Court finding in *El Al Israel Airlines v Tseng*[471] that:

> "the 'cardinal purpose' of the Warsaw Convention was to establish uniformity of law governing international aviation liability"[472]

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[465] *In re Air Crash Disaster Over Makassar Strait, Sulawesi*, No. 09-cv-3805, MDL 2037, 2011 WL 91037 (N.D. Ill. Jan. 11, 2011).
[466] Clark R W and Richardson T M, *Is Lessor More?,* 75 J. Air L. & Com 69, 2010.
[467] Annals of Air and Space Law, Volume XXXIV, 2009, at 379-436.
[468] Weigand Published, 3/30/01.
[469] Dempsey PS and Milde M, *International Air Carrier Liability: The Montreal Convention of 1999*, McGill University Centre for Research in Air & Space Law, 2005.
[470] *Ibid*., at 71-72.
[471] 525 U.S. 155 (1999).
[472] See also Tompkins Jr G N, *The Continuing Development of Montreal Convention 1999 Jurisprudence*, Air and Space Law 35, No. 6, 2010, at 433-440, for a discussion on the differing judgments following *Tseng* in the United States on this issue, some of which, he argues, at 434, seek "to disregard or rationalize a restrictive interpretation of the Supreme Court's decision" in *Tseng*. It must be borne in mind that these cases concern actions against carriers, and not against non-carriers such as lessors. He writes, at 436, that eventually

> "this issue of exclusivity and pre-emption may find its way to the US Supreme Court and be resolved finally in the United States. Until that time, we shall have to live with the courts in the Seventh and Ninth Federal Judicial Circuits, which seem to be determined to disregard the clearly expressed intent of the Parties in Article 29 as to the exclusivity and pre-emptive effect of MC99."

without adding to the end thereof (or elsewhere in the discussion) words to the effect of "of airlines." Admittedly, the title of the work makes clear that its focus is not on liability of parties other than air carriers.

Even if such argument[473] is correct, it is submitted that it does not apply to cases where the Montreal Convention applies. Unlike Article 24 of the Warsaw Convention, the equivalent Article 29 of the Montreal Convention provides quite categorically:

> "In the carriage of passengers, baggage and cargo, any action for damages, however founded, whether under this Convention or in contract or in tort or otherwise, can only be brought subject to the conditions and such limits of liability as are set out in this Convention…."

The formulation "any action for damages, however founded, whether under this Convention or in contract or in tort or otherwise" was introduced first in Guatemala City Protocol 1971[474] at Article IX[475] and repeated in Montreal Protocol No. 4[476] at Article VIII.

The language is not restricted to "any action for damages against the carrier" but to "any action for damages", period. Where the Montreal Convention applies, this author sees no grounds from the text for any claim being brought against the lessor of the aircraft involved as the lessor is not the carrier. Further, given the different wording, case law under the Warsaw Convention on this issue is not relevant to interpretation of the Montreal Convention.

Further, Article 37[477] of the Montreal Convention provides:

> "Nothing in this Convention shall prejudice the question whether a person liable for damage in accordance with its provisions has a right of recourse against any other person."

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[473] That claims against lessor are not precluded by the Warsaw Convention or the Montreal Convention where it applies.

[474] Protocol to Amend the Convention for the Unification of Certain Rules Relating to International Carriage by Air Signed at Warsaw on 12 October 1929 as Amended by the Protocol Done at The Hague on 28 September 1955, Signed at Guatemala City on 8 March 1971.

[475] Unfortunately, in his article on the Montreal Convention, one of the participants in the conference which produced the Guatemala City Protocol did not discuss the reasons for the different wording from that of the Warsaw Convention. Vide Mercer A, *The Montreal Convention 1999: The challenges of a new, modern liability regime for international civil aviation – an airline perspective on certain features*, Civil Aviaiton Summit, Sao Paulo, Brazil, 29-30 March 2005.

[476] Additional Protocol No. 4 to Amend the Convention for the Unification of Certain Rules Relating to International Carriage by Air Signed at Warsaw on 12 October 1929 as Amended by the Protocol Done at The Hague on 28 September 1955, Signed at Montreal on 25 September 1975.

[477] This provision has no equivalent in the Warsaw Convention but was copied from Article 30A of the Montreal Protocol No. 4 (1975) thereto.

In support of his view, this author refers to Article 31(1) of the Vienna Convention which provides that:

> "A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose."

Article 31(2) of the Vienna Convention makes clear that the context includes the preamble and annexes in addition to the text of the main body itself. The preamble to the Montreal Convention does not talk of carriers at all but of "protection of the interests of consumers" and the "need for equitable compensation."[478]

Article 32 of the Vienna Convention allows recourse to supplementary means of interpretation, "including the preparatory work of the treaty and the circumstances of its conclusion" in three cases only:

> (1) "in order to confirm the meaning resulting from the application of article 31;"[479]
>
> (2) "to determine the meaning when the interpretation according to article 31…leaves the meaning ambiguous or obscure";[480] or
>
> (3) "to determine the meaning when the interpretation according to article 31…leads to a result which is manifestly absurd or unreasonable."[481]

It is submitted that, following these provisions, nothing in the context suggests that the words "against the carrier" should be implied after the words "any action for damages" in Article 29 of the Montreal Convention. Article 29 is clear on its face, in its context, and does not lead manifestly to an absurd or unreasonable result: the plaintiff brings its claim against the carrier under Article 29, or not at all, and the carrier in turn is not restricted from bringing a claim against any other parties.[482] Thus, recourse should not be had to supplementary means of interpretation.

In considering a case involving the interpretation of Article 35 of the Montreal Convention 1999 (providing for a two year limitation period for bringing claims thereunder), in *UPS*

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[478] It is true that Article 29 appears within Chapter III of the Montreal Convention which is headed "Liability of the Carrier…" but this entirely consistent with a channeling of claims against the carrier in the first instance. Likewise, Article 43 allowing servants and agents of a carrier to avail of the conditions and limits of liability of the Montreal Convention is, it is submitted, no more than clarifying the liability of the master or principal as a matter of *respondeat superior* in a master-servant or principal-agent relationship. On the other hand, it is conceded that this could be argued as consistent with the view that express extension beyond the carrier itself is necessary as it was done in the case of servants and agents.

[479] Article 32. Note this is only to confirm, not to overturn.

[480] Article 32(a).

[481] Article 32(b).

[482] Article 37.

Supply Chain Solutions (f/k/a Menlo Worldwide Forwarding, Inc. v Qantas Airways Limited at al.[483], O'Scannlain J of the US Ninth Circuit Court of Appeals cited held, in response to an argument that the drafters of the Montreal Convention did not intend to overrule precedents under the equivalent provision of the Warsaw Convention, that:

> "We are not allowed to consider the treaty's drafting history, however because its text is unambiguous."[484]

O'Scannlain J cited as authority for his decision the following:[485]

> "The interpretation of a treaty, like the interpretation of a statute, begins with its text." *Medellin v Texas*, 552 U.S. 491, 506 (2008). And, where the text of a treaty is clear, a court has "no power to insert an amendment" based on consideration of other sources. *Chan v Korean Air Lines, Ltd.*, 490 U.S. 122, 134 (1989)."[486]

This is consistent with the judgment of the United States Court of Appeals, Second Circuit, in *Fishman Fishman v Delta Airlines Inc.*[487] which held that:

> "In interpreting the Warsaw Convention, we look first to the literal language of the treaty and go no further if that language is reasonably susceptible to no more than one interpretation….. Because the language of Article 29 is susceptible to at least two plausible interpretations, we turn to the negotiating history of the Convention to resolve the ambiguity."[488]

Nevertheless, courts do not interpret treaties in precisely the same manner as private contracts.

In the United States, the Supreme Court has held:

> "Treaties are construed more liberally than private agreements, and to ascertain their meaning we may look beyond the written words to the history of the treaty, the negotiations, and the practical construction adopted by the parties."[489]

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[483] U.S. Court of Appeals, 9th Circuit, No. 08-55281, 2 October 2010.
[484] At 2501.
[485] The United States is not a party to the Vienna Convention.
[486] At 2496.
[487] Nos. 1818, 2038, Dockets 96-9345, 96-9457 (1998).
[488] At 3-31.
[489] *Air France v Saks*, 470 U.S. 392, 405, 105 S.Ct. 1338, 1345, 84 L.Ed.2d 289 (1985), at 1345.

In the United Kingdom, Lord Wilberforce[490] in the House of Lords in *Fothergill v Monarch Airlines Ltd*[491] noted that the courts of the United States are more liberal in referring to *travaux préparatoires* than those of the United Kingdom and commented:

> "there may be cases where such travaux preparatories can profitably be used. These cases should be rare, and only where two conditions are fulfilled: first, that the material involved is public and accessible, and, secondly, that the travaux preparatories (sic) clearly and indisputably point to a definite legislative intention."[492]

Even if, pursuant to Article 32 of the Vienna Convention or otherwise, recourse is had to supplementary means of interpretation of Article 29 of the Montreal Convention, we find nothing substantial in the *travaux préparatoires*[493] therefor discussing the significance of the difference on wording on this point between the Warsaw Convention and the Montreal Convention or anything to suggest that the words "against the carrier" should be implied after the words "any action for damages" in Article 29 of the Montreal Convention.

This author submits, therefore, that the better reading of the Montreal Convention, construed in accordance with the Vienna Convention, is to limit a passenger's recourse, in circumstances where the damage complained of is covered by the Convention, to the airline, and to the airline alone, while allowing the airline then to bring a claim where appropriate against other parties such as manufacturers or lessor. In other words, the passenger cannot in such circumstances claim directly against the manufacturer or the lessor.

He acknowledges, nevertheless, that this is a disputed (perhaps minority) view; for a contrasting view, see the discussion of Wool at 3.11.2.1 *supra*. Specifically, in the context of contrasting it with Article 29 of the Montreal Convention, Wool writes of Article 29.1 of the Unlawful Interference Compensation Convention[494] that:

> "[t]his provision, while superficially similar to parallel clauses in other air law instruments, is in fact quite new. It channels liability to the operators. It prevents actions by third-party victims against others."[495]

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[490] Cited with approval by Lord Phillips, *per curiam*, in *KLM Royal Dutch Airlines v Morris*, [2001] Part 8 Case 2 [CAEW].

[491] [1981] AC 251; [1980] 2 All ER 696; [1980] 3 WLR 209; [1980] 2 Lloyd's Rep 295, (33 ICLQ 797).

[492] *Id.*, at 75.

[493] International Civil Aviation Organization, *International Conference on Air Law, Montreal, 10-28 May 1999, Minutes*, 1999, at 103.

[494] Discussed at 3.11.2.1 *supra*.

[495] Wool J, Lessor, Financier, and Manufacturer Perspectives on the New Third-Party Liability Conventions, The Air & Space Lawyer, Volume 22, Number 4, 2010.

Thus, by contrast, Wool does not believe that Article 29 of the Montreal Convention is so limited. Likewise, Neenan[496] writes that, unlike certain other conventions:

> "the Montreal Convention and its predecessors do not create a positive obligation on a plaintiff to bring their action only against the carrier; they neither state that no other person shall be liable nor do they state that the right for compensation can only be exercised against the carrier"[497]

Further, this proposition is not always made by defendants in cases where it could be: for example, *In re Air Crash Over the Mid-Atlantic on June 1, 2009*[498] where the U.S. District Court for the Northern District of California granted the defendant manufacturers' motions to dismiss all claims arising from the 2009 accident of Air France Flight 447 over the Atlantic Ocean on grounds of *forum non conveniens.*

Support for this author's view is, however, expressed by Mendelsohn[499] who argues for just such an approach on the basis of the decision in *Tseng*:[500]

> "In short, victims enjoy full recoveries quickly and under the absolute liability standards of Montreal 1999. And afterwards, the professionals can litigate for as long as they wish over the issue of who was partially, mostly or completely at fault."[501]

Whalen[502] points out that the addition of the words "or in contract or in tort or otherwise" to Article 29 of the Montreal Convention, "unwilling to leave Article 24 alone",[503] and thus differentiating it from the Article 24 of the Warsaw Convention, means that:

> "[t]he Delegates also unwittingly may have made a fundamental change in the litigation posture of Warsaw cases in the United States."[504]

A fortiori the same case can be made for the innovation of the words "In the carriage of passengers, baggage and cargo, any action for damages" in Article 29 of the Montreal Convention.

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[496] Neenan P, *The effectiveness of the exclusivity provision in foreign serious accidents: does the Montreal Convention channel liability against the carrier?*, LLM Thesis, Leiden University, 2011.
[497] *Id.*, at 53.
[498] MDL Docket No. 10-2144-CRB (N.D. Cal. Oct. 4, 2010).
[499] Mendelsohn A I, *Foreign Plaintiffs, Forum Non Conveniens and the 1999 Montreal Convention*, paper presented to the IATA Legal Symposium held in February 2011 at Vancouver, British Columbia, Canada.
[500] *Op. cit.*
[501] *Id.*, at 9.
[502] Whalen T J, *The New Warsaw Convention: The Montreal Convention*, Air & Space Law, Vol. XXV, Number 1, 2000.
[503] *Id.*, at 20.
[504] *Ibid.*

A case[505] against a lessor currently before the California state courts may help to cast some judicial light on the matter and, however decided, is, given the stakes, likely to be appealed through the federal courts unless settled before then.

No matter how it is decided, it should not be assumed that other courts will follow its approach. Although writing apparently on the assumption that the Warsaw Convention only deals with claims against the carrier, and in the context of who has the right to bring such claims, Myburgh writes:

> "While Civilian jurisprudence has consistently tended to the view that the Convention was intended to operate as an exclusive code, thereby restricting rights of action to the consignor and consignee named in the air waybill exclusively, courts in Common Law jurisdictions have, for the most part, traditionally adopted a non-exclusive reading of the Convention."[506]

As a matter of policy rather than of textual interpretation, this author also submits that his interpretation of the Montreal Convention is more consistent with the trend towards operator-only liability discussed in 3.12.2.1 *supra* in the context of the Unlawful Interference Compensation Convention 2009[507] and the General Risks Convention 2009.[508] Certainly, it would, in the view of this author, have a more just result in disallowing a claim against a lessor by a plaintiff who could have claimed instead from the carrier airline.[509]

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[505] *Hassanati v International Lease Finance Corporation*, No BC452279 (Cal. Super. Ct. Jan. 10, 2011).

[506] Myburgh P, *Title to Sue under the Warsaw Convention: Construing a Dinosaur Text in the Digital Age* (2000) 6 New Zealand Business Law Quarterly 305-313, at 306.

[507] *Vide* International Civil Aviation Organization, *Report of the Rapporteur: Draft Convention on Compensation for Damage caused by aircraft to Third Parties*, Legal Committee – 33rd Session, Montreal, 21 April – 2 May 2008, in Annals of Air and Space Law, Volume XXXIV, 571-586.

[508] *Vide* International Civil Aviation Organization, *Report of the Rapporteur: Draft Convention on Compensation for Damage caused by aircraft to Third Parties, in case of Unlawful Interference*, Legal Committee – 33rd Session, Montreal, 21 April – 2 May 2008, in Annals of Air and Space Law, Volume XXXIV, 549-570.

[509] In this regard, there is a fascinating discussion in Bunker D H, *The Law of Aerospace Finance in Canada*, McGill University, Montréal, 1988, at 62, about how the International Institute for the Unification of Private Law, in its preliminary draft uniform rules with respect to international leasing (which drafts eventually became the Cape Town Convention discussed at 3.14.4.2 and 3.15.3 *infra*), at Article 7 thereof, proposed that a lessor would be excluded from liability in tort and contract while merely in its capacity as lessor where it is essentially performing a financial function (injection of necessary capital for purchase of the equipment).

Although Bunker notes that such rules were initially aimed solely at finance not operating leases, and although the Cape Town Convention did not distinguish between operating and finance leases, the principle is the same: the operating lessor performs essentially a financial function (injection of necessary capital for purchase of the equipment but also assumption of residual value risk. It is (except in the rather different case of airline lessors) never an operator or maintenance performer itself.

This is consistent with the views of Mauritz,[510] who writes:

> "As financiers[511] of aircraft are generally not involved in the operational aspects of the flight of the aircraft, the chances of their implication in liability suits are evidently more remote than those of the operators of aircraft. However, owners of aircraft may be implicated in certain cases, for instance for supplying a defective aircraft or aircraft components or for improper maintenance, if they are obliged to provide such a service under the conditions of the lease. More alarmingly, they may even be implicated for the mere fact that they are perceived as the so-called deepest pocket from which to seek compensation.
>
> "These distinctions between operators and owners of aircraft imply that the legislature should clearly exclude the category of owners from his absolute or strict liability regime if the owners are not the same entities as the operators of aircraft."[512]

Support for this view is given by Germany in its presentation[513] in Montréal in 2009 on the draft Unlawful Interference Compensation Convention 2009 then under discussion, where it made clear that it objected to a proposed complete exoneration of all parties other than the operator, noting, for example, that such a provision would encompass manufacturers and thus breach European law on products liability[514], with the result that European Union member states would be prevented from ratifying the Convention.[515] Germany drew a distinction, however, between entities involved in the operational process, such as manufacturers and airlines, on the one hand, and parties not involved in the operational process, on the other hand, such as aircraft lessors and financiers, since they are not involved in the operational process and thus cannot "contribute to damage".[516]

Such an argument, ultimately, as noted, adopted in the Unlawful Interference Compensation Convention 2009, cannot be distinguished from that of a claim of a

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[510] Mauritz A J, *Liability of the operators and owners of aircraft for damage inflicted to persons and property on the surface*. PhD Thesis, Leiden University, 2003.

[511] *Id.*, note that Mauritz adds: "Under leasing agreements, the term 'owner' can refer to a number of potential entities engaged in the financing of aircraft, such as lenders, investors, and lessors of aircraft. Lessors on their part can be divided into financial and operational lessors, although the latter category is strictly speaking not a financier due to the nature of the lease."

[512] *Id.*, at 45. It is conceded, however, that Mauritz is writing prescriptively *de lege ferenda* rather than descriptively *de lege lata*.

[513] International Conference on Air Law (Montreal, 20 April to 2 May 2009), *Draft Convention on Compensation for damage to Third Parties, resulting from Acts of Unlawful interference involving Aircraft*, presented by Germany, ICAO DCCD Doc. No. 7, 13/03/09. Also, *vide* 3.11.2.1 *supra*.

[514] *Vide* 3.11.2.3 *infra.*

[515] *Id.*, at 4.2.

[516] *Id.*, at 4.3.

passenger for injury where the Montreal Convention 1999 applies: the lessor is no more an operator under either situation.

The report[517] of the rapporteur on the draft Unlawful Interference Compensation Convention rightly discusses this as an "integrated approach to the industry" which:

> "channels all claims to the aircraft operator" for the good reason that leaving out non-operators from the protections of the convention would "undermine the protection that the Convention gives to aircraft operators because of the potential that these other actors have for recovery from the carriers through interlocking agreements, subrogation and other recovery means."

In the context of the United States, the provisions of the US Federal Aviation Act[518], discussed further at 3.4.2.3 *supra*, to the effect that a "lessor…is liable for personal injury, death or property damage…only when a civil aircraft is in the actual possession or control of the lessor…" are also consistent with the Warsaw Convention and the Montreal Convention 1999 on this point.

For these reasons, efforts to found liability based on the tort of negligent entrustment will, of necessity, involve an argument that the Warsaw Convention and Montreal Convention 1999 do not apply – either on the basis that the relevant convention does not apply at all on technical grounds[519] or on the grounds (even if doubted by this author) that even if they do apply, they do not limit recourse against the owner or lessor.

A further reason for arguing that they do not apply is that the whole *raison d'être* of negligent entrustment theory, discussed next, is to bring cases within the United States judicial system which would not otherwise be justiciable there.[520]

If the Warsaw Convention or Montreal Convention 1999 applied, not only would the exclusive remedy provisions thereof limit a passenger's claim to one against the carrier, but United States jurisdiction might well become impossible anyway.

Under Article 28 of the Warsaw Convention, a claim thereunder must be brought:

> "at the option of the plaintiff, in the territory of one of the High Contracting Parties, either before the Court having jurisdiction where the carrier is ordinarily resident, or has his principal place of business or has an

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[517] International Civil Aviation Organization, *Report of the Rapporteur: Draft Convention on Compensation for Damage caused by aircraft to Third Parties, in case of Unlawful Interference*, Legal Committee – 33rd Session, Montreal, 21 April – 2 May 2008, in Annals of Air and Space Law, Volume XXXIV, 549-570, at 563.
[518] 49 USC S. 44112.
[519] For example, a purely domestic point to point flight with no connecting international passengers.
[520] See the discussion of *forum non conveniens* at 3.11.3.1 and 3.18.2 *infra*.

> establishment by which the contract is made or before the Court having jurisdiction at the place of destination."

Article 33(1) of the Montreal Convention 1999 repeats in essence this provision and Article 33(2) thereof adds a fifth jurisdiction, and thus a greater possibility of bringing an action within the jurisdiction of the United States courts,[521] for cases of death or personal injury, allowing additionally the plaintiff to choose to bring an action:

> "in the territory of the State Party in which at the time of the accident the passenger has his or her principal and permanent residence and to or from which the carrier operates services for the carriage of passengers by air…"[522]

Thus, for example, if an action based on negligent entrustment or any other theory were brought against a lessor in the United States simply by virtue of the lessor being incorporated or resident there, where there is no other connection to the United States, that action should not be allowed to proceed where the Warsaw Convention, arguably, or Montreal Convention, clearly, applies both because the exclusive remedy should be against the carrier and because the United States is not one of the jurisdictions allowed thereunder.

3.11.2.3 Product liability

Product liability[523] concerns the liability of the manufacturer of goods for damage caused by those goods and is not of direct relevance to the situation of the lessor of an aircraft. Nevertheless, it is of indirect relevance in the context of the foregoing discussion on the nature of the exclusivity of the remedies set out in the Warsaw Convention and the Montreal Convention and thus will be examined here in brief.

Council Directive 85/374/EEC of 25 July 1985 deals with product liability and provides that "a producer shall be liable for damage caused by a defect in his product."[524] Product is defined to mean all movables[525] and thus includes aircraft. A producer means not only the manufacturer of the product but also "any person who imports into the Community a product for sale, hire, leasing or any form of distribution in the course of his business".[526]

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[521] Discussed at 3.11.3 *infra.*

[522] Dempsey P S and Milde M, *International Air Carrier Liability: The Montreal Convention of 1999*, McGill University Centre for Research in Air and Space Law, 2005, suggest, at footnote 485 on page 219 that the requirement for such service may be satisfied by code-sharing or wet lease arrangements.

[523] Defined by Nolan J R and Nolan-Haley J M, *Black's Law Dictionary*, West Publishing Co., 6th edition, 1990, as referring to the "legal liability of manufacturers and sellers to compensate buyers, users and even bystanders, for damages or injuries suffered because of defects in goods purchased", noting that liability may also be imposed…occasionally…upon a lessor…."

[524] Article 1.

[525] Article 2.

[526] Article 3(1).

Thus, if the Warsaw Convention or the Montreal Convention can be construed, as argued at 3.11.2.2 *supra*, in such a manner as to exclude recourse against a lessor where there is recourse to the operator thereunder, there will be a conflict with this Directive on product liability. It is clearly undesirable for states to have conflicting international legal obligations.

That is not to say that this is a reason to give anything other than their plain meaning to the words of the Warsaw Convention and the Montreal Convention where they are unambiguous but, although Brownlie[527] points out that "[j]urists are in general cautious about formulating a code of 'rules of interpretation'"[528] for treaties, he points out that the International Law Commission and the Institute of International Law consider the "intention of the parties as expressed in the text"[529] as being the best guide to the parties' intent.

Further, as noted, the Vienna Convention[530] provides, at Article 31(1) that:

> "A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose."

If, on the other hand, the Warsaw Convention or the Montreal Convention can indeed be construed in such a manner[531] as not to preclude any action against a manufacturer where there is recourse to the operator thereunder, there is a different problem. If there is recourse to any party other than the operator, then these conventions do not distinguish between such other parties, in other words, they do not distinguish between manufacturers and lessors. This would lead to a different result than claims brought under the Unlawful Interference Compensation Convention or the General Claims Convention,[532] which do distinguish between manufacturers, who have an operational role, and lessors, who do not.

It also appears from this analysis that there is a *prima facie* conflict between the Unlawful Interference Compensation Convention and the General Claims Convention, on the one hand, precisely because they make this distinction, and the Council Directive 85/374/EEC, because it does not.[533]

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[527] Brownlie I, *Principles of Public International Law*, Oxford, 1982
[528] At 624.
[529] *Ibid.*
[530] Vienna Convention on the Law of Treaties done at Vienna on 23 May 1969.
[531] This is the opposite of the position taken by this author at 3.11.2.2 *supra*.
[532] *Vide* 3.11.2.1 *supra.*
[533] This would not be the first such conflict between the Montreal Convention 1999 and European Union law: see Dempsey P S and Johansson S O, *Montreal v Brussels: The Conflict of Laws on the Issue of Delay in International Air Carriage*, Air and Space Law 35, No. 3 (2010) which discusses Commission Regulation (EC) 261/2004 and the Montreal Convention 1999 where they point out, at 208, that, under Article 27 of the Vienna Convention, if an "international convention provides that its remedies are exclusive, then any inconsistent domestic law of ratifying States addressing the same subject is void."

Recommendations for dealing with the varying approaches of these actually or potentially conflicting legal provisions are made at 4.2 *infra*.

3.11.2.4 A note on public international air law instruments

In the realm of public international air law,[534] there are some conventions which are worth briefly examining for any relevance to aircraft operating leasing and in particular indemnities with respect to liability to third parties.

3.11.2.4.1 Tokyo Convention

Under Article 1(b) of the Tokyo Convention,[535] the Convention applies to "acts which, whether or not they are offences" may or do jeopardise the safety of the aircraft or of persons or property therein…" Under Article 1(2), the Tokyo Convention only applies where such acts are "done by a person on board any aircraft…while that aircraft is in flight or on the surface of the high seas or of any other area outside the territory of any State".[536]

Abeyratne[537] states that, as the Tokyo Convention provides that the state of registration[538] has jurisdiction for offences committed on board aircraft, and as more carriers are entering into lease agreements, these developments "necessitate a closer look at the requirements of registration and nationality as dictated to by the Chicago Convention", presumably in the context of how such state of registration may differ in the case of leased and owned aircraft due to Article 83 *bis*.

Having undertaken just such a closer look, this author has concluded that there is little material relevance being inferred by reason simply of an aircraft being leased rather than owned and thus being registered in a different state than would otherwise be the case.

ICAO set up[539] a panel of experts on lease, charter and interchange of aircraft. The panel's recommendations ultimately led to Article 83 bis of the Chicago Convention.[540] It considered recommending amending Article 3 of the Tokyo Convention to provide that, in the case of an aircraft leased without crew to a lessee having its principal place of business in a state other than the state of registration of the aircraft, that other state should "also be competent to exercise jurisdiction."[541] Various amendments to this effect were discussed but misgivings were expressed and ultimately, although the relevant:

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[534] *Vide Public International Air Law Instruments* in Annals of Air and Space Law, Volume XXX Part I, McGill University, 2005, at 5-322.
[535] Convention on Offences and Certain Other Acts Committed on Board Aircraft, signed at Tokyo on 14 September 1963.
[536] Note the reference to "any State", not "any Contracting State."
[537] Abeyratne R I R, *Aviation in Crisis*, Ashgate, 2004, at 101.
[538] Article 3(1).
[539] Pursuant to ICAO Council decision C-Min 87/13 paragraphs 17-24 of April 7, 1976.
[540] *Vide* 3.15.8 *infra.*
[541] Fitzgerald G F, *The Lease, Charter and Interchange of Aircraft in International Relations: Amendments to the Chicago and Rome Conventions*, Annals of Air and Space Law, Volume II, 1977, 103-137, at 120.

> "Tokyo Conference had before it a text prepared by an ICAO Legal Subcommittee, [it] rejected the idea of making criminal jurisdiction depend upon a private-law transaction such as a lease."[542]

Article 11 of the Tokyo Convention requires Contracting States to take "all appropriate measures" to restore control of an aircraft to its lawful commander when:

> "a person on board has unlawfully committed by force or threat thereof an act of interference, seizure or other wrongful exercise of control of an aircraft in flight…."

The person must be established to be on board the aircraft, the act complained of must be unlawfully committed "by force or threat thereof" and, most of all, while the aircraft is "in flight."[543]

Article 10 of the Tokyo Convention provides that the aircraft commander and other crew members are not responsible to any person against whom they take actions under the Tokyo Convention, such as under Articles 5-9 therefor allowing him or crew members authorized by him to restrain and deliver to competent authorities a person whom he has "reasonable grounds"[544] to believe has committed an offence as contemplated by the Tokyo Convention.

Article 10 is where leasing is of relevance as Article 10 also provides that the owner, operator and person on whose behalf the flight is performed shall have no such liability either.

In *Eid v Alaska Airways, Inc.*,[545] the United States 9th Circuit Court of Appeals upheld the requirement of Article 6(1) of the Tokyo Convention that the aircraft commander have reasonable grounds to restrain and hand over suspects to the competent authorities and that it was a for a jury to decide whether he had indeed acted on such reasonable grounds to determine whether the airline was entitled to the protection of Article 10. Following this logic, a lessor would also have to show that the aircraft commander acted on reasonable grounds in order to avail of the protections of Article 10 in that a claim were made against the owner.

However, mere failure to establish the protection of Article 10 does not equate to liability on the part of the lessor for the actions of the aircraft commander provided, in the case of a dry lease, by the lessee. Nevertheless, while it may be fair to impute a reasonableness test in order for the aircraft commander's employer to be relieved of responsibility, it is the

[542] Ftizgerald, *op. cit*., at 136.
[543] As defined in Article 1(3).
[544] Article 6(1).

[545] 621 F.3d 858 (9th Cir. 2010).

author's view that, for a lessor to rely on the protection of Article 10, it should not have to show that the aircraft commander acted reasonably since it has no control whatsoever over the commander.

3.11.2.4.2 Hague Convention

Article 1(a) of the Hague Convention[546] makes it an offence punishable under Article 2 by "severe penalties" where any person on board an aircraft in flight:

> "unlawfully, by force or threat thereof, or by any other form of intimidation, seizes, or exercises control of, that aircraft, or attempts to perform such act…"[547]

One point worth perhaps just noting is that a Contracting State must establish its jurisdiction over offences covered by the Convention not only when the aircraft in question is registered in such state[548] or located within its territory[549] but also:

> "when the offence is committed on board an aircraft leased without crew to a lessee who has his principal place of business or, if the lessee has no such place of business, his permanent residence, in that State."[550]

Nevertheless, it is submitted that, apart from this provision, as with the Tokyo Convention, the Hague Convention has little or no applicability to the lessor-lessee relationship.

3.11.2.4.3 Montreal Convention 1971

Under the Montreal Convention[551] of 1971, a person commits an offence under Article 1(b) thereof if he:

> "destroys an aircraft in service or causes damage to such an aircraft which renders it incapable of flight or which is likely to endanger its safety in flight…"

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[546] Convention for the Suppression of Unlawful Seizure of Aircraft, signed at The Hague on 16 December 1970.
[547] Under Article II of the Protocol Supplementary to the Convention for the Suppression of Unlawful Seizure of Aircraft, signed at Beijing on 10 September 2010, which is not yet in force, this will, when it does come into force, be replaced by language referring to the situation where a person " unlawfully and intentionally seizes or exercises control of an aircraft in service by force or threat thereof, or by coercion or by any other form of intimidation, or by any technological means" or, *inter alia*, attempts or credibly threatens to do so. See http://www2.icao.int/en/leb/Lists/Current%20lists%20of%20parties/AllItems.aspx on 12 April 2011.
[548] Article 4(1)(a).
[549] Article 4(1)(b).
[550] Article 4(1)(c).
[551] Convention for the Suppression of Unlawful Acts against the Safety of Civil Aviation, signed at Montreal on 23 September 1971.

Article 4(2) provides that the Montreal Convention 1971[552] shall apply:

> "irrespective of whether the aircraft is engaged in an international or domestic flight, only if:
>
> (a) the place of take-off or landing, actual or intended, of the aircraft is situated outside the territory of the State of registration of that aircraft; or
>
> (b) the offence is committed in the territory of a State other than the State of registration of the aircraft."

The Beijing Convention 2010[553] will, if and when it is in force,[554] will prevail,[555] as between states party thereto, over the Montreal Convention 1971, but, as it is not yet in force, the Montreal Convention 1971 remains in force for all states party thereto.[556]

In the context of leasing, Article 5(d) of the Montreal Convention 1971 obliges Contracting States to establish jurisdiction:

> "when the offence is committed against or on board an aircraft leased without crew to a lessee who has his principal place of business or, if the lessee has no such place of business, his permanent residence, in that State."[557]

3.11.3 Negligent entrustment

In the context of liability to third parties, such as passengers or third parties on the ground, with whom there is no contract, aircraft lessors need to be mindful of a relatively new theory of tort liability whereby a lessor may be liable for injury or damage caused by a lessee while in possession of an aircraft pursuant to an operating lease between it and the lessor. This is the theory of negligent entrustment – the lessor negligently entrusted an unsuitable entity with possession of a potentially dangerous asset, an aircraft, with resulting liability for damage caused by that unsuitable entity.

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[552] Article 5(2) of the Beijing Convention 2010 reads likewise.
[553] Convention on the Suppression of Unlawful Acts Relating to International Civil Aviation done at Beijing on 10 September 2010.
[554] It is not yet in force: see http://www2.icao.int/en/leb/Lists/Current%20lists%20of%20parties/AllItems.aspx on 12 April 2011.
[555] Pursuant to Article 24(a) thereof.
[556] In any event, Article 1(b) of the Beijing Convention 2010 is the same as Article 1(b) of the Montreal Convention 1971.

[557] Article 8(1)(d) of the Beijing Convention 2010 reads likewise except for non-substantive gender neutralizing changes in language.

There are two primary theories of liability, one seeking to impose liability based on delivery of a defective or improperly maintained aircraft. The second theory is much broader and seeks to impose liability where the lessor is alleged to have delivered an aircraft on lease to an airline that "was not capable of operating and maintaining the aircraft in a safe and appropriate manner,"[558] thus, essentially attempting to make the lessor vicariously liable for the negligent act of the airline.

A classic example of the second theory is an adult allowing a minor to use his or her car, where an accident occurs and the adult knows or has reason to know that the driver, whether due to inexperience or otherwise, is likely to use it in a manner involving an unreasonable risk of harm to third parties. The instinctive answer to this might be to say that there is surely a difference between the case of a minor who does not yet have a driving license and one who does have a license.[559]

3.11.3.1 Extension to aircraft operating leases

Applied to an aircraft, a lessor would argue that the theory was not intended for complex commercial transactions where the lessor is not an operator and relies on the lessee's possession of all necessary licenses and certificates issued by the lessee's aviation authority.[560]

As has been noted by Byrnes T B and Kass G R,[561] this puts the lessor in the difficult position of either defending the lessee's maintenance practices as sufficient or else having to justify its failure to uncover insufficient maintenance practices. They suggest dealing with this in language in the lease dealing with lessor's inspection rights but this author doubts that this will be sufficient for plaintiffs' counsel – they will, it is submitted, either argue that the wording in the lease leads to an inspection right sufficient to uncover insufficiencies or, if such wording is not there, blame lessor for failing to include such language.

A leading plaintiff's counsel, Don Nolan, is quoted as stating that a lessor "having in the lease reserved to itself rights of inspection, and requiring that maintenance and safety be followed…can face responsibility for loss of life".[562] One can only imagine his reaction to a lessor which did not reserve in its lease inspection rights and did not require the lessee to follow all applicable rules relating to safety and maintenance. In a press release, his firm has stated that lessor have a duty "to provide oversight to ensure that passengers fly on airplanes that are adequately equipped, safely maintained, and operated by properly trained pilots."[563] It is submitted that such a duty is, in fact, the duty of the airline with operational

[558] Byrnes T P & Kass G R, *Aircraft Lessor Liability*, Joint Presentation to 26th Annual Conference of the International Society of Transport Aircraft Trading, Scottsdale, Arizona, held on March 17, 2009.
[559] *Ibid*.
[560] *Ibid*.
[561] *Ibid*.
[562] Quoted in Chicago Lawyer Magazine, May 2008.
[563] Press release of Nolan Law Group, 10 March 2008.

control of the aircraft and the aviation authority granting it its requisite licenses and certificates.

The reason behind the extension of the theory of negligent entrustment has a lot to do with a desire on the part of plaintiffs' counsel, it is submitted, to get emotionally powerful if legally weak arguments in front of reputedly more generous American juries than compelling legal scholarship.

An argument against dismissal of action from United States courts on grounds of *forum non conveniens* often involves an argument that foreign plaintiffs "often face insurmountable procedural or practical problems that effectively preclude redress in their home countries"[564] such as "a 10-year plus backlog of cases, lack of access to qualified aviation attorneys in their home jurisdiction, inadequacies in their justice system, and the high cost of prosecuting claims…"[565]

On the other side is the argument that "only those matters sufficiently related to the United States"[566] remain in those courts. A three step analysis is applied to considering motions to dismiss on grounds of *forum non conveniens*: the degree of deference to be given to the plaintiff's chosen forum, the adequacy of an alternative forum and the balancing of interest of the parties.

Even allowing for the argument that a defendant cannot seriously argue that its home jurisdiction is not a convenient forum,[567] the other arguments raised above against dismissal can be dealt with by examination of the adequacy of the alternative forum at the hearing. It is hard to escape the conclusion that the real attraction of the United States courts is indeed the intention:

> "to gain advantage in settlement discussions from the substantial damages awards that may be obtained from American juries".[568]

To this author, it is thus hard to escape the conclusion that the initiation of proceedings against an American lessor is largely with a view to finding any American party at all to an action in an attempt to get a case before such a jury which would not otherwise be eligible – were that not the case, lessor would routinely be sued in courts other than the those of the United States. Indeed, this author agrees with Dameris *et al.* who state that:

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[564] Verna M P, *Convenience has nothing to do with FNC motions*, The Air and Space Lawyer, Volume 22, No. 1, 2008, at 9.
[565] *Id.*, at 10.
[566] Dameris T T, Weiner D J, Crane A R, *The United States is no longer the courthouse for the world*, The Air and Space Lawyer, Volume 22, No. 1, at 13.
[567] Verna, *op. cit* at 11.

[568] *Esheva v Siberia Airlines*, 499 F. Supp. 2d, 498 (S.D.N.Y 2007) in Dameris *et al., op. cit.*, at 13.

> "it is disingenuous to assert that these claims are brought here for any reason other than strategic gamesmanship."[569]

As Olson succinctly puts it:

> "Both parties of the two sides of aviation litigation today can rightly be considered to engage in so called forum shopping; the plaintiffs at the stage of selecting the forum where to initiate the action and similarly the defendants by seeking to remove the case to a jurisdiction where local law treats passenger claims less favorable."[570]

3.11.3.2 US federal law

Under the US Federal Aviation Act,[571] a lessor:

> "is liable for personal injury, death or property loss or damage on land or water only when a civil aircraft is in the actual possession or control of the lessor…"

This is a federal statute and not all state laws in the United States of America accept it as pre-empting any state law to the contrary. Without such pre-emption, it is open to a plaintiff to bring suit in the courts of a US state under this theory of negligent entrustment, thus forcing a lessor to defend the suit on its merits.

Sterns[572] points out that the language here is disjunctive: "possession or control", not "possession and control". He continues:

> "The obvious intent of this section was to protect those who passively either provide capital for the operation of aircraft by airlines, or who provide the aircraft itself as a business investment similar to the investment of capital and who are not involved in the day to day operations or control of the aircraft itself."[573]

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[569] Dameris *et al.*, *op. cit.*, at 16.
[570] Olson U, *Interpretation of the Montreal 99 Convention in a Forum Non Conveniens Case*, http://www.mcgill.ca/files/iasl/Session_7_olson.pdf on 14 April 2011.
[571] 49 USC S. 44112.
[572] Sterns G C, *Lessor Liability; or Absence thereof – Federal Immunity or not for Lessors of Commercial Aircraft*, paper presented at McGill Institute of Air & Space Law Conference on International Aviation Liability & Insurance, Montreal, Canada, 6-7 May 2011.
[573] *Id.*, at 4.

Wickersham[574] points out that the financier, in this case including the lessor, never have zero control[575] and never (in the absence of possession) have complete control of the aircraft.

One state which rejects the pre-emption theory is Illinois,[576] where both an aircraft manufacturer, The Boeing Company (Boeing), and an aircraft leasing company, AAR Parts and Trading Co. (AAR), are headquartered and thus are attractive targets for plaintiffs. Another such state is Florida, where, in the recent case of *Vreeland v. Ferrer, et al.*,[577] the Florida Supreme Court held, with Lewis J writing for the majority, that federal pre-emption is narrowly construed, that there is no express pre-emption in the federal statute in question[578] and that the words "on land or water" in Section 44112 mean that the provision only applies for damage caused to persons or property on the surface, not to passengers[579].

3.11.3.3 AAR cases

Air Philippines (PAL) acquired a Boeing 737-700 aircraft on a finance lease from AAR and, after some years of operation, it crashed causing tragic loss of life. There was no allegation of a defect in the aircraft at the time of delivery. Plaintiffs' counsel sued AAR in Illinois in a case referred to by Holland and Knight[580] as an "aberration" and a "perfect storm."

In *Ellis v AAR Parts Trading, Inc*.,[581] the Illinois courts rejected *forum non conveniens* arguments as to Illinois jurisdiction and in *Layug v AAR Parts Trading, Inc.*,[582] they held that AAR's argument:

> "with regard to the issue of control of the aircraft is without merit as that was a distinction that had no bearing on the issue of preemption in the applicable case law. Accordingly, the Court here finds that the Plaintiff's state law claims are not preempted by the Federal Aviation Act"

Ultimately, however, PAL's insurers settled the claim without admission of liability and plaintiffs' counsel, The Nolan Group,[583] in claiming victory, described the problem as one

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[574] Wickersham D K, When should courts pierce the veil protecting aircraft financiers, University of California, Los Angeles, May 2007, at 15, at http://works.bepress.com/david_wickersham/1 on 16 May 2011.
[575] For instance they have contractual rights to monitor and in certain situations to repossess the aircraft.
[576] *See Retzler v Pratt & Whitney Co*., 309 Ill. App. 3d 906 (1st Dist. 1999).
[577] Supreme Court of Florida, No. SC10-694, July 8 2011.
[578] At 9.
[579] At 22 *et seq.*
[580] http://www.hklaw.com/id24660/PublicationId2434/ReturnId31/contentid52181/ on 14 April 2009.
[581] 357 Ill. App. 3d 723, 828 N.E.2d 723 (2005).
[582] No. 00 L 9599, 2003 WL 25744436 (Ill. Cir. Ct., Cook Cty. May 16, 2003).
[583] http://www.nolan-law.com/the-crash-of-air-philippines-541/

of dumping of older aircraft in the third world as the American fleet became younger and called for increased safety oversight by lessors.

To the extent that the AAR cases are followed, and it is submitted that they should not be considered as good legal precedents, the direct effect on lessor will be limited with the primary effect being rather that the lessees, who, under the lease, bear the responsibility and cost of insuring the lessor against liability claims (as to which, see 3.5 *infra*), will have the costs of this increased risk passed onto them by their insurers by way of higher insurance premiums.

Even if the AAR cases are good law, they may well be limited to their facts as the only causal connection to Illinois was the presence there of the defendant. Apart from AAR and Boeing, Illinois is not a noted aviation centre and so future attempts to replicate the fact pattern there are likely to be limited. Further, the flight in question was a domestic flight and, for reasons discussed in 3.11.2 *supra*, the plaintiffs would not have wished to assert that the Warsaw or Montreal Conventions applied.

The theory as applied to an aircraft operating lessor makes as much sense as suing a car salesman or a car rental company for selling or renting a car to a customer based on no more than payment by the customer and production by him or her of a valid driving license – if one is forced to look behind a valid qualification, where does the duty stop? And of what use then is the license?

Under Article 33 of the Chicago Convention, certificates and licenses issued by a state of registration must be recognized as valid by other contracting states so long as the minimum standards established pursuant to the Convention are met. To the extent that contracting states do not, and even may not, look behind such certificates and licenses, why should operating lessors be obliged to do so?

In the European Union, under Commission Regulation (EC) No. 1071/2010, amending Commission Regulation (EC) No. 474/2006, certain airlines are banned from operating within the European Union on safety grounds.

In the United States, a foreign air carrier must obtain a foreign air carrier permit under the Federal Aviation Act.[584] Under 14 Code of Federal Regulations Part 129, the carrier must meet the safety standards contained in Part 1 (International Commercial Air Transport) of Annex 6 (Operations of Aircraft) to the Convention on International Civil Aviation (Chicago Convention). If the civil aviation authority of the carrier is found to be meeting its minimum safety obligations under the Chicago Convention, the Federal Aviation Administration of the United States will forward a positive recommendation to the United States Department of Transportation for issuance of a foreign air carrier permit.[585]

[584] 49 USC 41302.
[585] http://www.faa.gov/about/initiatives/iasa/more/ on 18 April 2011.

If the lessee in question is not on the European banned list or has a foreign air carrier permit for the United States, and the lessor is a European Union or United States lessor, there appear to be no justifiable grounds for requiring it to look behind the licenses and certificates issued to the lessee by its aviation authority.

What of other carriers? Should a lessor not lease to such carriers at all? Or should it only not lease if it is a European Union or United States based lessor, as the case may be? To what liability should a lessor be exposed for deciding to proceed with a lease in such a situation? An increased role for ICAO has been proposed[586] in determining implementation of SARP's[587] but, even if ICAO determines a state not to be in compliance, on what legal basis should this affect a lessor's decision whether or not to lease to such a carrier? All that can be said is that these matters are still unclear at the time of writing.

An operating lessor, having by definition an interest in the residual value of the aircraft after the lease, will always be concerned that its aircraft is well maintained well beyond minimal airworthiness in order to maintain the residual value of its aircraft – in so doing, it will indirectly contribute to the overall safety of passengers who fly on it – this can be ensured by providing for covenants as to maintenance on the part of the lessee in the lease - but a lessor is not a regulatory authority with the power and means to ensure safety but rather only has its remedies for breach of a contractual covenant under the lease. Even inspection rights, which might disclose a breach of such covenant as to maintenance, under the leases are limited by lessees – they may, so long as there is no default, be limited to once a year visual inspections only with limited rights to open panels[588].

It is submitted that the arguments in favour of extending the theory of negligent entrustment to operating lessors are intellectually dishonest (a point made by Byrnes and Kass[589]) and are simply a means to an end of getting cases into more generous US court system. They could in any event simply be avoided by the lessor's relocating to less generous jurisdictions.[590]

Even if negligent entrustment is determined to be in principle applicable to operating leases of aircraft, for the reasons discussed *supra* at 3.11.2.2, the impact should be limited to claims falling outside the scope of the Montreal Convention or, possibly, the Warsaw Convention.

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[586] *Vide e.g.* Blumenkron J, *Implications of transparency in the International Civil Aviation Organization's universal safety oversight and audit programme,* Annals of Air and Space Law, Volume XXXIV, 2009, 31-70, at 69.

[587] *Vide* 3.10.2.1 *supra.*

[588] See the discussion in Bunker D H, *International Aircraft Financing, Volume 2: Specific Documents*, IATA, 2005 at 117.

[589] Byrnes T P & Kass G R, *Aircraft Lessor Liability*, Joint Presentation to 26th Annual Conference of the International Society of Transport Aircraft Trading, Scottsdale, Arizona, held on March 17, 2009

[590] A point noted by Wickersham, *op. cit.*, at 40.

3.11.3.6 Liability insurance and indemnities

Particularly in light of the issues discussed at 3.3 and 3.4 *supra*, a prudent lessor will naturally want to be covered against potential claims being brought against it by third parties when it does not have possession of the aircraft, whether due to lease to a lessee or sale to a purchaser by providing in the contract that the lessee (for the term of the lease) or the purchaser (typically until the earlier of two years after the sale or until the next heavy check) indemnifies the lessor against any claims brought against it and then require the lessee or purchaser to obtain insurance whereby such indemnity obligation is insured, with the lessor named as an additional insured.

Bunker describes the indemnity provisions of aviation transactions as "probably the most frustrating and misunderstood subjects of transaction negotiations."[591] He explains their need as being based on a "straightforward insurance and risk-assignment concept" with one party, the lessee, agreeing to "assume responsibility through indemnification and lay off the risk through insurance."[592]

Sometimes, particularly in sale contracts, but occasionally also in leases, a party will suggest eliminating the indemnity clause altogether but leaving the obligation to obtain such liability insurance coverage. The reason for such a suggestion is that, if for some reason the insurer refuses to pay or its limit of coverage is insufficient, the indemnifying party is still liable to pay and may not have the funds to do so.

The problem with such an approach is that the lessee or purchaser must have an insurable interest: it insures against its obligation to pay out under an indemnity clause. In the absence of an indemnity clause, it would be open to an insurer to refuse to pay under the insurances on the basis that the lessee or purchaser had no "insurable interest" (its indemnity obligation) against which it was taking out insurance coverage.[593]

Even if such an insurable interest can be established, the insurance coverage will most likely be narrower if it does not expressly cover the scope of the indemnity language in the lease or sale agreement.[594]

A prudent lessor, therefore, should not agree to drop indemnity provisions where it wishes to rely on insurance coverage to be provided by a lessee or purchaser.

3.11.4 Conclusions

Not having operational control of the aircraft, the lessor naturally requires indemnities from the lessee to cover any claims brought against the lessor for actions which may not be

[591] Bunker D H, *International Aircraft Financing*, IATA, 2005, Volume 2, at 162.
[592] *Ibid*.
[593] Bunker D H *International Aircraft Financing*, IATA 2005, Volume 2, at 353.
[594] Patrick J Wielinski et al, *Contractual risk Transfer: Strategies for Contract Indemnity and Insurance Provisions*, International Risk Management Institute, Inc., 2000 at XI.B and XI.C.9

attributable to it. Whether or not the lessor can enforce such a right of indemnification in practice will, in theory, depend on the solvency and adequacy of assets of the lessee against which to enforce a judgment, and, in practice, on the adequacy of insurances, examined next, in place.

The relative length of 3.11 is proof of the great level of interplay between, on the one hand, public, but more particularly, private international air law and national law, as seen above, and, on the other hand, the practice of aircraft operating leasing.

The lessor must guard against not only damage to its own property, but also against claims brought against it for injury to or damage to the property of third parties, the legal *régimes* for which may differ, not only depending on whether the case is purely domestic or has an international dimension, but also depending on whether the third party is a passenger or a non-passenger on the ground.

The foregoing analysis has led this author to three principal conclusions in connection with the issue of lessor liability to third parties.

The first is that, on its face, the Montreal Convention 1999 is intended as an exclusive remedy so that claims that may be brought thereunder must be brought only against the carrier thereunder, to the exclusion of claims brought against the carrier or any non-carrier, such as a lessor, outside of the terms thereof. Any claim against a non-carrier must, under the terms of Article 37 the Montreal Convention 1999, only be brought by the carrier, having been found liable under the Montreal Convention 1999, against a non-carrier, such as a lessor.[595]

The second is that, regardless of whether his view as to the exclusivity of the Montreal Convention 1999 is correct or not, in the area of private international law, there are differences of approach as to the liability of non-carriers which cannot in his view be rationally justified, and he returns to this theme with his recommendations in Part 4.[596]

The third is that attempts to extend liability to lessors are not so much about ensuring justice for plaintiffs, who have recourse against the carrier, which carries liability insurances, and are more about creative attempts by plaintiffs' counsel to find whatever routes they can into plaintiff-friendly courts in the United States in the hope of increasing the quantum recovered by way of damages. Whether the operator or the lessor is sued, both are covered under the same liability insurances: thus, the real issue, in this author's view, is about obtaining a judgment which will maximize the insurance payout.

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[595] In the event of such a claim, the lessor would defend itself by reference, *inter alia*, to the conclusivity of the acceptance certificate signed by the lessee in respect of the aircraft at delivery, as discussed at 3.6.2.3 *supra*.

[596] Adding to the complexity, under the Unidroit Convention on Financial Leasing discussed at 2.1 *supra*, while a lessor shall not be liable to third parties for death, injury or damage caused by the property in its capacity as lessor (Article 8(1)(b)), there is expressly no statement as to liability in any other capacity, such as owner (Article 8(1)(c)). As the lessor will in many cases be the owner, this distinction is curious.

3.12 Insurances

These are closely linked to the indemnities, discussed at 3.11 *supra*, and to the concept of risk allocation inherent in the aircraft operating lease.[597]

Invariably, the lease will require the airline to take out hull and liability insurances in respect of the aircraft for the duration of the lease term, and sometimes for a certain period thereafter.

The lessee has an insurable interest in the aircraft by virtue, *inter alia*, of the fact that it has operational control of the aircraft and thus stands to lose financially if the aircraft is damaged; further, it will typically be liable to indemnify the lessor for damage to the aircraft under the lease and can insure against such contractual indemnification obligation.[598]

Insurances are generally divided into hull and liability insurances. Hull insurances provide coverage to the owner of the aircraft in case of damage to or loss of the aircraft – this is a commercial risk which a lessor generally will not want to take but is not a matter of concern under public or private international air law.

3.12.1 Liability insurances

Liability insurances, on the other hand, which provide limited cover for damage or injury to third parties are indeed such a concern. The Warsaw Convention[599] and Montreal Convention[600] cover carrier liability for death, injury or damage of or to passengers, baggage and cargo in international carriage.

Chrystal[601] has wryly noted that, as airline marketing departments are reluctant to dwell on safety as it is a sensitive issue, it is not surprising that the subject of aviation insurance maintains a low profile in aviation industry. Airlines want passengers to concentrate on excellence of service, not on the likelihood of a crash or adequacy of insurance in the event of one. The subject of insurance is nonetheless an important one.

The Warsaw Convention does not set out any specific requirements that airlines be insured for liability. Article 50 of the Montreal Convention, by contrast, does require that state parties "shall require their carriers to maintain adequate insurance covering their liability" thereunder and "may be required by the State Party into which it operates to furnish evidence" thereof. Under Article 55 of the Montreal Convention, the provisions of the

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[597] *Vide* Sections 9 and 11 of the Supplement *infra*.
[598] Margo R D, *Aviation Insurance*, Butterworths Law; 3rd Revised edition, 1999, at 147.
[599] At Article 1, as amended by Article I of the Hague Protocol thereto.
[600] At Article 1.
[601] Chrystal P, *The Aviation Insurance and Reinsurance Markets-Defying the Odds*, in Butler G F and Keller M R, executive editors, *Handbook of Airline Finance*, 1st edition, Aviation Week:McGraw-Hill, 1999, at 297 *et seq*.

Montreal Convention prevail, for parties thereto, over those of the Warsaw Convention. Nevertheless, what constitutes "adequate" insurance coverage is not spelled out in the Montreal Convention. Peña[602] see this as complex and concludes that it is a matter left to each contracting state to the Montreal Convention to determine under its national law.

The Rome Convention 1952 provides for liability of the operator of an aircraft for damage to persons on the surface caused by an aircraft in flight or anything falling therefrom.[603] The liability falls on the operator but, under Article 2(3), the registered owner is presumed to be the operator unless he proves some other person was the operator and "in so far as legal procedures permit, takes appropriate measures to make that other person a party to the proceedings".

As with claims brought under the Warsaw or Montreal Conventions,[604] Article 9 of the Rome Convention provides that, where the Rome Convention applies, the remedies set out therein are an exclusive remedy.

The phrase "registered owner" may be problematic. The Chicago Convention provides, at Article 17, for registration of aircraft, not owners of aircraft, and leaves the details to national law.[605] Article 21 of the Chicago Convention requires contracting states to supply information concerning registration and ownership of the aircraft to ICAO and it may be implied that this is the register owner intended by the Rome Convention but this is not clear. As further discussed at 3.10.2.3 *supra* there may potentially be four or so parties who may be described as owner of the aircraft for various purposes.

In any event, Article 11 of the Rome Convention sets out the limits of liability and Article 15 sets out the requirements as to insurance (or other acceptable security, such as cash deposit or bank guarantee). Article 15(5) allows a state overflown by an aircraft to require that the aircraft carry on board a certificate of insurance setting out details of coverage, unless such certificate is instead filed with a designated authority of the overflown state or with ICAO. Article 15(5) was deleted by Article VI of the Montreal Protocol 1978 and replaced with a simpler requirement that evidence of insurance or guarantee by other security adequate to cover liability under 11 be provided to an overflown state upon request – thus the certificate of insurance need not be kept on the aircraft. Article 15(7) provides that states may refer any dispute over the adequacy of financial responsibility of an insurer or bank guarantor to submit it to ICAO for arbitration but this was removed by Article VI of the Montreal Protocol 1978.

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[602] Peña S F, *Defining insurance coverage adequacy under the Montreal Convention of 1999*, Annals of Air and Space Law, Volume XXXIV, 2009, 343-378, at 369.
[603] Article 1.
[604] *Vide* 3.11.2.2 *supra*.
[605] Article 19.

National legislation (two examples are given below: one from a developed country, the United Kingdom, the other from a developing country, Nigeria[606]) may set out further details on required liability insurance, and, in the case of the European Union, such legislation will have to comply with the requirements of Commission Regulation (EC) No 785/2004 (discussed below).

An important point to note is that aircraft operating leases will typically require airlines to maintain liability insurances in excess of the minimum amounts required under national law.[607]

To take an example from a developed country, the United Kingdom, the Civil Aviation (Insurance) Regulations 2005 (S.I. 2005 No. 1089) implement Commission Regulation (EC) No 785/2004 and provide for minimum liability coverage based, *inter alia*, on minimum take off weight, cargo payload and passenger capacity. According to public records,[608] the estimated minimum liability insurance required for commercial operations of a Boeing 737-800 aircraft[609] is GBP 341,070,425.83 (at the time of writing, approximately US$556,251,168.16).[610] Typically, in this author's experience, a lessor will require substantially higher minimum liability coverage in the range of US$600,000,000 to US$750,000,000 for each occurrence. This is consistent with the advice given by Aon Group Limited, Aviation, a leading provider of aviation insurance broking:

> "Minimum liability limits are often stipulated by domestic law. These minimum limits can be surprisingly low and should not be viewed as recommendations."[611]

By way of example from a developing country, in Nigeria,[612] the Civil Aviation Act, 2006 requires minimum liability coverage in case of death or injury of passengers of $100,000 per passenger, as compared with SDR 250,000 (at the time of writing, approximately US$396,855.62)[613] per passenger as required in the European Union by Article 6(1) Commission Regulation (EC) No 785/2004. In the case of the Boeing 737-800 aircraft referred to above, Boeing[614] estimates a typical passenger capacity of 189 passengers in one class configuration. The Nigerian regulations, therefore, would only require minimum

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[606] See also Mauritz A J, *Liability of the operators and owners of aircraft for damage inflicted to persons and property on the ground*, PhD Thesis, Leiden University, 2003, at 119-140 , for a discussion of the national liability *régimes* and insurances requirements of additional jurisidictions.

[607] See Bunker D H, *International Aircraft Financing, Volume 2: Specific Documents*, IATA, 2005, at 146-153 and 207-209.

[608] http://www.caa.co.uk/application.aspx?catid=60&pagetype=65&appid=1 at 7 April 2011.

[609] Bearing manufacturer's serial number 28229 and UK aircraft registration number G-CDZI.

[610] http://www.xe.com on 7 April 2011.

[611] The Aon Aviation Guide: *The Banker's & Lessor's Guide to Insurance Aspects of Aircraft Financing*. Aon Group Limited, Aviation, 2000 (2nd edition).

[612] http://www.ncaa.gov.ng/index.php?option=com_content&view=article&id=65&Itemid=71 on 7 April 2011.

[613] http://www.xe.com on 7 April 2011.

[614] http://www.boeing.com/commercial/737family/pf/pf_800tech.html on 7 April 2011.

liability coverage in respect of passengers of approximately US$18,900,000, and are silent as to other minimum liability coverage (for example, in respect of non-passengers, cargo or property damage).

Typically, the lease will require the lessee to maintain the lessor and other additional insureds on its liability insurances for two years after the expiration of the lease, or until the next heavy check of the aircraft to occur after such expiration. The lessor has an insurable interest if:

> "he would suffer prejudice on the occurrence of the event insured against. Thus where an insured is obliged by law or by contract to indemnify third parties or passengers for damage to property or personal injury (including death), the insured would have an insurable interest in respect of his potential liability."[615]

Such potential liability is discussed at 3.11 *supra.*

3.12.2 Hull insurances

Agreed Value and Total Loss are key concepts with respect to hull insurances and are examined here.

The lessor has an insurable interest in the hull insurances insofar as it is the owner of the aircraft. According to Margo:[616]

> "…an insured will have an insurable interest if he is so related to the subject-matter of the insurance that he will suffer prejudice if it is lost or damaged by the occurrence of the risks insured against."

The lessor need not be the owner to have an insurable interest in the hull insurances. Likewise, financiers have an insurable interest therein:

> "In the case of hull insurance, ownership is not the only basis for acquiring an insurable interest. Such interest may be based on contract such as in the case of a mortgage, or even on mere lawful possession."[617]

While the lessor need not be the owner, ownership is in itself sufficient for this purpose: Margo notes that such ownership may be "sole, joint, absolute, limited, legal or equitable."[618]

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[615] Margo R D, *Aviation Insurance in the United Kingdom: Law and Practice*, DCL Thesis, McGill University, Montréal, 1979, at 106.
[616] *Id.*, at 105.
[617] *Id.*, at 106.
[618] *Id.*, at 110.

3.12.2.1 Agreed value

One other tool by which the owner can protect itself is to require that the lessee insure the aircraft for the term of the lease on an agreed value basis rather than a replacement basis, naming the owner as the sole loss payee[619] in the event of actual or constructive total loss of the aircraft. This agreed value is fixed at the outset of the lease and is normally (in this author's experience) slightly greater than the then current market value.

In order to manage its insurance costs, the lessee may negotiate with the lessor to reduce this agreed value by an agreed percentage every year during the lease term. If the aircraft is a total loss, the insurer will then pay to the owner the then agreed value of the aircraft under the hull insurance policy regardless of the then market value of the aircraft.

The lessor should ensure that any aggregate limits on the coverage available will be sufficient to pay it out in the event of simultaneous calamitous damage to multiple aircraft in the lessee's fleet (such as for example by a bombing of the lessee's home base).

3.12.2.2 Determination of total loss

A total loss of an aircraft occurs if it is so damaged as to be beyond economical repair, having regard to its value.[620]

The timing of the occurrence of an event of total loss is normally clear in the case of a crash. However, if the aircraft simply disappears or is hijacked, it may be difficult to determine when exactly the aircraft should be deemed to be a total loss. Under the terms of hull insurance policies, such a decision is normally left to the judgment of the insurer.

This raises the issue of unacceptable uncertainty for the owner and it is therefore normal[621] to find in leases that the lessee is obliged to pay the agreed value to the lessor once the disappearance or hijacking has continued for more than a certain period.[622] Thus, the lessee will be obliged to pay the agreed value at the expiration of such period whether or not the insurer has at that time agreed that the disappearance or hijacking constitutes a total loss.

Of course, this is largely a theoretical protection for the lessor since, in practice, the airline will not likely have the funds to pay the agreed value of a commercial aircraft to the lessor other than through payment on its behalf by its insurers.

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[619] As to which, see McBain G, *Aircraft Finance: Registration, Security and Enforcement*, General Editor, Sweet & Maxwell, 2000, Volume-1 at Insurance-10 (paragraph D-25). Another approach is to provide for payments to the contract parties as their interests appear so that payment for buyer furnished equipment, such as in-flight entertainment systems, belonging to the airline is made to the airline.

[620] Margo, *op. cit*., at 186.

[621] See Bunker D H, *International Aircraft Financing, Volume 2: Specific Documents*, IATA, 2005, at 154.

[622] This period is most often in the range of 90 to 180 days.

Leases may sometimes provide for separate agreed values for the airframe and for each engine in the event that the airframe but not the engines are destroyed or *vice versa*.

3.12.3 Deductibles

Other insurance risks of which the lessor should be aware are deductibles, which is the first amount of damage the insurer will not bear (for example, it may only pay for damage above $250,000). Although the lease will require the lessee to pay this, if the lessee is bankrupt, the lessor will end up paying it.

3.12.4 Reinsurance and Cut-Through Clause

Where a lessor requires in a lease that a lessee obtain reinsurance coverage for the insurance coverage required by the lease, it is standard practice to demand a "cut through" clause.

Reinsurance basically insures the insurances: in many jurisdictions, insurance must be placed with a local insurance company. Lessors may have concerns about the jurisdictional risk of the local insurance company or about its credit – hence they may require reinsurance, which pays out in the event that the primary insurer has to pay out.

Originally, the idea was to ensure that the primary insurer would have funds with which to meet its obligations - if called upon to pay under its insurance policy, it could make a corresponding claim on its reinsurers under its reinsurance policy.

By means of a "cut through" clause, the lessor, or other insured parties, can ensure that the reinsurers will pay directly to it rather than to the primary insurer for further payment to it – this makes sense as it cuts out the "middle man" and spares the lessor from the uncertainties and possible delays of litigation in a potentially unfriendly or undeveloped jurisdiction.

In an English High Court case, *Grecoair v John Tilling and Others*,[623] Langley J refused to allow a lessor of an aircraft to Angola Air Charter Ltda. to proceed directly against the reinsurers where the aircraft was involved in a crash in circumstances where it could have proceeded against the insurers in the normal fashion and left it to the insurer to pursue the reinsurers. In this case, the lease provided only for the lessee to obtain insurances, and did not deal with the need for reinsurances or a "cut through" clause therein. The primary insurances did provide for a "cut through" clause in respect of reinsurances on other aircraft, but for the aircraft in question, the insurances provided that the provisions of the relevant lease with respect to insurances were incorporated.

[623] [2004] EWHC 2851 (Comm).

3.12.5 Termination of insurances

If the lessee fails to pay the premium on renewal for any reason, the insurances may be terminated by the underwriter. In such event, the lessor will be left without hull coverage, which could be disastrous in the case of damage *to* the aircraft. Accordingly, a prudent lessor will insist on obtaining a broker's letter of undertaking whereby the lessee's insurance broker undertakes to inform the lessor if for any reason the insurances are not renewed or the insurance premium is not paid.[624]

Further, the liability coverage will lapse, leaving not only the lessee but, potentially, the lessor liable for any damage caused *by* the aircraft.[625] Such termination may also cause the air transport license[626] of the airline to be revoked[627] as it is generally a condition of such license that required liability insurances be in place.[628]

The lessor may also want to consider taking out contingency insurance which takes effect if the primary insurance fails to respond or proves inadequate for any reason.[629] However, such insurance will not cover a situation where the primary insurance is terminated – hence the importance of obtaining the broker's letter of undertaking referred to above.

In *Oxford Aviation Services Limited v Godolphin Management Company Limited,*[630] Cooke J of the English High Court held that a bailee pursuant to a draft agreement for hire (as to which, *vide* 3.20 *infra*) had to account to the bailor for the loss of its aircraft where the agreement provided for the bailee to arrange insurances, notwithstanding the assertion by the bailee (rejected by Cooke J) that the bailor had agreed to arrange its own insurances.

3.12.6 Conclusions

Private international air law is largely concerned with the protection of third parties and thus is not concerned with hull insurances which protect only those with an ownership interest in the aircraft. The discussion at 3.11 shows how the private air law instruments[631] discussed, where they require liability insurances, do not set out themselves the required minimum amounts of coverage, leaving those to national or, where relevant, European law.

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[624] McBain G, Aircraft Finance: Registration, Security and Enforcement, General Editor, Sweet & Maxwell, 2000, Volume 1, at Insurance -18 (paragraph D-33).
[625] *Vide* 3.11.2 *supra*.
[626] *Vide* 3.5.2.5 *supra*.
[627] This author has experience of just such a case with a European airline which flew after termination of its insurances took effect – its air transport license was revoked upon proof to the relevant aviation authority thereof.
[628] See, for example, Article 4(h) of European Commission Regulation (EC) 1008/2008.
[629] Aon Aviation Guide, *The Banker's & Lessor's Guide to Insurance Aspects of Aircraft Financing*, 2nd edition, 2000, at 90.
[630] [2004] EWHC 232 (QB).
[631] *Vide* also *Private International Air Law Instruments* in Annals of Air and Space Law, Volume XXX, Part I, McGill University, 2005, at 323-655.

In practice, the aircraft operating lease will provide still higher levels of liability coverage again than those required by law, which constitutes *de facto* additional level of protection for third parties.

Just because a lessee is required by law to insure the aircraft, or else risk losing its right to operate, a lessor cannot assume that a lessee will do so and should take steps to ensure that the lease contract provisions as to insurance are being complied with at all times.

3.13 Redelivery

Redelivery in required redelivery condition, consequences of delay and/or failure so to redeliver are of vital consequence to the aircraft operating lessor.[632]

The main components of redelivery are timely redelivery in the condition required by the lease agreement, with physical delivery of the aircraft, together with all records, and, often, deregistration of the aircraft.[633]

3.13.1 Redelivery in redelivery condition

At the end of the lease, the lessee must redeliver the aircraft to the lessor in the redelivery condition set out in the lease. Disputes between lessors and lessees are not infrequent here since, if upon tender for redelivery, the lessor successfully asserts that the aircraft is not in the required redelivery condition, not only must the airline incur additional cost in order to meet the redelivery conditions, but rent will continue to accrue, with the lease sometimes providing for an increasing, in this author's experience, of one and a half to two times the normal rent if the delay in redelivery continues beyond a certain agreed time period.

3.13.2 Timely redelivery

The lessor needs timely redelivery of the aircraft in the agreed condition as it will plan on having a follow on lessee ready to take the aircraft and that follow on lessee may not accept delivery if the aircraft is delayed or does not meet its contracted delivery condition (which should normally match the redelivery condition from the previous operator), thereby causing loss to the lessor. A "time of the essence" clause in the lease is most advisable here.[634]

A lessee may sometimes assert that a lessor is unreasonably arguing, rather than accepting redelivery, so as to continue the lease, particularly where the lessor does not have a follow on operator ready to take the aircraft or, in the words of Thomas LJ, that the lessor is engaged in what is "Simply a clever attempt to obtain more money for the use of the aircraft."[635]

There is also the case to consider where the lessee refuses or fails to redeliver the aircraft at the end of the lease for whatever reason. It is possible for such a refusal or failure to constitute the tort of conversion. Cresswell J reviewed conversion in the case of *Kuwait Airways Corporation v Iraqi Airways Company.*[636]

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[632] *Vide* Section 12 of the Supplement *infra.*
[633] *Vide* 3.15 *infra.*
[634] *Vide* 3.19.1 *infra.*
[635] *Sunrock Aircraft Corporation Limited v Scandinavian Airlines System Denmark-Norway-Sweden* [2007] EWCA Civ 882 at 24(vi).
[636] [2004] EWHC 2603 (Comm).

He outlined the basic threefold features of the tort of conversion as (1) whether the defendant's conduct was inconsistent with the rights of the owner (or other person entitled to possession); (2) whether the conduct was deliberate rather than accidental, and (3) whether the conduct was "so extensive an encroachment on the rights of the owner as to exclude him from use and possession of the goods."[637] Importantly, he held that it does not matter whether the defendant still had the goods in his possession or whether he acted "in the genuine and reasonable belief that the goods were his."[638]

He went on to cite[639] with approval Lloyd LJ in *Ministry of Defence v Ashman*[640] who held that the owner of the property did not need to establish that he would have let the property to somebody else or used it himself and stated the principle, rejecting the defendant's claim that user damages should not exceed the value of the benefit to the defendant, that:

> "[w]hen good are converted and some (but not all) of the goods are returned months or years later, the claimant may be awarded by way of damages a sensibly/reasonably calculated amount of money to provide just compensation in respect of the period between the date of conversion and the date of return." [641]

Beatson J cited the judgment in *Kuwait Airways* with approval in *Blue Sky One and others v Blue Sky Airways LLC and others*[642] but he also noted[643] that, under the *English Tort (Interference with Goods) Act 1977*[644] that an order to deliver up the asset to its true owner would not be made if damages were an adequate remedy and noted further that:

> "[w]hile in some circumstances a contract concerning a ship or aircraft will be specifically enforceable, it is clear that this is not the invariable position. The court must still ask whether damages would be an adequate remedy…."[645]

It is submitted that situations where damages would not constitute an adequate remedy include those where the lessor is already contractually committed to deliver the aircraft to a follow on operator or buyer and, possibly, where to award the lessor the market value of the aircraft would punish the lessor unfairly by requiring it to post a loss on its books in respect of that aircraft through no fault of its own where the book value of the aircraft is above the fair market value.[646]

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[637] *Id.*, at paragraphs 220-223.
[638] *Ibid.*
[639] *Id.*, at paragraph 450.
[640] (1993) 25 HLR 513, at 845.
[641] *Ashman*, at paragraph 462.
[642] [2009] EWHC 3314 (Comm), at paragraph 306.
[643] *Id.*, at paragraph 309.
[644] Which act put the common law tort of conversion on a statutory footing.
[645] *Id.*, at paragraph 313.
[646] Alternatively, the court could award the lessor damages in the amount of the book value.

An important point to note in transactions with a head lease and sub-lease structure is that, in the event of a late redelivery, there may be difficulty recovering damages for a lost sale by the owner which might not be present if the owner and lessor were the same. Even though the aircraft was owned by a company in the same group as the lessor, the English High Court held in *Pindell Limited and BBAM Aircraft Holdings 98 (Labuan) Limited v AirAsia Berhad*[647] that, where the owner lost a sale of the aircraft due to the late redelivery by the lessee to the lessor, such loss was too remote to allow recovery. It is not clear how the court would determine a case on similar facts but where the lessor was also the owner and the lease contained clear language providing for indemnification in such event. It is submitted that, in such event, the lessor should be allowed recovery due to the direct contractual relationship between lessor and lessee and the express agreement to such indemnification in the contract.

3.13.3 Non-compliance with redelivery condition

Although a lessor will require strict compliance with the redelivery condition and procedures, under English law, this may only be possible to the extent that the aircraft is diminished in value as a result of such non-compliance. In *Sunrock Aircraft Corporation Limited v Scandinavian Airlines System Denmark-Norway-Sweden*[648] before the English Court of Appeal Thomas LJ held, *per curiam*, that it is:

> "common ground that the measure of damages for redelivering a hired chattel in damaged condition was the cost of repairs, unless it was unreasonable to effect the repairs; if it was unreasonable to effect the repairs, then the measure was the diminution of value."[649]

In this case, where scab patches were not repaired on an aircraft prior to redelivery, in breach of the lease, nominal damages were awarded when the lessor's expert witness conceded that such breach was immaterial to the value of the aircraft. It follows from this case that specific performance would, as an equitable remedy, most likely not be available either.

A lessor planning to lease the aircraft to a follow on lessee rather than to sell it, it is submitted, could reasonably claim the cost of repairs even if there is no diminution in overall value of the asset. The reason is that, bearing in mind that the delivery conditions in the follow on lease should normally mirror the redelivery conditions of the prior lease, the follow on lessee may well refuse to take delivery of the aircraft until the non-conformity is rectified and thus the lessor would be required to perform the necessary repair or remedial work itself.

[647] [2010] EWHC 2516.
[648] [2007] EWCA Civ 882.
[649] *Ibid* at 32.

It is entirely reasonable that in such circumstances the prior lessee, who was responsible for the non-conformity, should perform the repair or remedial work and, in addition, pay rent to the lessor for the duration involved to the extent that it goes beyond the expiry date agreed in the prior lease. Indeed, leases often provide that the rent for any period beyond the originally contracted period should be at a higher rate since this period was not initially agreed to by the parties but is, in effect, forced on the lessor due to the lessee's failure to redeliver the aircraft in good time in the agreed condition. The lessor's justification for this is that it risks losing the follow on lessee if the prior lessee causes a delay in delivery to the follow on lessee.

3.13.4 Residual value guarantee

In an operating lease, the owner is normally not only the legal owner of the asset but also the economic owner. In the legal context, "ownership" can be defined to mean a "[c]ollection of rights to use and enjoy property, including the right to transmit it to others"[650]. In the economic context, the "economic owner" of an asset can be defined to mean "the party who has the risks and rewards of ownership."[651]

In the case of the aircraft operating lessor, its rights and rewards consist of leasing the asset for rent and in due course selling it. One of the risks of economic ownership, however, is the risk that the residual value of the aircraft will be lower than forecast by the lessor. In order to manage this risk, an owner will occasionally accept a residual value guarantee, either from the manufacturer of the asset (where the owner buys new), if market conditions are such that the manufacturer deems it commercially necessary at the time of sale to grant such support, or from a third party guarantee provider in return for a fee.

Typically, the guarantee will spell out a required minimum condition of the aircraft at the time the guarantee is invoked, in order to ensure that market demand and not poor maintenance is the reason for the lower than expected value. Further, the guarantor may structure the guarantee such that, if the owner cannot sell the aircraft in the required condition for the guaranteed amount at the contracted time, the guarantor will either have the option to purchase the aircraft itself for the guaranteed amount or to allow the sale at a lower price to a third party to proceed, with the guarantor making up the shortfall in sale price. Given the requirement as to minimum condition, a residual value guarantee is not an effective tool to manage the risk of failure of the airline to redeliver in the agreed redelivery condition.

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[650] *Black's Law Dictionary*, 1990, 6th edition.

[651] *Balance of Payments and International Investment Position Manual*, International Monetary Fund, 2007 at http://www.imf.org/external/pubs/ft/bop/2007/pdf/chap5.pdf on 23 March 2009.

3.13.5 Records

As mentioned, not only the aircraft, but all relevant records must be returned in accordance with the requirements of the lease agreement. It is easy to overlook the importance of records but they should be considered as part of the aircraft.

In an Irish High Court case, *Cityjet Limited v Irish Aviation Authority,*[652] Kelly J held that, even where a United Kingdom certificate of airworthiness was in place in respect of an aircraft, the Irish Aviation Authority was entitled to refuse to issue an Irish certificate of airworthiness in respect of the aircraft due to *lacunae* in the aircraft records. This would be of particular importance to lessor seeking to change the state of registration of an aircraft at the end of one lease and the start of another.[653]

It is advisable that, during the term, the lessor keep copies of relevant documentation so that, in the event of difficulties with the documentation on redelivery, reconstructing the documents should not be too onerous and any *lacunae* therein should not defeat an attempt to change the state of registration of its aircraft.

3.13.6 Conclusions

Redelivery condition is a frequently disputed issue between lessor and lessee. The foregoing review does not reveal any provisions of public or private air law instruments therewith. This is not surprising as this is a dispute *inter partes* which generally involves contractual requirements to meet a condition better than that simply of the existence of a certificate of airworthiness. Cases have been dealt with under the governing law of the lease and this author, respectfully disagreeing with the decision, is concerned by the refusal of the court in the *SAS*[654] case to require precise compliance with the contractually agreed redelivery condition.

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[652] 2005 [IEHC] 206.

[653] An important point here hinged on the fact that, at the time in question, the relevant part M of European Commission Regulation 1702/2003 had not yet come into force, and pursuant to Article 2(12) of which, relevant national rules were to prevail until it did come into force. Part H 21A.183(2) thereof provides that a European Union member state must issue a certificate of airworthiness so that, Part M having come into effect on 28 September 2005, such a case would be decided differently now.

[654] *Vide* 3.13.3 *supra.*

3.14 Events of default

Default, events of default, grace periods, cross default, bankruptcy, illegality are all matters which both lessor and lessee will want to negotiate closely due to their potentially serious consequences.[655]

It is established in English law[656] that the parties to a commercial contract are entitled to agree as between themselves what breaches of a contract by one party entitle the other party to terminate it: this was upheld by the House of Lords in *Mardorf Peach & Co., Ltd. v Attica Sea Carriers Corpn of Liberia, The Laconia.*[657] The consequences of an event of default in terms of the lessor's remedies are examined in 3.15 (remedies) *infra*: here we are concerned with what triggers such remedy rights. Typical events of default are set out at Annex 10.

Leases often distinguish between "Default" and "Events of Default"[658] defining the former as any breach of the agreement, but the latter, which trigger the lessor's remedies, only where any grace period provided for has expired or determination or notice by lessor provided for has been made and served. Sometimes "Events of Default" are termed "Termination Events" as this some are not attributable to a breach by lessee, but some external event beyond its control, such as government action. Alternatively, both terms may be used, the former for actions within the lessee's control and the latter for those outside it.

The rationale here is in part to avoid triggering of cross default provisions in other leases and other contracts of the lessee due to the existence of a default under a given lease for reason beyond the lessee's control. That rationale is often defeated by such cross default provisions referring to events of default "however defined" or by referring both to events of default and termination events.

In situations where the Cape Town Convention applies, Article 11(1) thereof provides that:

> "[t]he debtor and the creditor may at any time agree in writing as to the events that constitute a default or otherwise give rise to the rights and remedies specified…."

Thus, courts applying by the Cape Town Convention should honor express agreements in lease agreements as to what constitute events of default at least insofar as such events give rise to the remedies as set out in the Cape Town Convention.

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[655] *Vide* Section 13 of the Supplement *infra*.
[656] Furmston M O, *Cheshire & Fifoot's Law of Contract*, 10th edition, Butterworths, 1981, at 497.
[657] [1977] AC 850, [1977] 1 All E R 545.
[658] Although Bunker does not so distinguish the definitions, dealing only with "Events of Default", he does discuss those events which may become events of default: *vide* Bunker D H, *International Aircraft Financing, Volume 2: Specific Documents*, IATA, 2005, at 167 *et seq.*

3.14.1 Payment

For scheduled payments, such as rent, and maintenance reserves, a short grace period, typically of a week or less, may be negotiated. A lessee does not want to be declared in default just for being a day late, which may be due to the vagaries of electronic banking, but where the amounts are fixed (in the case of rent) or known in advance to the lessee (in the case of maintenance reserves calculated in advance by reference to lessee's own operation of the aircraft), the grace period should not be long as the lessee should know each month to have funds ready for timely payment.

3.14.2 Breach of other obligations

Other obligations, even payment obligations, which are unscheduled, such as indemnity payments, are generally allowed a slightly longer grace period before failure to pay constitutes an event of default.

3.14.3 Insurance

Given the importance of insurances, as discussed in depth at 3.11.3.4 and 3.12 *supr*a, typically it is an immediate event of default should the required insurances not be in place at any time during the lease term. There is no grace period.[659]

In such event, the lessor should require the aircraft be taken immediately out of service by the lessee with the lessee to provide insurance cover to cover the aircraft on the ground.[660] Of course, in such event, the lessor should not want to take the risk that the lessee will not or cannot comply and should consider having its own contingent insurance in place.

3.14.4 Bankruptcy

The applicable law in the case of the bankruptcy of an airline will be the law of the state having jurisdiction over the airline, not the governing law of the lease. All obligations of the bankrupt airline are typically[661] stayed while the liquidator liquidates the assets of the airline and then distributes what is left to the creditors in accordance with that law.

The aircraft under an operating lease, of course, is an asset of the lessor, not the airline. Nevertheless, the owner may face certain restrictions in repossessing its aircraft in the case of bankruptcy. There follows an examination, by way of example, an examination of a national bankruptcy code (focusing principally on the United States). For states party to the Cape Town Convention the bankruptcy *régime* set out at Article XI of the Aircraft Protocol thereto will apply and this too will be examined below.

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[659] See Bunker D H, *International Aircraft Financing, Volume 2: Specific Documents*, IATA, 2005, at 151 and 167.
[660] *Ibid.*
[661] Especially in the United States – *vide* 3.14.4.1 *infra.*

For comparison, with respect to finance leases covered thereunder, the Unidroit Convention on Financial Leasing[662] provides[663] that a lessor's real rights in an aircraft shall be valid against the lessee's trustee in bankruptcy and creditors provided that where the law of the state of registration of the aircraft[664] so requires, any public notice requirements are first complied with.[665] The foregoing shall not, however, affect the provisions of any other treaty requiring the lessor's real rights to be recognized[666] – clearly, thus the provisions of the Cape Town Convention prevail where they apply.

3.14.4.1 US Bankruptcy Code

For example, Section 1110 of the United States Bankruptcy Code has special provisions relating to aircraft. Under Section 1110, the automatic stay under Section 362 against repossession, unless the court finds cause to grant relief, applies to aircraft lessor only for the first 60 days after the official commencement of a bankruptcy case. During that period, the debtor must cure any pre-bankruptcy defaults and enter into a court-approved agreement to perform all obligations under the pre-petition lease.

By the end of the 60-day period, if all defaults are not cured and a court-approved agreement is not in place, Section 1110 overrides the automatic stay such that, immediately upon the debtor's default and without court order, it entitles the lessor to retake possession of its aircraft and to enforce any of its rights or remedies in accordance with the provisions of the underlying lease.[667]

In the context of the Section 1110 stay period, Dempsey and Gesell[668] have noted, somewhat drily but accurately, that:

> "[t]ypically, during this period, the company negotiates at a feverish pace with aircraft lessors and lenders, urging that they give the airline additional time to make good on outstanding indebtedness, and re-open the financial terms to place the airline in a position to emerge from bankruptcy successfully."

This is essentially the same concept as proposed by Alternative A on bankruptcy proposed in Article XI of the Aircraft Protocol to the Cape Town Convention.[669] Other jurisdictions may prefer allowing a court greater flexibility as regards repossession by a lessor upon an airline lessee insolvency. This will always be governed by the laws of the jurisdiction of

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[662] *Vide* 2.1 *supra*.
[663] Article 7(1)(a).
[664] Article 7(3)(b).
[665] Article 7(2).
[666] Article 7(4).
[667] http://www.weil.com/news/pubdetail.aspx?pub=8827 on 7 April 2011.
[668] Dempsey, P.S. and Gesell, L.E., *Air Commerce and the Law*, Coast Aire, *200*4, at 389-390.
[669] *Vide* 3.14.2 *infra.*

the airline and thus may vary widely, too widely to be examined in detail in this study. Such states, wishing to adopt the Cape Town Convention, but wishing to retain such flexibility, may opt for Alternative B.[670] To date, only Mexico has elected for Alternative B.[671]

3.14.4.2 Cape Town Convention

The Cape Town Convention and Aircraft Protocol provide in Article XI of the Aircraft Protocol for two alternatives, A and B, in the case of an airline bankruptcy. A contracting state may elect either A in its entirety, B in its entirety or neither.

Alternative A

Under Alternative A, upon the occurrence of an insolvency related event, the insolvency administrator shall either cure all defaults or return the aircraft to the lessor by the end of whatever time period is stated by the contracting state in its declaration (or such earlier date on which the lessor would have been entitled to repossession in the absence of Article XI). This is similar in concept to the United States Section 1110 procedure.

Alternative B

Under Alternative B, the insolvency administrator must, upon the lessor's request, indicate to the lessor within the time period stated by the contracting state in its declaration whether it will cure all defaults or allow the creditor to take repossession.

However, the court has broad discretion in requiring additional steps and the court may (not shall) allow the lessor to repossess the aircraft "upon such terms as the court may order".

Wool and Littlejohns have criticised Alternative B as follows:

> "Alternative B is unsatisfactory to creditors because it does not impose a time limit for actual assumption of the agreement or return of the aircraft – the only time limit imposed on the airline or its insolvency administrator is to notify its initial decision"[672]

As of the date hereof, only Mexico has opted for the more debtor-friendly Alternative B.[673]

It should be noted that, just as any sovereign state may choose to adopt or not to adopt the Cape Town Convention, it may, if it chooses to adopt it, choose Alternative A or

[670] *Vide* 3.14.4.2 *infra.*
[671] *Ditto.*
[672] Wool J and Littlejohns A, *Cape Town Treaty in the European context: The case for Alternative A, Article XI of the Aircraft Protocol*, Airfinance Annual 2007/2008 at http://www.awg.aero/capetownconvention.htm on 19 April 2011.
[673] http://www2.icao.int/en/leb/List%20of%20Parties/capetown-prot_en.pdf on 7 April 2011.

Alternative B as it in its sole discretion decides. That said, there are certain implications to its choices.

If it decides to adopt the Cape Town Convention, and if it chooses Alternative A, then certain officially supported export credit enhancements, by way of a lower minimum rate of interest for such financing, may be available.[674] In addition to the other requirements, it is necessary in order to obtain such lower rate, that:

> "[t]he operator of the aircraft (or the borrower/buyer or lessor if, in the view of the Participant providing the official support, the structure of the transaction so warrants) is situated in a State which appears on the list of States which qualify for the reduction of the minimum premium rates"[675]

and such State shall have made the "qualifying declarations" set out in Annex 1 to the Sector Understanding on Export Credits for Civil Aircraft – Final Text.[676]

In addition, the State shall have:

> "[h]ave implemented the Cape Town Convention, including the qualifying declarations, in its laws and regulations, as required, in such a way that the Cape Town Convention commitments are appropriately translated into national law."[677]

In other words, by adopting the Cape Town Convention, and made qualifying declaration, including Alternative A, all of which are intended to give greater certainty to enforcement of the lease in accordance with its terms, the very concern of this study, a state can ensure[678] that its airlines can benefit from cheaper financing, or that lessor to its airlines can, which benefits can be passed on by way of lower lease rental.

In the context of the European Union, the Cape Town Convention[679] and the Aircraft Protocol[680] provide for the accession thereto not only of states but of regional economic integration organizations. Pursuant thereto, the European Union is a party thereto.[681] The declaration made by it are complex due to the division of competencies between the European Union and its member states[682] but, for these purposes, it is sufficient to note that

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[674] Organisation for Economic Co-operation and Development, *Sector Understanding on Export Credits for Civil Aircraft – Final Text*, 20 December 2010, Section 35(b).
[675] *Id*., Section 1.
[676] Set out for convenience at Annex 11 hereto.
[677] *Id*., Section 37(c).
[678] At least in theory.
[679] Article 48.
[680] Article XXVII.
[681] http://www.unidroit.org/english/implement/i-main.htm on 19 April 2011.
[682] Unidroit, *Seminar Report: The European Community and the Cape Town Convention*, Rome, 26 November 2009, at http://www.awg.aero/capetownconvention.htm on 19 April 2011, at 5.

the European Union declined to make a declaration regarding remedies on insolvency, leaving it to each member state to decide.[683]

3.14.5 Conclusions

What constitutes an event of default is not dealt with in the public or private air law instruments and is generally a matter for the governing law of the lease. This includes the occurrence of a bankruptcy or insolvency event in respect of the lessee. However, whether or not, and for how long, or subject to what conditions, a lessor's rights may be stayed before he can enforce them in the case of the bankruptcy of an airline will depend on the law of the jurisdiction of the airline. As the aircraft will likely be in the hands of the airline, and thus its liquidator or other trustee in bankruptcy, this may lead to legal claims not only in the dispute resolution venue set out in the lease[684] but also the bankruptcy courts of the jurisdiction of the airline.

An event of default in and of itself only has contractual implications under the lease to the extent that it triggers remedy rights on the part of the lessor, which remedy rights are next examined.

[683] *Id.*, at 6.
[684] *Vide* 3.18 *infra*.

3.15 Remedies

In addition to a claim for unpaid rent or other payments,[685] a lessor's main concern on a default will be to obtain repossession of the aircraft and its documents, to deregister the aircraft from the aircraft register on which the lessee placed it, and to export it from the lessee's country as soon as possible, ideally before any declaration of bankruptcy in respect of the lessee.[686] Complications with liens, and borrowed engines, can turn this into a very difficult area for lessors.

Under English law, where the lessor terminates the leasing of the aircraft pursuant to a default by the lessee, and seeks to exercise its rights, a breach by the lessee, under a lease worded in accordance with industry practice, involves a repudiation by the lessee and a breach by it of all obligations remaining unperformed: the loss suffered by the lessor is treated in law not as being caused by the lessor's decision to treat the lease as discharged but by the lessee's breach which led the lessor to take such a step.[687]

Under English law, a lessor also has a duty to mitigate its damages: otherwise any amount of damages which it receives must be reduced accordingly. This was confirmed in *BAE Systems*[688] which also confirmed that:

> "[t]he duty to mitigate arises only when a breach of contract has been committed, not before. It is not open to a person who has broken his contract to say that the other party should have acted before the breach in a way that would have reduced his loss when the breach eventually occurred."[689]

For comparison, it should be noted that, with respect to finance leases covered thereunder, the Unidroit Convention on Financial Leasing[690] allows for recovery of unpaid rentals together with interest and damages[691] but restricts repossession to where the lessee's default is "substantial"[692] and to claim for acceleration of payment of future rentals[693]. Further, the lessor can only recover damages if it has taken all reasonable steps to mitigate its loss.[694]

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[685] Which are beyond the scope of this study and are generally of less importance to the lessor, who accepts the lessee's credit risk when the lessor agree to lease its aircraft to it, than the ability quickly to repossess the aircraft and to remarket it.
[686] *Vide* Section 13 of the Supplement *infra*.
[687] *BAE Systems Management Service (Two) Limited & Another v Trident Aviation Leasing Services (Jersey) Ltd & AS Enimex,* [2010] EWCA Civ 107.
[688] *Op. cit.*
[689] *Id.*, per Moore-Bick LJ, at paragraph 16.
[690] *Vide* 2.1 *supra*.
[691] Article 13(1).
[692] Article 13(2).
[693] Articles 13(4) and (5).
[694] Article 13(6).

3.15.1 Repossession

In the event the airline defaults in its obligations under the lease, the lessor may be entitled to exercise certain remedies under applicable law. The applicable law providing such remedies could be the law of the jurisdiction where the aircraft is located, the law of the jurisdiction where the aircraft is registered, the law where the airline is located, and/or the governing law provided for in the lease. In each case, the parties will need to consult with legal counsel in each of those jurisdictions in order to verify the situation in that jurisdiction.[695]

The Cape Town Convention[696] provides:

> "References to the applicable law are to the domestic rules of the law applicable by virtue of the rules of private international law of the forum State."[697]

The Cape Town Convention goes on to provide that a court has jurisdiction to grant an order of repossession of the aircraft[698] if it is:

(a) a court chosen by the parties;[699]

(b) a court of a Contracting State on the territory of which the lessee is situated, being relief which, by the terms of the order granting it, is enforceable only in the territory of that Contracting State;[700] or

(c) a court of the state of registration of the aircraft.[701]

In addition, the lessor will normally[702] want to set out certain agreed contractual remedies in the lease, including the contractual right to terminate the leasing of the aircraft under the lease and to take repossession of the aircraft. Article 10(a) of the Cape Town Convention provides that, subject to the right of a contracting state under Article 54(2)[703] to require that

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[695] The jurisdictional questionnaire discussed at 2.4 *supra* may identify remedies available in respect of the jurisdiction concerned.
[696] *Vide* 3.15.3 *infra*.
[697] Article 5(3).
[698] Under Article 13(1)(b) of the Cape Town Convention.
[699] Under Article 43(2)(a) of the Cape Town Convention.
[700] Under Article 43(2)(b) of the Cape Town Convention
[701] Under Article XXI of the Aircraft Protocol to the Cape Town Convention.
[702] See Bunker D H, *International Aircraft Financing, Volume 2: Specific Documents*, IATA, 2005, at 174-183.
[703] According to Krupski, Article 54(2) was added in order to accommodate civil law jurisdictions that are generally hostile to nonjudicial remedies such as self help. *Vide* Krupski JA, *Conflict of Laws in Aircraft Securitization*, Annals of Air and Space Law, Volume XXIV, 1999, at 144.

leave of the court first be obtained, in the event of default under a lease, the lessor may terminate the leasing agreement and take possession and control of the aircraft.[704]

Physical repossession alone of the aircraft is not, however, enough. The lessor will want to put the aircraft into revenue service with a new lessee with a minimum of delay. In order to do so, it needs not only the aircraft with all engines and parts but all aircraft documents, as the new lessee will not otherwise accept delivery of the aircraft. It needs to fly the aircraft away from the airport where it is located at the time of repossession (and thus may need to deal with unpaid landing and parking fees), export the aircraft from the jurisdiction of the previous lessee (and thus may need to deal with excise taxes and export duties) and to deregister the aircraft, where relevant, from the aircraft register of the jurisdiction of the previous lessee.

How exactly a hostile repossession will proceed is hard to gauge in advance. To give one sanguine view:

> '"It's pretty exciting walking through customs with $30,000 in cash strapped to your stomach," says one lessor. "But you need it when you are repossessing an aircraft."'[705]

Although self help[706] remedies may be possible in certain jurisdictions to a greater or lesser degree,[707] often some kind of court order will be required in the case of a legal hostile repossession. This will typically involve seeking an interim order, often on an *ex parte* basis, granting the lessor repossession of its asset pending resolution of the underlying dispute in substantive proceedings. This is because it is unlikely that the lessor can afford to await the outcome of substantive proceedings in a situation where it almost certainly is not being paid rent.

In order to protect a lessee in case it should later win in the substantive proceedings, the lessor is often required to post a bond in an amount which will be paid should the lessee ultimately be successful. This amount may, according to the jurisdiction, be fixed by the judge or may be determined by reference to the value of the asset in question[708] (even though the lessee has no ownership interest therein and even though its losses would be calculated by reference to lost revenue rather than by reference to the underlying value of the asset which it is renting).

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[704] In other words, absent a declaration under Article 54(2), self help is allowed.
[705] Segal S, *Repossessions and remarketing after the repo man*, Airfinance Journal, December 2008/January 2009, at 28.
[706] That is, remedies exercised directly by the lessor without first obtaining a court order.
[707] Crans B and Nath R, Aircraft *Repossession and Enforcement: Practical Aspects*, Wolters Kluwer, 2009.
[708] Basch K and Iezzi I, *Summary of Repossession Procedure in Brazil*, a paper presented to the American Bar Association Air and Space Law Forum annual meeting in Seattle, Washington on 11 October 2010.

By way of example, in Brazil,[709] which has ratified the Rome Convention 1933,[710] the amount of the bond is at the court's discretion but in practice is usually between 10-20% of the "value of the cause", which, in the most recent case there, was taken to be the amount of the overdue debt. The Rome Convention 1933 is discussed in detail at 3.15.2 *infra.* Further, a preliminary injunction is normally insufficient to allow export of the aircraft from Brazil. Although the lessor can take possession of the aircraft, therefore, until the order is final, the aircraft cannot be effectively remarketed.[711]

Lessors should be aware that, where the grounds for seeking forfeiture or repossession of the aircraft relate solely to a money claim for unpaid amounts under the lease, such as rent, it is open to a lessee, under English common law, to seek equitable relief against forfeiture on the grounds that the right to forfeit is essentially to secure payment of that money as contrasted, with, say, an obligation to keep the leased property in good repair. This right was confirmed by Teare J of the English High Court in *Celestial Aviation Trading 71 Limited v Paramount Airways Private Limited.*[712]

The effects of repossession of an aircraft may go beyond simply the aircraft itself:[713] if the aircraft repossessed is the only aircraft operated by the airline, it may stand to lose its air transport license.[714] For example, in the context of the European Union, European Council Regulation 1008/2008 provides:

> "An undertaking shall be granted an operating license by the competent licensing authority of a Member State provided that:…
>
> (c) it has one or more aircraft at its disposal through ownership or a dry lease agreement;"[715]

The consequences for the lessee in such a situation could be terminal for the airline. Without an air transport license, the airline may well be faced with liquidation: a situation with which this author has experience[716] in the French courts.

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[709] *Vide* 3.15.2 *infra.*
[710] The Convention for the Unification of certain Rules relating to the Precautionary Arrest of Aircraft, signed at Rome on 29 May 1933.
[711] Basch K and Iezzi I, *Summary of Repossession Procedure in Brazil*, a paper presented to the American Bar Association Air and Space Law Forum annual meeting in Seattle, Washington on 11 October 2010, at 4.
[712] [2009] EWHC 3142 (Comm), at paragraph 22 *et seq.* This case is discussed in detail at *2.1 supra.*
[713] This author has personal experience of just such a situation involving the loss of its air transport license where the last aircraft in its fleet was repossessed by the lessor after defaulting under the lease. Such revocation led to the liquidation of the airline.
[714] *Vide* 3.5.2.5 *supra*.
[715] Article 4.
[716] *Me Raymond Dupont acting as appointed liquidator of SAS Noor Airways v Aviation Capital Group Acquisition XX LLC,* Case 119083, Commercial Court of Saint Nazaire, 2011.

3.15.2 Rome Convention 1933

The Convention for the Unification of Certain Rules Relating to the Precautionary Arrest of Aircraft (Rome Convention), signed at Rome on 29 May 1933[717] has not been widely ratified but it is in force[718] and may impede a lessor's ability to seek repossession prior to obtaining a final judgment. Under Article 3(1) thereof, the following aircraft are exempt from arrest unless the owner dispossessed of his aircraft by an unlawful act:[719]

> "(a) aircraft exclusively appropriated to a state service, including the postal service, but excluding commercial service;
>
> "(b) aircraft actually in service on a regular line of public transport, together with the indispensable reserve aircraft;
>
> "(c) every other aircraft appropriated to the carriage of persons or goods for reward, where such aircraft is ready to start on such carriage, unless the arrest is in respect of a contract debt incurred for the purposes of the journey which the aircraft is about to make, or of a claim which has arisen in the course of the journey."

Under Article 4, if the airline is not entitled to the protection of Article 3 or does not invoke such protection, the airline shall have the right to immediate release. Upon posting security sufficient to cover:

> "the amount of the debt and costs and if it is appropriated exclusively to the payment of the creditor, or if it covers the value of the aircraft if this value is smaller than the amount of the debt and costs."

This author has successfully obtained,[720] in the courts of Ontario, Canada, the precautionary arrest of an aircraft where the Rome Convention did not apply – many variables are in play: persuading the court to accept jurisdiction, persuading the court to post a bond which is not prohibitively high[721] and, perhaps most importantly, persuading the judge to issue the order on an *ex parte*[722] basis.

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[717] The ratifying states are Belgium, Brazil, Denmark (excluding Greenland), Germany, Guatemala, Hungary, Italy, The Netherlands (excluding colonies), Norway, Poland, Romania, Spain (excluding colony) and Switzerland. The adhering States are Algeria, Finland, Haiti, Mali, Mauritania, Niger, Senegal, Sweden and Zaire. See P. Martin E. Martin, Shawcross and Beaumont Air Law, 4th ed., vol. 2 (London: Butterworth, 1977-1991) at http://www.aviation.go.th/airtrans/airlaw/ArrestofAircraft.html on 7 April 2011.

[718] It should be noted that the Rome Convention (1933) does not apply in cases of bankruptcy – see Article 7.

[719] Article 3(2).

[720] *Mitsui & Co., Ltd. and Tombo Aviation Inc v Viacao Aerea Sao Paulo S.A. – VASP*, Court File No. 99-CV-170574, Superior Court of Justice, Ontario, 1999.

[721] Depending on the jurisdiction, for example, in Brazil (*vide* 13.5.2 *supra*), the judge may not have discretion and the amount of the bond may be calculated by reference to the value of the asset in dispute, even

The reason for this is simple to grasp – Rochus Mönter,[723] in his most interesting account of his legal actions on behalf of a lessor against a Mexican airline which refused either to pay the lessor rent or to return the aircraft to the lessor, observes that, without the benefit of an *ex parte* basis for a precautionary order in California, the delinquent airline could easily have evaded sequestration of the aircraft by the simple expedient of not flying it into California.

Prior to his successful detention, this author witnessed such simple expedient. Having successfully obtained a court order on an ex parte basis, he received confirmation from a private detective hired by his aircraft lessor employer that the nationality and registration mark of an aircraft departing the airline's home base at a particular time matched the scheduled departure time for a flight to a city where an *ex parte* detention order had been obtained upon posting a reasonable bond. Unfortunately, somehow, word got to the airline, and the flight was diverted to another jurisdiction: it is not known how the passengers were accommodated or the reason for the diversion explained to them. In any event, ultimately, the aircraft was successfully arrested, and possession granted to the lessor – this still did not resolve payment of the unpaid rent and other amounts or deregistration of the aircraft.[724]

3.15.3 Cape Town Convention

The Rome Convention is superseded by the Cape Town Convention pursuant to Article XXIII of the Aircraft Protocol thereto insofar as aircraft as defined in the Aircraft Protocol[725] are concerned and states are party thereto, except for states which make a declaration to the contrary pursuant to Article 24 of the Aircraft Protocol.

If the Cape Town Convention and Aircraft Protocol apply, then, so long as the lessor acts in a commercially reasonable manner,[726] it may, if the lessee has agreed to it, take possession of the aircraft or apply for a court order authorizing it to take possession or control of the aircraft. Under Article 54(2) of the Cape Town Convention, a state may require leave of the court for such taking of repossession or control.

Under Article 13 of the Cape Town Convention, a contracting state shall ensure that a lessor may, pending final determination of a claim, and if the lessee has so agreed, obtain speedy relief as to possession, control and custody of the aircraft, subject to such terms as the court thinks necessary to protect the lessee or other interested parties.

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though in the case of an operating lease, the lessee has no ownership interest in the aircraft, only a leasehold interest.

[722] That is to say, without notice to the other party, the airline.

[723] Mönter R, *Today's Challenges of Leasing Aircraft into Mexico*!, Air And Space Law, Kluwer Law International, Volume XXXIII, Issue 6, November 2008, 430-443, at 437.

[724] As to which, *vide* 3.15.6 *infra*.

[725] As to which, *vide* Article 1(2) of the Aircraft Protocol.

[726] Article 9(3) of the Aircraft Protocol.

It remains to be seen how the provisions of the Cape Town Convention and the Aircraft Protocol will be interpreted by the courts.

3.15.4 Geneva Convention

The Convention on the International Recognition of Rights in Aircraft, signed at Geneva on 19 June 1948 (Geneva Convention), has already been discussed at 3.10.2.4.3 *supra* in the context of engines. Under the Geneva Convention, which has been ratified by 89 states,[727] the contracting states undertake to recognise property rights in aircraft provided that such rights have been constituted in accordance with the laws of the state of registration of the aircraft applicable at the time of their creation and are recorded in a public record of such state of registration[728] and include the right to possess an aircraft under a lease of six months or more.[729]

The remainder of the Geneva Convention largely deals with the rights of secured creditors and is of little practical use to operating lessors. Honnebier has commented that the Geneva Convention is merely a conflict of laws treaty rather than a substantive law treaty, and from the outset has been simply regarded as a "provisional body of rules".[730]

Pursuant to Article 23 of the Aircraft Protocol to the Cape Town Convention, the Geneva Convention is superseded by the Cape Town Convention and the Aircraft Protocol as it relates to aircraft as defined in the Aircraft Protocol except in relation to parties thereto which make a declaration to the contrary.

3.15.5 Subleasing

Finally, in the context of repossession, a lessor should be careful in consenting[731] to any proposed subleasing by its lessee of its aircraft.[732] The sublease term should not extend beyond the term of the head lease and the rent thereunder should not be less than that under the head lease. Most importantly in the context of repossession, however, is that the lessor

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[727] http://www2.icao.int/en/leb/Lists/Current%20lists%20of%20parties/AllItems.aspx on 20 June 2011.
[728] Article 1(a).
[729] Article 1(c).
[730] Honnebier B P, *Clarifying the Alleged Issues Concerning the Financing of Aircraft Engines: Some Comments to the Alleged Pitfalls Arising under Dutch, German and International Law, as Proposed* , ZLW 3/2007 at 33-44. *Vide* 3.10.2.4.3 *supra*.
[731] Whether such consent is a general subleasing right set out in the lease or a specific consent to a specific subleasing request by the lessee.
[732] Indeed, a prudent lessor should carefully review which sub-leases by the lessee will require its prior consent since this will involve the lessee parting with possession of the lessor's property to a third party. This will vary by case: a lessor may require its specific prior consent to any sub-lease, or a lessee may negotiate for such consent to be dispensed with for sub-leases to other airlines within its corporate group or to certain specified other airlines acceptable to the lessor.

should be clear up front as to what will happen to the sub-lease should the head lease terminate.

Either the sub-lease should be explicitly stated to be subordinate to the head lease such that, should the head lease terminate, the sub-lease automatically terminates too, thus entitling the lessor to repossession from the sub-lessee, or the head lessee[733] should assign its rights, but not its obligations, to the lessor as security for the performance by the lessee of its obligations under the head lease.

The effect of this will be that, if the lessee defaults, the lessor can terminate the head lease, but can take over the sub-lease so as to enjoy the rights of the sub-lessor thereunder. Notice of the assignment should be given to the sub-lessee and an acknowledgment thereof and consent thereto obtained from the sub-lessee.

In return for this, the lessor normally (in this author's experience) grants a letter of quiet enjoyment to the sub-lessee confirming that, so long as the sub-lessee performs under the sub-lease in favour of the lessor (pursuant to the assignment), the lessor will not interfere with the sub-lessee's quiet enjoyment of the aircraft for the term of the sub-lease.

Annex 1 sets out the interplay of the assignment by way of security and the letter of quiet enjoyment in a typical operating lease structure.

3.15.6 Deregistration

Simply obtaining possession of the aircraft alone may not of itself by a sufficient remedy for the lessor in respect of the aircraft itself.

The aircraft must be registered pursuant to Article 17 of the Chicago Convention. Under Article 19 of the Chicago Convention, however, it is up to each contracting state to decide what laws and regulations will govern registration of aircraft. See the discussion at 3.10.2.3 *supra*.

Where the aircraft is registered in the name of the owner, the owner[734] will control deregistration and thus should not face any difficulty in this regard.

Where the aircraft is, however, registered in the name of the lessee as operator, and the lessee refuses to deregister the aircraft, the lessor will be unable to deliver the aircraft to another lessee on terms whereby that lessee can operate the aircraft. To deal with the likelihood of such a refusal on the part of the lessee, the lessor may demand a deregistration power of attorney, which is next examined.

[733] This is also the sub-lessor under the sub-lease.
[734] Assuming it is, or is related to, the lessor – *vide* 2.2 *supra*.

3.15.7 Deregistration power of attorney

In cases where the aircraft is registered in the name of the lessee as operator of the aircraft, in order to protect the lessor in the case where the lessee is in breach of the lease and refuses to deregister the aircraft despite being required to do so under the lease, the lessor frequently demands a deregistration power of attorney to be executed by the lessee in favour of the lessor authorizing the lessor to deregister the aircraft from the aircraft register.

In practice, such powers of attorney are of limited practical use. Notwithstanding any language therein to the effect that they are irrevocable, under many legal systems they are irrevocable at any time and aviation authorities are loath to rely on them alone to deregister an aircraft in the face of opposition from the local operator.

Further, under English law, powers of attorney must be executed as a deed. This fact is frequently forgotten, especially where the power[735] is granted in the body of the lease itself. English law regarding due execution of a deed must be followed carefully.

In a recent English High Court case,[736] a document purporting to be executed as a deed was disallowed since, following common practice, the signature pages thereto had been pre-placed and the final text added later, in breach of the requirement that the signature and attestation form part of the same physical document such that the deed was signed in its final form**.**

3.15.8 Article 83 *bis* transfer

One possible step which may be open to a lessor who is wary of leasing to an operator based on a country with an operator only registration system for aircraft may be to effect a transfer under the widely adopted Article 83 *bis*[737] of the Chicago Convention which provides that:

> "when an aircraft registered in a contracting State is operated pursuant to an agreement for the lease… of the aircraft… by an operator who has his principal place of business… in another contracting State, the State of registry may, by agreement with such other State, transfer to it all or part of its functions and duties as State of registry in respect of that aircraft…."[738]

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[735] This may take the form of a specific power of attorney to deregister or the form of a broader power of attorney to take all steps necessary to allow the lessor to exercise its remedies thereunder.

[736] *R. (on the application by Mercury Tax Group and another)* v *HMRC* [2008] EWHC 2721.

[737] Article 83 *bis* has been adopted by 157 of the 190 contracting states of the Chicago Convention – see http://www2.icao.int/en/leb/List%20of%20Parties/83bis_en.pdf and http://www2.icao.int/en/leb/List%20of%20Parties/chicago_en.pdf on 7 April 2011.

[738] Leloudas and Haeck express concern that the reference to the principal place of business rather than to the place of incorporation of the operator "means that the State of the operator is unable to maintain control of the airline and the aircraft": Leloudas G and Haeck L, *Legal Aspects of Aviation Risk Management*, Annals of Air and Space Law, Volume XXVII, 2002, 149-169, at 163. This author, however, sees no reason why an

This is also popularly referred to as an Annex 6 delegation or transfer since what are transferred are the obligations of the state of registration under Annex 6 of the Chicago Convention, dealing with International Standards And Recommended Practices relating to the operation of aircraft. Areas which may be covered by such a transfer are rules of the air,[739] aircraft radio equipment,[740] certificates of airworthiness[741] and licenses of personnel.[742]

If it is possible to achieve such a transfer, then the risk of the lessee's wrongly refusing to deregister the aircraft can be managed but it should be borne in mind that such transfers are done between states and thus require two willing states, either of which can refuse the transfer or impose such conditions as it may see fit.

For example, the United Kingdom will not normally agree to such a transfer for a period exceeding six months in duration.[743] Such a period would not be long enough for most operating leases and is more often availed of in practice where a lessee itself wishes to sublease an aircraft for a summer or winter season.

Dempsey[744] gives the hypothetical example that Ireland could delegate to Germany the responsibility to oversee the airworthiness of aircraft owned by Irish leasing companies but operated by Lufthansa. Although Dempsey indeed gives a good example, in fact, there is no such delegation between Ireland and Germany. One reason why Article 83 *bis* is not more widely availed of[745] may be that the state of the aircraft operator has no motivation to accept such responsibility, even though it would have no ability to avoid such responsibility if, in this example, the lessor and Lufthansa agreed that the aircraft should be registered in Germany rather than Ireland for the term of the lease.

Although Ireland and Germany have not entered into any such agreements, there is no reason, in principle, why they should not as, for example, Ireland and Italy have entered into such agreements and also Italy and Germany have likewise entered into such agreements. It is a matter of both states being willing: no state can be forced into such an agreement..

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operator having its principal place of business in a state would not be subject to the jurisdiction of that state, and has seen no evidence of this issue causing any problem in practice.

[739] Article 12 of the Chicago Convention.

[740] Article 30 of the Chicago Convention.

[741] Article 31 of the Chicago Convention.

[742] Article 32(a) of the Chicago Convention.

[743] United Kingdom Civil Aviation Authority Official record Series 4, Air Navigation Order 2005 General Exemption, 30 September 2005.

[744] Dempsey P S, *Public International Air Law*, McGill University, 2008, 118.

[745] A full list of Article 83 bis agreements registered with ICAO may be found at http://www.icao.int/applications/dagmar/main.cfm?UserLang= (as of 16 November 2010).

ICAO[746] has made clear that the concept of registration implies responsibility of the state of registration for safety of aircraft registered with it, wherever they may be operated.[747] Article 83 *bis* was developed in response to safety concerns arising out of the growing trend for aircraft leasing. The aim is to offer:

> "a solution under public international law that aims at facilitating safety oversight, taking into account the need of airlines for flexible commercial arrangements in the use of their aircraft."[748]

As at 20 November 2002, 25 transfer agreements had been registered with ICAO, twelve of them by Italy (and six of those to Germany) and eight of them by Ireland.[749] Thus, the take up rate has not, apparently, been very high.[750]

A note of diffidence to such arrangements may, perhaps, be noted in recital 8 to EC Regulation 1008/2008,[751] which provides:

> "In order to avoid excessive recourse to lease agreements of aircraft registered in third countries, especially wet lease,[752] these possibilities should only be allowed in exceptional circumstances, such as a lack of adequate aircraft on the Community market, and they should be strictly limited in time and fulfil safety standards equivalent to the safety rules of Community and national legislation."

Certainly, this shows a greater concern with wet leasing than with dry leasing but the regulation does not discuss what greater comfort, if any, may be taken in the case of dry leases of aircraft registered in third countries where there is a transfer of oversight pursuant to Article 83 *bis.*[753]

The model transfer agreement[754] and sample transfer agreements set out by ICAO refer to Annexes to, rather than to Articles of, the Chicago Convention, but generally show full

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[746] *Guidance on the Implementation of article 83 bis of the Convention on International Civil Aviation*, ICAO, 2003. More recent agreements can be looked up at http://www.icao.int/applications/dagmar/main.cfm?UserLang= but no overall list or number of agreements are available there.
[747] *Ibid* at 4-5.
[748] *Ibid* at 5.
[749] *Ibid* at 23.
[750] That said, although the website does not disclose precisely how many have been registered with ICAO, the ICAO website shows at least 100 having been registered. See http://www.icao.int/applications/dagmar/main.cfm?UserLang= on 8 April 2011.
[751] Regulation (EC) No 1008/2008 of the European Parliament and of the Council of 24 September 2008 on common rules for the operation of air services in the Community.
[752] *Sic*.
[753] It should be noted here that a party to the Chicago Convention which is nevertheless not a party to Article 83 *bis* is not bound by any such delegation among states.
[754] Set out as Annex 12 hereto.

transfer of oversight in respect of Annex 1 (personnel licensing), Annex 2 (rules of the air), Annex 6 (operation of aircraft), as referred to above, but reserving oversight or having only a limited transfer in respect of Annex 8 (airworthiness).

In this context, according to Abeyratne:[755]

> "[t]echnically, Article 83 *bis* is calculated to tighten and ensure the more efficient operation of aircraft in terms both of safety and of commercial expediency…."

It is not, therefore, a case of having to choose between one and the other. He helpfully goes on to point out[756] that an incentive to a state considering whether or not to conclude an agreement under Article 83 *bis* is the assurance that the state to which safety oversight is delegated has the capability of fulfilling its responsibilities in respect of the aircraft involved: such state has access to the results of audits carried out under the ICAO Safety Oversight Audit Programme.

Although there is no reason under the terms of Article 83 *bis* why a delegation under Article 83 *bis* need be limited to specific aircraft, in practice, they are: see for example, the Memorandum of Understanding (with two Schedules) between the Irish Aviation Authority (Ireland) and the Ente Nazionale per l'Aviazione (Italy) on the Implementation of Article 83 *bis* of the Convention on International Civil Aviation for the Transfer of Surveillance Responsibilities (Operations, Maintenance and Continuing Airworthiness) of Aircraft Operated under Dry Lease Contract[757] dated 14 October 2000.

It is specific to 53 aircraft listed by aircraft type, registration mark and manufacturer's serial number and Italian operator. Under its terms,[758] consistent with the ICAO model transfer agreement referred to above, there is full transfer, in respect of the aircraft covered by the agreement, of oversight in respect of Annex 1 (personnel licensing), Annex 2 (rules of the air), and Annex 6 (operation of aircraft), but only a limited transfer in respect of Annex 8 (airworthiness): oversight is retained by the state of registration except for maintenance surveillance in respect of leased aircraft. Further, each party agrees[759] to the other only to authorize leasing contracts of aircraft which are in compliance with the terms of the agreement.

Even before Article 83 *bis* took effect, on 20 June 1997, ICAO urged states of registration unable adequately to fulfil their responsibilities adequately in instances where aircraft are leased "in particular without crew" by an operator of another State to delegate to the state of the operator, subject to acceptance by the latter, those functions of the state of

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[755] Abeyratne R I R, Aviation Trends in the New Millenium, Ashgate, 2001, 25.
[756] *Op. cit.*, 27.
[757] http://www.icao.int/applications/dagmar/agr_details.cfm?UserLang=&icaoregno=4276%2E0 on 7 April 2011.
[758] At Part IV (Transferred Responsibilities) thereof.
[759] Under Part VI (Lease Authorisation) thereof.

registration that can more adequately be discharged by the latter, it being understood that pending entry into force of Article 83 *bis*, such delegation would only be a matter of practical convenience and would not affect the provisions of the Chicago Convention.[760] Further, even after such entry into force, any such delegation will only have force as against third states if it has been communicated to the ICAO Council and made public or communicated directly to such third states.[761]

Under the multilateral Article 83 *bis* agreement, entitled *Agreement on the Practical Application of the Provisions of Article 83 bis of the Convention on International Civil Aviation*, registered with ICAO on 22 April 1996 by the Russian Federation, and entered into among the Russian Federation, Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Republic of Moldova, Tajikistan, Turkmenistan, Ukraine and Uzbekistan, the parties thereto did, in fact, agree to apply the provisions of Article 83 *bis*, *inter se*, prior to its coming into force.

This is the only example of a multilateral Article 83 *bis* agreement registered with ICAO – all the others showing on the ICAO database at the time of writing are bilateral in nature.[762]

In the absence of a delegation under Article 83 *bis*, the state of registry may set certain requirements where aircraft on its registered are leased to operators in another state. For example, in Ireland, the aviation authority must be satisfied that, where aircraft registered in Ireland are to be leased to operators elsewhere, the air operator's certificate of the operator must extend to the leased aircraft, the operator's facilities and maintenance arrangements must be acceptable to it, and deregistration will be required in any instance where such requirements are not met, in order to avoid Ireland's being in breach of its obligations as the state of registration under Article 20 of the Chicago Convention.[763] Of necessity, this will require an examination of each case individually whereas an Article 83 *bis* delegation can be as broad as the terms of delegation set out therein.

3.15.9 IDERA

Given the difficulties faced by lessor in enforcing deregistration powers of attorney, the Cape Town Convention and Aircraft Protocol introduced[764] a new form of Irrevocable Deregistration and Export Request Authorization (IDERA), the form of which is set out in the Annex to the Aircraft Protocol. The form set out in the Annex must be used and not

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[760] *Annex 6 to the Convention on International Civil Aviation: Operation of Aircraft*, ICAO, 8th edition, 2001, at 3-1, and *Annex 8 to the Convention on International Civil Aviation: Airworthiness of Aircraft*, ICAO, 10th edition, 2005, at II.1.1.
[761] Article 83 *bis* (b).
[762] http://www.icao.int/applications/dagmar/main.cfm?UserLang= on 8 April 2011.
[763] Aeronautical Notice of the Irish Aviation Authority, Nr SP1A, Issue 2, 31 March 2000 (Arrangements for Maintenance of Irish Registered Commercial Transport Aircraft Leased to Overseas Operators) pursuant to Article 18 of the Irish Aviation Authority (Airworthiness of Aircraft Order) (S.I. No. 324 of 1996) and Part VIII of the Irish Aviation Authority (Operations) Order (S.I. 19 of 1999).
[764] Article 13(2) of the Aircraft Protocol.

altered. Under Article 13(3) of the Aircraft Protocol, the person in whose favour the IDERA is granted is the only person who may procure the deregistration and export remedy set out in Article 9(1) of the Aircraft Protocol and may do so only in accordance with the terms of the IDERA "and any applicable safety laws and regulations".

Article 13(3) goes on to provide that the authorization may not be revoked without the consent of the party in whose favour it is made and Article 13(4) provides that the relevant registry authority "shall expeditiously co-operate with and assist the authorized party in the exercise of the remedies…".

The provisions regarding the IDERA therefore systematically attempt to resolve each of the shortcomings of the deregistration power of attorney and seek to remove the discretion of the aviation authority.

So far, the only case of which this author is aware involving an attempted use of an IDERA involves an aircraft registered in Ireland. Apparently, the Irish Civil Aviation Authority refused to deregister an aircraft on the Irish register but operated by a Mexican operator and subject to an Article 83 *bis* transfer to the Mexican authority on the grounds that the party authorized by the IDERA had not first secured repossession of the aircraft and removed all Irish registration marks, on grounds relating to the reference to "applicable aviation safety laws and regulations" in Article 13. This has not at the time of writing been fully confirmed[765] or finally resolved but, if true, would be remarkable, given that nothing in the Cape Town Convention or the Aircraft Protocol links enforcement of the IDERA to prior repossession of the aircraft.

It is at least consistent with the general rules relating to deregistration where the Irish Aviation Authority requires proof, *inter alia*, of removal of registration marks[766] but even here it should be pointed out that the regulations governing cancellation of registration do not provide for such requirements.[767]

It is unclear what is the Irish Aviation Authority's concern as to safety laws and regulations since, pursuant to the Article 83 *bis* transfer, oversight of compliance with Articles 12 (Rules of the Air), 30 (Aircraft Radio Equipment), 31 (Certificates of Airworthiness) and 32(a) (License of Personnel) of the Chicago Convention are transferred from the state of registration and "[t]he State of registry shall be relieved of responsibility in respect of the functions and duties transferred". There are no other safety obligations imposed on the state of registration by the Chicago Convention and no other grounds in the Cape Town Convention for not deregistering upon presentation of a valid IDERA.

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[765] See, however, the proceedings of *The Cape Town Convention after Three Years* participatory seminar on advanced contract, registration and transaction practices held at Freshfields, London on 18 March 2009, Session III: Legal Opinions, Closings and Opinions.

[766] http://www.iaa.ie/index.jsp?n=396&p=321 on 7 April 2011.

[767] Section 18(1) of the Irish Aviation Authority Nationality and Registration of Aircraft order 2005 (S.I. No. 634 of 2005).

If the above report is true, this author submits that the Irish aviation authority may be mistaken in law, at least to the extent that a full transfer of oversight was made. The only plausible explanation is that, if the registration marks remain on the aircraft, and the Irish aviation authority did not transfer oversight of airworthiness, it could remain liable as the state of registration.

Further, if it is followed in future cases, it will greatly limit the value of the IDERA.

Both in the case in question, and in previous cases in which this author has been involved, the operator had refused to divulge the whereabouts of the aircraft to the owner and was refusing to pay the owner for it. In such cases, repossession is not possible, and deregistration[768] is one of the few practical remedies open to the owner. It may not restore possession to the owner but at least it prevents the airline from operating the owner's aircraft for reward while failing to pay the owner for the use of its asset.

3.15.10 Indemnity claim

Usually, a lessor will, upon a default, in practice, be willing to take repossession of its aircraft and to remarket it – it may not be worth the cost in terms of money and time to pursue the lessee for unpaid rent. That said, a lessor will not wish to waive its right to make such a claim. Except for claims regarding inadequate condition of the aircraft of redelivery, such money claims are largely beyond the scope of this study but there is one point worth noting here.

Leases typically give the lessor the right to obtain indemnification from the lessee not only for unpaid rent but for any other losses incurred by the lessor. The lessor, certainly under English law, has a duty to mitigate its loss but, having done so, if it leases the aircraft out at a lower rent than from the defaulting airline, will reserved the right to claim the difference under the defaulted lease and the replacement lease for what would have been the balance of the term of the defaulted lease.

Further, it may mitigate its loss by deciding to sell the aircraft, rather than leasing it (if it cannot do so on reasonable terms) or leaving it producing no income off lease on the ground, in which case, the lessor will likely reserve the right in the lease to pursue the airline for indemnification of the diminution in value of selling the aircraft in the condition as when repossessed from the defaulting lease as compared with sale of the aircraft with no such diminution of value or sale of the aircraft with the lease attached as if there had been no such diminution.

[768] By the owner itself *qua* owner in case of registration in the case of owner registration or by the owner pursuant to enforcement of a deregistration power of attorney, as discussed at 3.15.7 *supra*, or IDERA, in the case of operator registration.

In this regard, parties should note the English High Court case of *Protea Leasing Limited v Royal Air Cambodge and others,*[769] where Moore-Bick J held that, even if the lessor acted in a commercially reasonable manner in response to a difficult situation facing it, and even if it had done a great deal of work to the aircraft and had attempted to sell or lease the repossessed aircraft, nevertheless, the lessor is obliged to give credit to the lessee for the value of the aircraft in repossession, not the price for which it was eventually sold (if lower):

> "If [the lessor] dealt with the aircraft in a manner which prevented it from realizing their full value, it cannot in any event pass the resulting loss on to [the lessee] by giving credit only for the price actually obtained."[770]

3.15.11 Conclusions

The ability to enforce remedies for breach of contract is a key to its being an enforceable contract: if a contract may be breached without the breach giving rise to remedies, or to remedies which cannot be enforced, it is not a contract which may be relied upon.

Most often, the breach under an aircraft operating lease will be by the lessee. Depending on the breach, the lessor may wish to sue for unpaid rent or for other damages. It may wish to terminate the leasing of the aircraft – and thus terminate the contractual relationship between the parties - and to recover possession of its aircraft.

The Cape Town Convention generally upholds the agreement of the parties as to agreed events of default and agreed remedies upon the occurrence of such events of default. Exercise of such remedies may be tempered in the case of bankruptcy of the lessee[771] or by, for example, provisions of private air law instruments such as the Rome Convention where this is in force.

Even if physical possession of the aircraft and its records is achieved, the aircraft must still be deregistered, if it is registered in the name of the lessee, and this author makes certain recommendations in Part 4 as to Article 83 *bis* of the Chicago Convention and the IDERA under the Cape Town Convention whereby this can be more readily achieved.

Termination of the leasing of the aircraft for breach is one way by which the contractual relationship between the lessor and the lessee may be ended. Another way to terminate the relationship, not involving a breach, is for the leasing of the aircraft to continue, but for the lessor to assign its interest in the aircraft, together with the lease thereof, to another lessor, which assignment is examined next.

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[769] [2002] EWHC 2731 (Comm).
[770] *Id.*, at 67 *et seq.*
[771] Discussed at 3.14 *supra.*

3.16 Assignment

Assignment by a lessor upon a sale or upon a financing of the aircraft by the lessor will here be examined in turn.[772]

If a lessor decides to sell to a third party the aircraft, subject to the lease to the lessee,[773] the buyer will want an assignment in its favour of the lessor's interest in the lease, in addition to acquiring title to the aircraft.

If a lessor raises finance on a secured basis, with security for repayment of the loan consisting of the lessor's ownership of the aircraft and rights under the lease of that aircraft, the lessor's lender will require, in addition to a mortgage or other security over the aircraft, an assignment of the lessor's rights, but not its obligations, under the lease.

Where the lessor's interest in the lease itself is registrable as an "international interest" under the Cape Town Convention,[774] an assignment thereof, being an assignment related to an "international interest"[775] is likewise registrable thereunder[776] and thereby gains priority over any other interest subsequently registered and over an unregistered interest.[777]

Assignments are either absolute, in the case of a sale, or by way of security, in the case of a financing, each of which will next be examined.

3.16.1 Absolute assignment

An absolute assignment normally takes place upon the sale of the aircraft by the lessor, subject to the lease, to a third party. Such an assignment is, in practice, rare, since the lessor cannot assign its obligations without the consent of the lessee, only its rights.[778]

Where both the lessor's rights and obligations are assigned, this is typically pursuant to a novation, if the lease is governed by English law, or an assignment and assumption, if the lease is governed by New York law, whereby the assignor transfers both its rights and obligations under the lease and the assignee assumes both the assignor's rights and obligations thereunder.

A lessee will often require that any such assignee be reasonably experienced in aircraft leasing, that it have a minimum net worth or have its obligations guaranteed by another party having such minimum net worth and, sometimes, that it not be a competitor of the

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[772] *Vide* Section 14 of the Supplement *infra*.
[773] The lessor cannot sell the aircraft free of the lease due to the quiet enjoyment right of the lessee under the lease discussed at 3.10.1.1 *supra*.
[774] Article 2(2) and Article 16(1)(a).
[775] Article 1(b) of the Cape Town Convention.
[776] Article 16(1)(b).
[777] Article 29(1).
[778] Also, *vide* 3.9 *supra*.

lessee[779]. As the lessee must be a party to a novation or an assignment and assumption, it is in a good position to ensure that its legal position is adequately safeguarded through legal representation.

3. 16.2 Assignment by way of security

By way of contrast to an absolute assignment, under an assignment by way of security, a lessor assigns only its rights, not its obligations, to a third party by way of security by the performance by it of some obligation owed by it to such third party.

Under English law,[780] in order for such an assignment to be a statutory assignment,[781] notice of such assignment must be served on the lessee and, once such notice has been given, it is a legal assignment such that the assignee can directly enforce the assignor's rights under the lease as against the lessee without joining the assignor to the action.

On the other hand, if notice is not given, the assignment can, under English law, only amount to an equitable assignment, such that the assignee can still enforce its rights under the assignment but can only do so by joining the assignor to any action against the lessee.[782]

Although it is the giving of notice which makes an assignment a legal assignment under English law, in practice, an acknowledgment of such notice is typically requested of the lessee. The reasons are not only evidentiary, in relation to receipt of the notice, but because sometimes additional obligations are therein undertaken.[783] In the English High Court, Moore-Bick J held in *Protea Leasing Limited v Royal Air Cambodge Company Limited* [784] that, correctly drafted, assignment language could be construed such that:

> "[i]n the absence of any notice of default… the right to recover rent and other payments due under the lease remained vested in [the assignor]."[785]

As consideration for providing such notice, the lessee typically requests a letter of quiet enjoyment from the assignee to the effect that, so long as the lessee performs its obligations under the lease, the assignee will not interfere in the lessee's quiet enjoyment or possession of the aircraft**.**

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[779] Thereby addressing the need for caution on the part of the lessee addressed in Bunker D H, *International Aircraft Financing, Volume 2: Specific Documents*, IATA, 2005 at 190-192.
[780] First introduced into England by Section 25(6) of the Judicature Act 1873 as initially replaced by Section 136 of the Law of Real Property Act 1925.
[781] *Vide* 3.9 *supra.*
[782] *Vide* 3.9 *supra*.
[783] Typically, including to the effect that the lessee is still to discharge its obligations to the assignor until it receives a notice from the assignee that the assignor has defaulted under its secured obligations, whereupon henceforth the lessee is to discharge its obligations to the assignee.
[784] [2002] EWHC 2731 (Comm).
[785] *Id.*, at 213.

Even with such a letter of quiet enjoyment, lessees are sometimes justifiably nervous that such assignments by way of security may negatively affect them - they do take a limited credit risk of the lessor in respect of reimbursement of maintenance reserves and security deposit.

Such lessees may take some comfort from the English Privy Council case of *The Nippon Credit Bank Limited v Air New Zealand Limited*,[786] an appeal against a decision of the Court of Appeal in New Zealand. This involved an aircraft lease where "upon redelivery" the lessor was to reimburse the lessee for certain modification work undertaken by the lessee airline to extend the range of the aircraft. The lessor had sold the aircraft and assigned the lease to another company, which in turn granted a mortgage over the aircraft and granted an assignment over its rights under the lease in favour of its creditor bank. At the time of redelivery, the new owner defaulted under its loan and the bank sought to enforce the assignment of the lessor's rights under the lease.

Air New Zealand argued that it had a workman's lien for the modification work and that its obligation to return the aircraft was conditional upon its being paid the reimbursement amount. The bank argued that it had a proprietary interest in the aircraft, that there was no lien, and that the obligation to return was unconditional: the airline should, in its view, return the aircraft and claim against the liquidator of its debtor for the reimbursement amount.

On the drafting of the lease, the court held, by a majority, that no lien arose outside of the lease, such that this case involved the proper construction of the lease terms. Accordingly, Air New Zealand was entitled to be paid the reimbursement amount at the time it redelivered the aircraft. It is submitted that the dissenting judgment of Hoffmann L and Saville L make for better law: they pointed out that nothing in the lease made the redelivery of the aircraft conditional upon receipt of the reimbursement payment and that there was no basis (whether in law or by way of trade practice) for implying any form of lien.

3.16.3 Conclusions

Assignments by the lessor may be absolute assignments or assignments by way of security in favour of lessor's financiers. Lessees should be careful to ensure that their obligations are not increased – or their credit exposure to their lessor increased – as a result thereof and should insist on having their legal expenses in that regard covered by the lessor.

Assignments are generally dealt with under the governing law thereof, which in practice tend to follow the governing law of the underlying instrument the subject thereof, in this case the lease.

The Cape Town Convention provides protection for assignees where the assignment is registered on the international registry, as discussed above.

[786] [1997] UKPC 60.

3.17 Governing law

Typically, aircraft operating leases are expressed to be governed by English or New York law.[787] However, some may be governed by other law, for instance, Québec, Ontario or California law are occasionally encountered in practice also. The preference for England and New York is due to the existence of "well-developed commercial legal precedents"[788] in those jurisdictions.[789]

In transactions where the Cape Town Convention applies, and if the relevant contracting state has made a declaration to that effect,[790] then, the parties to a lease agreement:

> "may agree on the law which is to govern their contractual rights and obligations, wholly or in part."[791]

Unless they further agree to the contrary, such law shall be construed as a reference to:

> "the domestic rules of law of the designated State or, where that State comprises several territorial units, to the domestic law of the designated territorial unit."

It thus appears, although it is not made explicit, that, where the Cape Town Convention applies, if it is intended that the rules of private international law of a jurisdiction should be disapplied to a lease contract so that only the substantive laws of that jurisdiction are applied,[792] this need not be made explicit in the governing law clause of the lease.[793] Nevertheless, there is no harm in doing so in order to put the matter beyond doubt.

Within the European Union, Regulation (EC) No 593/2008[794] and Regulation (EC) No 864/2007[795] apply.

Rome I applies to "contractual obligations in civil and commercial matters"[796] but excludes various agreements including "agreements on the choice of court."[797] Article 3(1)

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[787] Bunker D H, *International Aircraft Financing, Volume 2: Specific Documents*, IATA, 2005, at 197-198.
[788] *Ibid*.
[789] *Vide* Section 15 of the Supplement *infra*.
[790] Under Article 71(1).
[791] Article 9(2).
[792] Thus avoiding the risk that the substantive laws of a different jurisdiction might instead be applied due to the application of the rules of private international law of the desired jurisdiction. See the discussion of the doctrine of *renvoi* at 3.10.2.4.3 *supra*.
[793] The governing law clause examined in Bunker D H, *International Aircraft Financing, Volume 2: Specific Documents*, at 197, does not provide for an explicit exclusion of the rules of private international law.
[794] Regulation (EC) No 593/2008 of the European Council and of the Parliament of 17 June 2008 on the law applicable to contractual obligations (Rome I).
[795] Regulation (EC) No 864/2007 of the European Parliament and of the Council of 11 July 2007 on the law applicable to non-contractual obligations (Rome II).
[796] Article 1.1.

recognises the freedom of choice of the contract parties to choose the governing law of the contract.

This freedom is limited only by Article 3(3), whereby if all other relevant elements are in a country other than that the laws of which have been chosen, the chosen law will not prejudice provisions of the law of the other country which cannot be derogated from. Article 3(4) provides likewise for where all other relevant elements are within one or more European Union member states. Further, Article 9(9) provides for overriding mandatory provisions "regarded as crucial by a country for safeguarding its public interests."

Rome II applies to "non-contractual obligations in civil and commercial matters,"[798] such as torts/delicts[799] including product liability.[800] Article 14(1)(b) allows parties pursuing a commercial activity freedom of choice to choose the governing law, subject to Articles 14(2) ad 14(3), which reflect Articles 3(3) and 3(4) of Rome I respectively.

Article 16 provides for overriding mandatory provisions of the law of the forum which apply irrespective of the law otherwise applicable to the non-contractual obligation.

Where Rome I and Rome II may apply, therefore, it would be better, if the parties wish for greater certainty, for the governing law clause to make clear that it extends not only to contractual but to non-contractual obligations also.

Even outside the European Union, in cases not covered by Rome I or Rome II, public policy exceptions typically apply to the choice of governing law. To take just two examples, in Canada, a choice of law will generally be upheld unless "contrary to public policy, or if…made for the purpose of avoiding a mandatory provision…"[801] and, in China, a choice of law will be upheld "unless the choice would violate the fundamental principles of Chinese law or the public interest…"[802]

The jurisdictional questionnaire[803] and legal opinion[804] should make clear that the courts of the jurisdiction covered thereby will enforce a choice of governing law as set out in the lease and will not seek to impose the laws of another jurisdiction and should make clear any exceptions or qualifications in that regard.

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[797] Article 1.2(e).
[798] Article 1(1).
[799] Chapter II.
[800] Article 5. McBain G, *Aircraft Finance: Registration, Security and Enforcement*, General Editor, Sweet & Maxwell, 2000
[801] McBain G, *Aircraft Finance: Registration, Security and Enforcement*, General Editor, Sweet & Maxwell, 2000, Canada-34.
[802] *Id.,* at China-22.
[803] *Vide* 2.4 *supra*.
[804] *Vide* 2.5 *supra.*

3.18 Dispute resolution

3.18.1 Contractual agreement

Goode comments that:

> "the typical international contract is likely to involve points of contact with several states, and this gives considerable opportunity to the plaintiff and his advisers to engage in forum shopping and to select the state whose law and procedural rules are most favorable to the claim."[805]

It is for this reason that an aircraft operating lease will typically set out a dispute resolution clause, providing for exclusive or non-exclusive jurisdiction to be granted to stated courts, or providing instead for settlement of disputes by arbitration.[806] The choices made, and any other requirements, such as the advisability of having an agent for service of process within the jurisdiction, should be guided at least in part by the result of the jurisdictional questionnaire.[807]

For transactions where the Cape Town Convention applies, Article 54(1) provides that, save as provided in Articles 55 and 56, the courts of a contracting state chosen by the parties shall have jurisdiction in respect of any claim brought under the Convention,

> "whether or not the chosen forum has a connection with the parties or the transaction. Such jurisdiction shall be exclusive unless otherwise agreed between the parties".

Article 55(1) allows such chosen forum as well as the courts of the contracting state in which the aircraft is registered and those of the contracting state in which such aircraft is situated jurisdiction to grant orders for:

> "(a) the preservation of the aircraft object and its value;
>
> (b) possession, control or custody of the aircraft object;
>
> (c) immobilization of the aircraft object;"[808]

as well as to:

> "(a) procure the de-registration of the aircraft; and

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[805] Goode CBE QC Sir Roy, *Commercial Law*, 2nd edition, Penguin Books, 1995.
[806] *Vide* Section 15 of the Supplement *infra.*
[807] *Vide* 2.4 *supra.*
[808] Article 20(1).

(b) procure the export and physical transfer of the aircraft object from the territory in which it is situated."[809]

Thus, the agreed forum has jurisdiction to order the deregistration of an aircraft even if the aircraft is registered elsewhere and to order the export and physical transfer of the aircraft even if it is located elsewhere.

In the unlikely event that no dispute resolution is chosen in the lease, it is not automatic that the courts of the jurisdiction whose law is chosen as the governing law will have jurisdiction: in other words, simply agreeing, for example, that a lease be governed by English law is not the same thing as submitting to the jurisdiction of the English courts, where the English courts would not otherwise have jurisdiction. Thus held the English Court of Appeal in *Novus Aviation Limited v Onur Air Tasimacilik AS.*[810] That case involved a wet lease, which, as discussed at 1.2.1 supra, is often negotiated under great time pressure and thus may not be properly negotiated.

In *Novus,* the lease provided that it was to be "governed and construed with English law" but there was no jurisdiction clause. Wilson LJ held *per curiam*, on appeal, here that the burden of relying on the governing law provision to determine the correct jurisdiction is a heavy one and that too much importance should not be placed on the governing law clause. On the other hand, given, *inter alia,* language differences, the English courts were clearly in a better position to construe the lease than Turkish ones. Neither party was a native English speaker – English was chosen since neither party spoke the other's language. The only connection to England was the governing law clause. Provided that the judge did not treat the governing law clause as equivalent to a submission to jurisdiction clause, which he did not do here, he was entitled, however, in this finely balanced case, to conclude that England was an appropriate forum.

The lessor should also consider, based on the jurisdictional questionnaire, discussed at 2.4 *supra*, whether it is better to provide for submission to binding arbitration, particularly where the lessee's jurisdiction is a party to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards:[811] recognition of foreign courts' judgments is not governed by any treaty.

Thus, if the jurisdictional questionnaire indicates a reluctance on the part of courts in the lessee's jurisdiction to enforce foreign courts' judgments, but such jurisdiction is a party to this Convention, submission to arbitration coming within the scope of such Convention may be preferable as a dispute resolution provision in the lease.

[809] Article 15(1), as referenced in Article 20(7), itself as referenced in Article 55.
[810] [2009] EWCA Civ 122.
[811] Signed at New York on 10 June 1958.

3.18.2 Third parties and *forum non conveniens*

We have examined *supra* at 3.11.2 liability of the lessor for damage to third parties. In this context, we consider the situation where a third party claim[812] is brought against the lessor in a particular forum on the basis that the lessor and the lessee have agreed that that particular forum is to have jurisdiction to hear disputes arising out of or in connection with the aircraft lease agreement.

In *Gambra v International Lease Finance Corp.*,[813] the plaintiffs in an air crash litigation case involving Flash Airlines of Egypt failed to defeat a *forum non conveniens* motion where they named the aircraft lessor as the defendant and relied on the choice of jurisdiction clause in the lease between that lessor, based in California, and the lessee airline. The only connection to California was the fact that the lessor was based there and the relevant submission to jurisdiction clause in the lease. The lease provided that:

> "Lessor and Lessee hereby… irrevocably waive any claim that any such suit, action or proceeding brought in any such court has been brought in an inconvenient forum."[814]

Plaintiffs argued that they were entitled to rely on this clause as third party beneficiaries of the lease. On the terms of the lease, the court rejected this argument, holding that:

> "the forum selection clause does not govern the claims of plaintiffs against the defendants in these cases. The lease governs the obligations of ILFC and Flash with respect to the subject aircraft, not the liability of either of them to those passengers and crew aboard the subject aircraft."[815]

Condon & Forsyth[816] note that this case provides "valuable guidance" on how to draft aircraft leases so as to minimize the risk that their terms may be used to defeat *forum non conveniens* motions.[817]

In *Esheva v Siberian Airlines,*[818] a similar case brought in the courts of the Southern District of New York where the only United States connection was the fact that the

[812] That is, a claim brought by a party other than a party to the contract.
[813] 377 F. Supp. 2d 810 (C. D. Cal. 2005).
[814] *Id.*, at 821.
[815] *Id*., at 822-823.
[816] Condon & Forsyth Newsletter, *Attempts by plaintiffs to defeat forum non conveniens motions by alleging aircraft owner or lessor liability*, Newsletter, Winter 2008, at 2.
[817] In an update in its Spring 2008 newsletter, Condon and Forsyth, *49 U.S.C. Section 44112(B): Limits on the liability of aircraft owners and lessor*, Condon & Forsyth Newsletter, Spring 2008, at 7, the authors note that, although the California court dismissed the case to France on grounds of *forum non conveniens*, the French court itself dismissed the case on the basis that none of the defendants was domiciled in France and the incident did not occur in France.
[818] 499 F. Supp. 2d 493 (S.D.N.Y. 2007).

lessor, Airbus Leasing II, Inc., of the aircraft to the airline involved in the crash, was based in the United States and the lease between it and the airline had a jurisdiction clause submitting to such jurisdiction, the court had no hesitation in rejecting the plaintiffs' attempt to defeat a *forum non conveniens* motion.

The court held that there was a "compelling argument" that the lessor had been added to the proceedings "solely to provide some American nexus to the litigation" and that the contractual relationship between the lessor and lessee "had no…relevance to the motion."[819]

3.18.3 Conclusions

Parties should be guided by the jurisdictional questionnaire[820] in deciding whether to provide for litigation or arbitration to resolve disputes and in choosing the forum for dispute resolution. Where the Cape Town Convention applies, such choice of the parties will be upheld, but it is not binding on third parties.

As part of their decision making process, parties should also consider more broadly the track record of the courts of such jurisdiction, and their level of expertise and experience, in determining complex cross border litigation involving high value assets such as commercial aircraft.

[819] *Id*., at 499, no. 4.
[820] *Vide* 2.4 *supra.*

3.19 Miscellaneous

This boilerplate language is often glossed over by lawyers for both sides but should be carefully examined since a judge will take care to read them should a dispute end in litigation.[821]

3.19.1 Time of the essence

Leases will typically contain a provision that time is of the essence to performance of the parties' obligations thereunder. Thus, the lessee should accept delivery by the final date provided therefor, should pay rent and reserves when due, and should redeliver the aircraft in a timely manner in the required contractual condition, failing which, the lessor should be free to exercise its remedies as set out in the lease and any other remedies available to it at law.

In *Celestial Aviation Trading 71 Limited v Paramount Airways Private Ltd,*[822] Hamblen J of the English High Court[823] was asked to rule on the plaintiff's submission[824] that equity does not intervene to relieve a party from the termination of a contract for a failure by that party to perform an obligation by a fixed date where the parties have made time of the essence expressly or by necessary implication, where the plaintiff cited an authority, albeit in connection with real estate, *Union Eagle Ltd. v Golden Achievement Ltd.,*[825] where Hoffman LJ, for the Privy Council, reaffirmed the principle that:

> "in cases of rescission of an ordinary contract of sale for land for failure to comply with an essential condition as to time, equity will not intervene."

While Hamblen J accepted in *Celestial* the *Union* judgment insofar as land was concerned, he did not accept in this case, involving an aircraft, that the

> "mere inclusion of a time of the essence clause provision necessarily excludes the relief jurisdiction."[826]

Unfortunately he did not give his reasons for making such a distinction. It should be concluded that such clauses should continue to be included since, even if their inclusion is not treated as conclusive, their omission may tempt a court to grant relief to a dilatory lessee even more readily.

In a New York case, *Austrian Airlines Oesterreichische Luftverkehrs AG v UT Finance Corporation,*[827] Kaplan J of the United States District Court, Southern District of New

[821] *Vide* Section 16 of the Supplement *infra.*
[822] [2010] EWHC 185 (Comm).
[823] Queen's Bench Division, Commercial Court.
[824] *Id.,* at paragraphs 76-80.
[825] [1997] AC 514, at 523.
[826] *Id.,* at 79.

York, refused to hold that a willingness to discuss extending a deadline for delivery of an aircraft meant that the deadline could be ignored and held that the plaintiff had failed to show that the defendant had waived its right to timely delivery. The legal analysis here, then was not of whether or not to uphold the clause but whether or not the defendant had waived its right to rely on it.

3.19.2 No waiver

Leases should contain a clause to the effect that no delay by lessor in enforcing its rights thereunder constitute a waiver of such rights, and any such waiver must be in writing signed by the lessor.

Although such inclusion is standard practice, of itself, it is not enough to protect the lessor, at least under English law. In *Tele2 International Card Company SA v Post Office Ltd*.,[828] the English Court of Appeal, holding that such clauses were of no particular benefit to the party seeking to rely on them except perhaps to emphasise that a right will only be waived if so communicated to the other party, found in favour of a party in breach where the other party knew of the breach but did nothing for a year, reasoning that its normal continued performance without complaint constituted such a communication. As a result, English law firms recommend that, as soon as a party becomes aware of a breach, it right to the other side at once, informing them thereof and reserving expressly its rights.[829]

3.19.3 Entire agreement

Leases will typically contain a provision that the terms thereof set out the entire agreement of the parties with respect to the subject matter thereof. The idea is to exclude extrinsic evidence of agreements or representations not set out in the lease itself which may contradict or impede enforcement of the lease upon the terms set out therein.

Typically, such clauses will also go on to provide that amendments to the lease may only be made in writing signed by both lessor and lessee.

In *Lithoprint (Scotland) Ltd. v Summit Leasing Ltd. & Others,*[830] Milligan J of the Scottish Court of Session held that a side letter entered into prior to execution of a lease and not referred to in the lease could, even if it did not come within such requirements of a lease, nevertheless be upheld as a collateral agreement in its own right, particularly where it did not contradict the terms of the lease. He also noted[831] that in commercial contracts, the

[827] 04 Civ 3854 (LAK) (2008).
[828] [2009] All ER (D) 144 (Jan).
[829] *Vide, e.g.*, Thomson K, *Waving goodbye to your rights*, Banking Update, Linklaters, 14 June 2009.
[830] [1998] ScotCS 36 (23 October 1998).
[831] *Id.*,at 8.

argument for admitting collateral agreement is stronger than in other cases and that it is easier to import collateral agreements where standard forms are used.[832]

3.19.4 Waiver of sovereign immunity

In addition to providing for representations and warranties in the lease that the airline is not entitled to claim sovereign immunity, it may be advisable to include a separate clause to the effect that, if the airline is or ever becomes entitled to claim such immunity, it waives such rights in respect of any claim brought against it by the lessor under or in connection with the lease or the aircraft.

Traditionally, under public international law, a sovereign state enjoyed absolute immunity "for all activities whether governmental or commercial."[833] It was thus held by the English Court of Appeal in *The Cristina* that:[834]

> "the courts of a country will not implead a foreign sovereign…whether the proceedings involve process against his person or seek to recover from him specific property or damages."

A development to public international law in this regard is the European Convention on State Immunity[835] which provides for certain exceptions in that a contracting state cannot claim immunity from the jurisdiction of the courts of another contracting state, *inter alia,* in the case of a counterclaim where it institutes the proceedings,[836] or has expressly consented to jurisdiction,[837] if it has on the territory of the state of the forum an establishment through which it engages, in the same manner as a private person, in an industrial, commercial or financial activity, and the proceedings relate to that activity of the office,[838] and, of particular interest in the case of an aircraft lease:

> "A Contracting State cannot claim immunity from the jurisdiction of a court of another Contracting State if the proceedings relate to:
>
> a. its rights or interests in, or its use or possession of, immovable property; or
> b. its obligations arising out of its rights or interests in, or use or possession of, immovable property

[832] Such is not generally the case with operating leases of commercial aircraft, such leases typically being fully negotiated.
[833] Clark T (editor), *Leasing Finance*, Euromoney, 1985, at 80.
[834] [1938] A.C. 485.
[835] Signed at Basle on 16 May 1972.
[836] Article 1.
[837] Article 2.
[838] Article 7.

> and the property is situated in the territory of the State of the forum."[839]

At the national level, for example, in the United States, under the Foreign Sovereign Immunities Act of 1976, a foreign state, defined in Section 1603 to include its political subdivisions, agencies and instrumentalities, shall:

> "[s]ubject to existing international agreements to which the United States is a party at the time of enactment of this Act…be immune from the Jurisdiction of the courts of the United States and of the States except as provided in sections 1605 to 1607 of this chapter."[840]

The main exceptions of concern in the context of this study are as follows:

> "A foreign state shall not be immune from the Jurisdiction of courts of the United States or of the States in any case
>
> "(1) in which the foreign state has waived its immunity either explicitly or by implication, notwithstanding any withdrawal of the waiver which the foreign state may purport to effect except in accordance with the terms of the waiver;
>
> "(2) in which the action is based upon a commercial activity carried on in the United States by the foreign state; or upon an act performed in the United States in connection with a commercial activity of the foreign state elsewhere; or upon an act outside the territory of the United States in connection with a commercial activity of the foreign state elsewhere and that act causes a direct effect in the United States;"[841]

A lessor would argue that even in the case where a lessee falls within the definition of a "foreign state" for the purposes of this statute, entering into an aircraft lease for the purposes of leasing a commercial aircraft constitutes a "commercial act" for the purposes of Section 1605(a)(2) of this statute also. Nevertheless, obtaining an express waiver provides an additional strong argument under Section 1605(a)(1).

In *Kuwait Airways v Republic of Iraq,*[842] the Canadian Supreme Court unanimously allowed a claim by Kuwait Airways against the Republic of Iraq to proceed to enforce a judgment of the English courts against the latter, despite the assertion of sovereign immunity by the latter, where the acts complained of consisted of the seizure of aircraft of the former by Iraqi Airways Company during the 1990 Gulf War. The Canadian Supreme

[839] Article 9.
[840] Section 1604.
[841] Section 1605(a).
[842] 2010 SCC 40.

Court held that Iraq had funded, controlled and supervised the litigation on behalf of Iraqi Airways, and that this involvement by Iraq fell within the "commercial activity" exception to the international law doctrine of state immunity. The Court held this on the basis that, even though the original appropriation of the aircraft by Iraqi Airways Company was a sovereign act, the subsequent retention and use of the aircraft by Iraqi Airways Company constituted commercial acts and thus fell within an exception to the claim for sovereign immunity.

3.19.5 Conclusions

It is all too easy to overlook these “boilerplate” provisions but it is important to read them and to consider them in the context of each transaction as they have been the subject of litigation and of international agreements.

Indeed, each of the time of the essence, no waiver, entire agreement, and waiver of sovereign immunity provisions has been the subject of litigation, as has been demonstrated above.

3.20 Execution

Formalities as to execution, filings that must be made, and other formalities which have to be observed, are all matters that should not be forgotten at this final stage. Reference should be had to the jurisdictional questionnaire and to the legal opinion to ensure that formalities for lease execution are known and have been met.

There is one interesting English High court case involving the lease of a light aircraft. In that case, *Oxford Aviation Services Limited v Godolphin Management Company Limited*,[843] Cooke J held that, on the facts, an agreement for hire or bailment existed on the basis of a draft unexecuted delivery for hire, where the parties had had a history of dealing with one another.

The jurisdictional questionnaire[844] obtained at the outset of a leasing transaction should, at the outset, and the legal opinion[845] at time of signing of the lease should clarify any issues regarding requirements for execution, witnesses, notarization and the like together with confirmation that no stamp duty will be imposed as a result of the place of execution of the lease or otherwise.

Disputes may exist as to the proper interpretation of any contract but no lawyer will want to tell his or her client that there is no contract to enforce at all for want simply of due execution.

[843] [2004] EWHC 232 (QB).
[844] *Vide* 2.4 *supra*.
[845] *Vide* 2.5 *supra.*