CLIFFORD
CHANCE

Briefing note April 2012

A Greek Tragedy: ACG v Olympic Airlines - English Court finds in favour of Operating Lessor; Airline bound by Certificate of Acceptance

Judgment has been handed down on the long-awaited case, *ACG Acquisition XX LLC v Olympic Airlines (in special liquidation) [2012] EWHC 1070 (Comm)*[1], involving the delivery condition of an aircraft leased by ACG to Olympic, the effect of a signed certificate of acceptance and the airline's absolute and unconditional obligation to pay rent.

Background to the dispute

ACG and Olympic entered into a 5 year operating lease of a Boeing 737-300 aircraft. In August 2008, following return from a previous lessee, the aircraft was immediately delivered to Olympic. Shortly after, a defective cable was discovered and the aircraft was withdrawn from passenger service. Investigations uncovered further defects and in September 2008, the Hellenic Civil Aviation Authority (the "HCAA") suspended the aircraft's Certificate of Airworthiness. The aircraft was repaired but the HCAA was not satisfied with its level of compliance with airworthiness directives and refused to reinstate its Airworthiness Certificate. The aircraft remained grounded in Athens and in October 2009, Olympic ceased trading. In March 2010, ACG terminated the lease and demanded return of the aircraft. It sued for rent and maintenance reserves up to November 2010 (when the aircraft was finally returned) and damages for loss of rent from the return date until the intended lease end.

The parties' respective claims

ACG claimed that, following delivery and acceptance, Olympic was liable under the lease to pay rent and maintenance reserves, notwithstanding any unavailability of the aircraft.

Olympic contended that the aircraft was not delivered in the condition required under the lease and, in particular, was not airworthy. Olympic was entitled to damages for breach of lease by ACG. In the alternative, there had been a total failure of consideration or the lease had been frustrated by the HCAA's cancellation of the Certificate of Airworthiness.

ACG argued that, even if the aircraft was found not to be airworthy or in the required delivery condition, Olympic's acceptance of the aircraft meant it was precluded from such claim, either on the basis of contractual agreement or under English law principles of estoppel. Its failure to pay rent and maintenance reserves amounted to a repudiation of the lease.

The condition of the aircraft at delivery

As a finding of fact, the aircraft's principal defect was corrosion, including the corroded flight cable which required the aircraft to be taken out of service shortly after delivery.

Lessor's delivery obligations

The lease included a specific obligation on ACG to deliver the aircraft "as is where is" and in the condition required in the relevant schedule. This was supplemented by a condition precedent in favour of Olympic, as lessee, to be satisfied by ACG that the aircraft should be in such condition.

Meaning of airworthiness – an objective test

The lease schedule detailing the condition of the aircraft at delivery required it to be "*airworthy and in a condition for safe operation*." The court held that the meaning of "airworthy" depends on its true construction in the context of the specific lease, with regard to the facts of which both parties are aware. As the relevant lease was of an aircraft intended for the safe carriage of passengers, in such context, "*the ordinary and natural meaning of airworthy is...fit or safe for the carriage of passengers by air*." It does not depend on whether a defect is known to the operator, thus hidden defects are not excluded.

The appropriate test is "*would a prudent operator of an aircraft have required that the defect should be made good before permitting the aircraft to fly, had he known of it. If he would, the aircraft was not airworthy*." The court was clear that, in the context of a lease of a commercial aircraft intended for the safe carriage of passengers, the reasonable lessor and lessee would expect the requirement of airworthiness to relate to the actual condition of the aircraft.

[1] Fly me to the courtroom November 2010

On this basis, the court found that the aircraft was not airworthy or in a condition for safe operation on delivery. As the specific lease terms imposed on ACG "*an unqualified obligation to deliver the aircraft*" in such condition, it followed that ACG was in breach of the lease.

Lessee's acceptance of the aircraft precluded claims

Under the Certificate of Acceptance signed by Olympic at delivery, it represented (a) that it "*irrevocably and unconditionally accepts and leases from Lessor*" the aircraft and (b) that it confirms the aircraft "*complied in all respects with the condition required at delivery*..", including the clause regarding ACG's own delivery obligations.

Conclusive proof clause not sufficiently clear

The lease itself provided that Olympic's execution of the certificate acceptance was conclusive proof, amongst other things, that it had "*irrevocably accepted the aircraft for lease*". However, it did not refer to compliance with the relevant delivery conditions. On a true construction of the clause, the court held that this was not sufficiently clear to contractually preclude a claim by Olympic for damages for breach of ACG's delivery obligations.

Estoppel

However, with respect to Olympic's specific representation in the Certificate of Acceptance, the court agreed with ACG that, applying the English law principle of estoppel, Olympic was prevented from subsequently alleging that the aircraft did not comply with the required delivery condition under the lease. Estoppel arose because Olympic had made a clear and unambiguous representation intending it to be acted upon, ACG believed the representation to be true and relied upon it to its detriment.

The court also rejected Olympic's assertion that it was unconscionable to preclude it from pursuing a claim against ACG for its breach of a "fundamental" obligation under the lease. This was a case involving a major airline and a lease it had freely negotiated with a leading aircraft leasing company. Although Olympic had limited pre-delivery inspection rights, it did not have to sign the Certificate of Acceptance and it would have appreciated that there might be hidden defects which could not be detected by its inspection.

Other matters

On the basis that Olympic was estopped from claiming that delivery had not taken place in accordance with the lease:

Absolute and unconditional obligation to pay rent

The court dismissed its claim that, where delivery had not occurred in accordance with the lease, its obligation to pay rent and maintenance reserves was never triggered. Rent became due once Olympic accepted and leased the aircraft from ACG.

Total failure of consideration

Olympic was unable to establish a total failure of the performance of the contract for which it had bargained. ACG was obliged to deliver possession of the aircraft to Olympic, which it did in August 2008, and in the agreed condition (Olympic estopped from claiming otherwise).

Frustration

Frustration of a contract occurs where, without default of either party, a contractual obligation becomes incapable of being performed or performance would be radically different from what was undertaken. The lease had not been frustrated by HCAA's withdrawal of the Certificate of Airworthiness. The risk of loss of a certificate of airworthiness was an obvious risk, which would be expected to be assumed by the lessee under a dry lease. Further, there was considerable scope for further performance during the remaining lease term, had the HCAA's requirements for reinstatement of the Airworthiness Certificate been met.

Lessons Learnt

Operating lessors and financiers should consider making clear that the delivery condition of the aircraft, including any statement as to airworthiness, is an objective condition precedent, rather than documenting any positive obligation on the relevant lessor. This is particularly significant in light of the definition of airworthiness, as laid out by the court.

Contacts

Marisa Chan
Senior PSL

T: +44 20 7006 4135
E: marisa.chan
@cliffordchance.com

Julian Acratopulo
Partner

T: +44 20 7006 8708
E: julian.acratopulo
@cliffordchance.com

William Glaister
Partner

T: +44 20 7006 4775
E: william.glaister
@cliffordchance.com

Nick Swinburne
Partner

T: +44 20 7006 2335
E: nick.swinburne
@cliffordchance.com

Robert Burley
Partner

T: +44 20 7006 6611
E: robert.burley
@cliffordchance.com

Ranbir Hunjan
Partner

T: +44 20 7006 2612
E: ranbir.hunjan
@cliffordchance.com