

COMMERCIAL COURT REJECTS FRUSTRATION ARGUMENT IN AVIATION LEASING DISPUTE

Date: 10 February 2021

UK Litigation and Dispute Resolution and Aviation Alert

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SUMMARY

The English Commercial Court has emphasized the difficulties airline operators and aviation lessees could face in seeking to rely on the common law doctrine of “frustration” in order to avoid their payment obligations under leases, especially where such leases contain “hell or high water” provisions and where they make clear that the obligation to pay rent continues in almost any conceivable circumstance.

In *Salam Air SAOC v. Latam Airlines Group SA* [2020] EWHC 2414 (Comm), a lessee (SalamAir) applied for an injunction to restrain the lessor (Latam) from calling on four standby letters of credit (SBLCs). The court concluded as a threshold question that it would not be appropriate to interfere with the operation of the SBLCs by injunction. Latam from making a demand under them. However, it went on to consider whether Salam Air could demonstrate an arguable case that the leases had been frustrated by the effects of the COVID-19 pandemic and, in particular, certain restrictions on air passenger flights imposed by the authorities in Oman, where Salam Air and the aircraft are based.

THE DOCTRINE OF FRUSTRATION

The English courts have adopted various tests for frustration, and the factual matrix will always be important in determining whether it applies. Broadly, the doctrine can apply when, after a contract is formed, an unexpected event occurs that would render performance in accordance with the literal terms of the contract impossible, illegal, or so different from what the parties reasonably contemplated at the time of execution that it would be unjust to insist on compliance with those literal terms. The courts will consider the contractual terms, the factual matrix, and, in particular, the parties' knowledge and expectations as to risk allocation under the relevant contract.

RISK ALLOCATION

The court in the *Salam Air* case found that a six-year dry aircraft lease is a “*challenging context in which to establish frustration*,” since the lessor assumes the obligation to provide quiet possession of the aircraft and the lessee assumes the commercial risks and rewards of operating the aircraft. The court found that, contrary to Salam Air's submissions, nothing in the lease suggested that Salam Air's use of the aircraft was a shared purpose of both parties to the leases, as opposed to a matter of concern only to Salam Air. There was no “*shared assumption*” as to a state of affairs assumed by both contracting parties to be the foundation of the contract, which had been disrupted by the unexpected event.

The court rejected the suggestion that such a “*common foundation*” of the contract could be found in a provision that the aircraft's base of operations could not be changed from Muscat International Airport without Latam's permission, since similar provisions appear in aircraft leases as a consequence only of lessors' interest in the physical and legal safety of the subject aircraft.

Further, the leases contained “hell or high water” clauses and made it clear that the obligation to pay rent was “*absolute and unconditional irrespective of any contingency whatsoever,*” including “*the ineligibility of the aircraft for particular use or trade.*” The court held that these clauses were “*fundamentally inconsistent with any suggestion that regulations in Oman which prevent Salam Air from using the Aircraft to earn revenue through passenger flights with an Omani terminus, or any long-term suppression of air travel...had the effect of terminating the Aircraft Leases and freeing Salam Air of its obligation to pay rent.*”

The court concluded that the risk that Salam Air might be unable to undertake passenger flights from Muscat or elsewhere in Oman, or that there might be a dramatic fall in demand for air travel, were risks inherent in the commercial operation of the aircraft, which had been assumed by Salam Air under the aircraft leases.

CONCLUSION

While the specific factual matrix and contractual risk allocation will always need to be considered in each case, this decision provides a strong indication that aviation lessees will be held to their payment obligations during the pandemic, especially where the relevant lease makes it clear that those obligations survive unforeseen circumstances.

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