CLIENT UPDATE

COURT OF APPEAL CONFIRMS EFFECTIVENESS OF CERTIFICATE OF ACCEPTANCE AND "CONCLUSIVE PROOF" WORDING IN AIRCRAFT OPERATING LEASE

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In a judgment that is likely to be welcomed by many in the aircraft leasing industry, the English Court of Appeal has upheld the effectiveness of provisions in an aircraft operating lease that purport to place the risk of the condition of the aircraft on the lessee.

In *Olympic Airlines SA (in special liquidation) v ACG Acquisition XX LLC [2013] EWCA Civ 369*, the Court of Appeal unanimously dismissed Olympic's appeal against a May 2012 High Court judgment[1] in favour of Aviation Capital Group, the aircraft operating lessor.

The judgment considered the circumstances in which the defective condition of an aircraft on delivery under an operating lease could entitle the lessee to refuse to pay rent and, in particular, whether the "hell or high water" and "conclusive proof" clauses in the lease, together with the Certificate of Acceptance, allocated the risk of defects in the condition of the aircraft at delivery to the lessee.

The dispute related to a B737-300 aircraft, delivered to Olympic by ACG under a five-year operating lease, immediately following redelivery from the previous lessee.

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1 *ACG Acquisition XX LLC v Olympic Airlines S.A. (in special liquidation) [2012] EWHC 1070 (Comm).*

The aircraft was inspected by Olympic prior to delivery, and a Certificate of Acceptance signed, which contained a confirmation from Olympic that it "*irrevocably and unconditionally accepts and leases*" the aircraft, and that the aircraft "*complied in all respects with the condition required at delivery*". The lease contained a standard "conclusive proof" clause, which provided that delivery would be conclusive proof that the lessee "*has examined and investigated the aircraft*", that the aircraft is satisfactory and that the lessee "*irrevocably and unconditionally accepted the aircraft*". The lease also contained a standard "hell or high water" or "net lease" clause which provided that the lessee's obligations under the lease were absolute and unconditional, irrespective of any contingency including any unavailability of the aircraft or any defect in airworthiness of the aircraft.

Just two weeks after entry into service, the aircraft was grounded following the discovery of, among other defects, broken spoiler cables, and as a result, its Certificate of Airworthiness was withdrawn. Olympic refused to pay rent and maintenance reserves, claiming that the Aircraft was not airworthy on delivery, in breach of an express contractual requirement that the aircraft be "*airworthy and in a condition for safe operation*" at delivery. In other words, it took the stance that the "hell or high water" clause in the lease was subordinated to ACG's overriding obligation to deliver the aircraft in airworthy condition. ACG terminated the lease, demanded return of the aircraft and brought a claim against Olympic for unpaid rent and maintenance reserves, along with damages.

ACG made two alternative submissions in support of its claim. The first relied upon the premise that Olympic was contractually precluded from claiming after delivery and the signing of the Certificate of Acceptance that the aircraft was not in the delivery condition, as the lease provided that the Certificate of Acceptance was conclusive proof that the aircraft was in the delivery condition. With respect to the second, ACG relied upon the English law principle of "estoppel by representation", submitting that Olympic was precluded from asserting that the aircraft was not in the delivery condition, as it had made a clear and unambiguous representation in the Certificate of Acceptance that the aircraft did comply with the delivery condition, which it intended ACG to act upon, and which ACG did in fact act upon, to its detriment.

The trial judge, Mr. Justice Teare, rejected ACG's first submission, but found for ACG on the basis that the Certificate of Acceptance gave rise to an estoppel by representation, notwithstanding that ACG was in breach of the express provision in the lease requiring the aircraft to be airworthy.

On appeal by Olympic, the Court of Appeal upheld Mr. Justice Teare's decision. However, the Court of Appeal went further and agreed that ACG could also recover in accordance

with its first submission. In other words, the "conclusive proof" clause precluded Olympic from subsequently contending that the aircraft was not in the delivery condition, as execution by Olympic of the Certificate of Acceptance constituted conclusive proof that the aircraft was in the delivery condition.

The Court of Appeal recognised that it was commonplace in the aircraft leasing industry for the aircraft to become the sole risk of the lessee after delivery and, accordingly, that lessees commonly accept the risk of defects in the condition of the aircraft, even where it would have been impossible or impractical to discover such defects prior to delivery. The Court of Appeal also acknowledged that Olympic had the opportunity to inspect the aircraft prior to delivery, and raise any discrepancies in the Certificate of Acceptance.

The decision will be welcomed by operating lessors and financiers, as it provides comfort that the contractual mechanisms for risk allocation in operating leases are understood, and will be upheld, by the English courts, and resolves the uncertainty created by the original High Court decision, and the initial summary judgment of 2010 in this matter, as to whether standard provisions such as the "hell or high water" and "conclusive proof" clauses could be relied upon by lessors.

The decision should also not cause too much concern for lessees, as in many ways it simply confirms established market practice in the aircraft operating leasing industry. A prudent and well advised lessee should already have been acting under the assumption that it would be responsible for the condition of an aircraft, and obliged to pay rent in all circumstances, immediately upon acceptance under an operating lease. The decision merely emphasises the need for careful inspections, and the risk inherent in accepting an aircraft on operating lease. In particular, a prudent lessee should not execute a Certificate of Acceptance unless it has properly inspected the aircraft and is satisfied with its condition.

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Please do not hesitate to contact us with any questions.

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