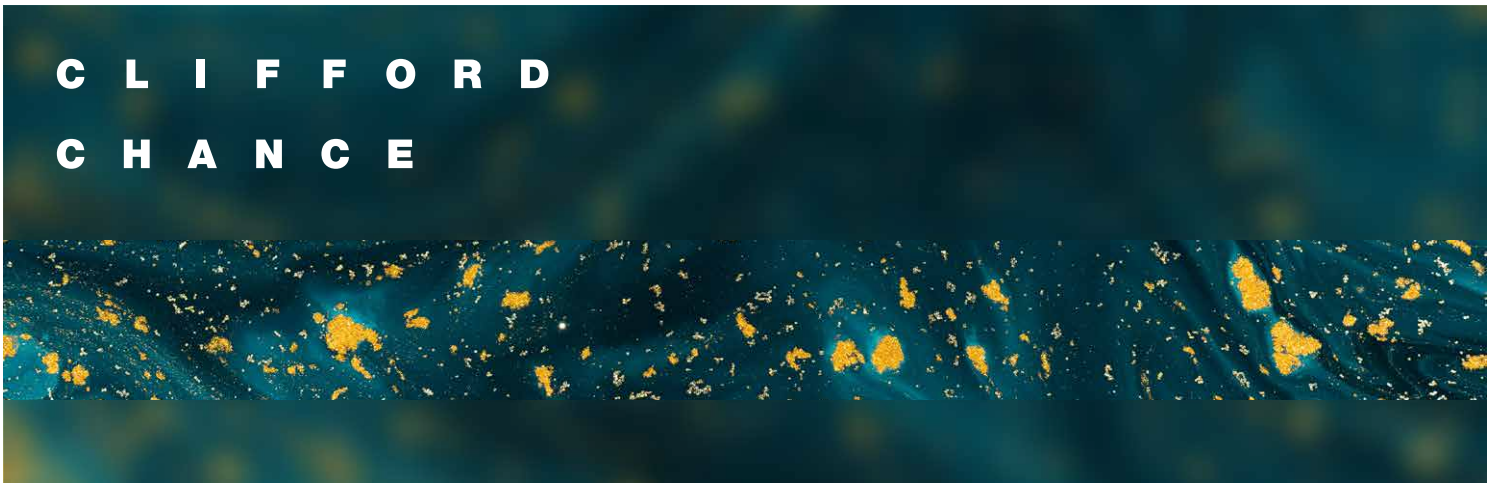

CORONAVIRUS – AIRCRAFT OPERATING LEASES

The aviation sector has been one of the industries most severely and immediately affected by the Coronavirus (Covid-19) outbreak. The decline in commercial passenger travel has put pressure on airlines, particularly those operating in the Greater China and Asia-Pacific region, a number of whom were already competing in a challenging market. Further, the disruption to supply chains, services and human resources for manufacturers, maintenance providers and other industry participants has been significant and is likely to continue in the short to medium term. These issues are considered in our other sector briefings on the rail industry, maritime industry and insolvency and in this briefing, we focus on the discrete considerations for aircraft operating leases.

Hell or high water obligations

An airline lessee facing specific restrictions on flights in and out of an affected region imposed by the relevant state to limit the spread of Covid-19, or having to scale back its routes in response to the sharp decrease in passenger numbers as people curtail their business and leisure travel, may seek relief from its rental and other payment obligations under the lease on the grounds that those restrictions, or the Covid-19 outbreak itself, has impaired its ability to operate and use the aircraft and that it should therefore not be required to pay all or part of the rent due for the relevant period. The lessee may claim that a "force majeure" or similar event has occurred which allows it to suspend or avoid payment and performance under the lease. We discuss force majeure provisions in contracts generally here.

In response, the lessor (or any related financier) should look to the "hell or high water" clause typically included in aircraft operating leases. Generally speaking, this clause provides that the lessee's obligation to pay rent and other amounts (and, in some cases, to perform its other lease obligations) is absolute and unconditional, without set-off or deduction, and regardless of the unavailability of the aircraft or the ineligibility of the aircraft for any particular use or trade, for any reason. The specific clause might include a (non-exhaustive) list of common events leading to such unavailability or ineligibility, such as a total loss where the aircraft is destroyed, lost or damaged beyond repair; government requisition or confiscation; or defect in airworthiness, design, condition, title or merchantability of the aircraft.

In other words, the risk of non-operation of the aircraft during the lease term is assumed by the lessee: this risk allocation is sometimes expressed through the term "net lease". Against this background, it is clear that the parties' commercial agreement is that any interruption to or cessation of the use or possession of the aircraft by the airline should not allow it to suspend or circumvent its payment obligations under the lease.

Where the "hell or high water" clause does not expressly address non-payment obligations, the position may be more nuanced. For example, obligations to effect maintenance undertakings or even to accept delivery of an aircraft under a new lease or to redeliver an aircraft upon lease expiry (whether consensual or non-consensual), could, conceivably, be adversely affected by the consequences of Covid-19. Generally, lease agreements contain mitigants on the part of the lessor in respect of such matters but obtaining legal advice may be necessary in such circumstances as the position may be very fact specific.

Carve-outs to the "hell or high water" clause are rare and limited, and it would be very unusual for the relevant clause to include an express exclusion for a force majeure event. In the absence of contractual provisions, English law (and New York law) will not, by default, excuse a party from performance of its obligations due to events beyond its control. The doctrine of "frustration", discussed below, is an exception to this rule. That said, the lessee may attempt to rely upon a codified or supervening principle for force majeure under another legal jurisdiction.

The issue by governmental agencies of "force majeure certificates" (such as those being offered by the China Council for Promotion of International Trade, an international trade promotion agency, to companies affected by the epidemic to provide to overseas trading partners) are intended to establish the fact of a force majeure occurrence rather than establishing a legal entitlement to claim force majeure.

Change in Law; Illegality; Frustration or other Supervening Event

The lessee may argue that the restrictions on movement and operations imposed by local regulatory authorities to limit the spread of the Covid-19 outbreak have triggered a change in law or illegality event under the lease agreement which may lead to a termination of the lease. Whether or not such contractual provisions may be invoked will depend on the specific terms and facts. However, it is unlikely that the circumstances surrounding the Covid-19 outbreak would constitute a change in law or illegality event, the relevant restrictions being determined by reference to the geographical operation of the aircraft, rather than the relevant lessee's performance of its lease obligations. Alternatively, it may contend that its performance of the lease has been rendered impossible at law: parties should note that the bar for a claim of frustration in English law is set high and a similar threshold applies under New York law. (Read our briefing, Brexit will not frustrate the European Medicine's Agency's lease at Canary Wharf).

Material Adverse Change; Event of Default; Insolvency

For certain operators, the consequences of Covid-19 may lead to severe financial distress and perhaps, ultimately, insolvency. Parties will need to assess the specific fact pattern within the lease agreement framework or any letter of intent, including the application of any material adverse change provisions and contractual events of default.

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