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# No silver bullet: an update on frustration in the aviation context from the English courts

*We take a look at the impact of two recent cases on the ability, or inability, of lessees to successfully rely on the doctrine of frustration in an aviation context in the wake of the Covid-19 pandemic and the Boeing 737-MAX crashes in 2018/19.*

The combined effects of the Covid-19 pandemic and the tragic Boeing 737-MAX crashes in 2018/19 have left lessors and airlines facing uniquely challenging circumstances. Many airlines have been left with leased aircraft being forcibly grounded for significant periods, with limited incoming passenger revenue but substantial outgoing monthly cash burn, including considerable payments of monthly rent and maintenance reserves that they have been unable to keep up with. The options available to lessor counterparties faced with these issues have been limited. Commercial negotiations to address the impact of the MAX groundings have been overshadowed by the deeper effect of Covid-19 across the global fleet; airline restructurings, the absence of a secondary trading market, and limited remarketing opportunities have largely rendered enforcement and repossession measures unattractive throughout the worst of the crisis save in extreme circumstances.

In the face of tightly drafted standard operating leases with "hell or highwater" clauses that preclude the withholding of payment of rent to lessors, and no force majeure clauses to fall back on, it is not surprising that many airlines have turned to the English common law doctrine of frustration for relief when lessors have elected to take enforcement action.

**Frustration is an English common law doctrine that may allow the parties to a contract to be discharged from their contractual obligations in circumstances where an event occurs after the formation of the contract that renders performance of that contract impossible, illegal or radically different from that intended by the parties when they entered into the contract.**

However, as the recent cases of *SalamAir SAOC v LATAM Airlines Group SA*[1] and *Wilmington Trust SP Services (Dublin) Limited & Others v SpiceJet Limited*[2] demonstrate, in an aircraft operating lease context the English courts remain reluctant to allow contractual parties to escape their obligations by seeking to rely on frustration in all but the most exceptional of circumstances, particularly where the lease in question contains a "hell or highwater" clause.

## SalamAir v LATAM Airlines Group SA

This case concerned the dry lease of three Airbus A320 aircraft from LATAM Airlines Group SA by the Omani airline SalamAir. Specifically, the English High Court was asked to consider SalamAir's application for an injunction to restrain LATAM from presenting a demand to SalamAir's bank under a number of standby letters of credit ("**SBLCs**") in response to certain non-payment defaults by SalamAir under the leases. These SBLCs had been given by the airline by way of deposit to secure the performance by SalamAir of its obligations under the three leases.

The three aircraft concerned were delivered to SalamAir in 2017 for a term of six years. Each lease was identical to one another; among other things, each lease required that the aircraft be operated from Muscat for the lease term, and each lease was governed by English law. From 26 March 2020 onwards, SalamAir became unable to operate the aircraft at all as a result of a decision by Oman to prohibit all flights to or from Omani airports as a consequence of the Covid-19 pandemic. As with so many other airlines, these restrictions caused a collapse in SalamAir's revenues and meant that the airline failed to make any lease payments to LATAM from March 2020 onwards. In May 2020, LATAM entered Chapter 11 bankruptcy in the United States and, in June 2020, LATAM terminated the leases and took redelivery of the leased aircraft following the

[1] [2020] EWHC 2414 (Comm)
[2] [2021] EWHC 117 (Comm)

collapse of compromise discussions between the parties. It was in this context that LATAM subsequently tried to make demands under the three SBLCs issued by SalamAir.

SalamAir's application for an injunction was pleaded on the basis of "frustration of purpose", namely that the purpose of the three leases had been frustrated as a result of the restrictions imposed by the Omani government. In this regard, SalamAir sought to argue that the common purpose of the leases had been for SalamAir to be able to operate the leased aircraft commercially. SalamAir asserted that the fact that it had shared its business plan with LATAM prior to leasing the three aircraft, and that LATAM had required that the three aircraft could only be operated from Muscat, supported this conclusion. For the reasons set out below, the Court had little hesitation in rejecting these arguments.

First, as SalamAir was seeking to injunct LATAM from calling on the SBLCs, the Court considered that it was required to meet a higher standard than usual when pleading its case. While the principles from *American Cyanamid Co v Ethicon Ltd*[3] typically require an applicant to show an "arguable case" when requesting an injunction, as SalamAir was seeking to restrain a beneficiary from enforcing its rights under a SBLC, the Court considered that SalamAir needed to demonstrate a "strong" case instead. This position was based on the well-established principle of English law that the status of irrevocable letters of credit as cash equivalents means that their independence should be guaranteed except in very limited circumstances.

Following on from that, the Court decided that SalamAir's argument for frustration of purpose had not achieved the "arguability" threshold of being a "strong" case. There were two factors that heavily influenced the Court in reaching this conclusion, as set out below.

First, although the Court accepted that SalamAir had shared its business plan with LATAM, the Court held that there was nothing in any of the leases that demonstrated that the use of the aircraft by SalamAir was a shared purpose of both parties. On the contrary, the Court determined that there were several provisions in the leases that indicated the opposite. In particular, the Court observed that at clause 8.2 of the leases the parties had included a "hell or highwater" clause, pursuant to which SalamAir's obligation to continue making rental payments to LATAM was "*absolute and unconditional irrespective of any contingency whatsoever*," including in circumstances where the aircraft was either requisitioned or became a total loss. The Court found that the inclusion of this clause was "*fundamentally inconsistent*" with the proposition that the restrictions imposed by the Omani government had frustrated the purpose of the leases. On the question of the base of operations specified by the leases, the Court noted that this did not speak to a shared purpose, but simply reflected LATAM's continued interest in "*the physical and legal safety of the aircraft, and in ensuring that that aircraft can be safely and efficiently repossessed if it is necessary to do so.*"

> ***"If total destruction of the Aircraft, or dispossession through requisition do not relieve Salam Air of the obligation to pay rent, it is highly improbable that the matters relied upon by SalamAir in this application have this effect."***
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> Para. 54, *SalamAir v LATAM Airlines Group SA*

Second, the Court made the practical observation that a six-year dry lease was a "*challenging context in which to establish frustration*." It observed that in such a case, the lessee effectively assumed all commercial risks and rewards of operating the aircraft in return for fairly limited obligations on the part of the lessor; namely, to ensure quiet possession of the aircraft. The Court noted that there were three years left to run on the leases at the time the Omani government imposed the travel restrictions, meaning that the aircraft could likely be operated again in due course, and that it was therefore a "*weak argument*" to suggest that the effect of the restrictions had frustrated the leases. The Court did accept, however, that this proposition would at least have been "arguable", and so may have crossed the "arguability" threshold if the usual conditions from *American Cyanamid* had applied, instead of the heightened requirements imposed as a result of the fact that SalamAir was seeking to injunct LATAM from calling on its SBLCs.

### Wilmington Trust SP Services (Dublin) Limited & Others v SpiceJet Limited

This case concerned three dry leases entered into between SpiceJet, the Indian low-cost carrier, and a number of entities acting on behalf of, or within the corporate group of, Goshawk Aviation Limited ("**Wilmington Trust**"). The first lease related to a Boeing 737-800 aircraft and was entered into in 2013, while the second and third leases related to two Boeing 737-MAX 8 aircraft and were entered into in 2018. Each of the leases was governed by English law. Wilmington Trust sought payment of various

[3] [1975] AC 396

unpaid amounts owed under the leases, including basic rent and maintenance reserves, and applied for summary judgment on these claims. In response, SpiceJet counter-claimed for the return of a security deposit that it alleged had been wrongfully drawn down by Wilmington Trust.

As with *SalamAir*, the initial difficulties for the lessee airline arose as a result of restrictions that significantly curtailed its ability to operate the three aircraft as it had intended initially. The two Boeing 737-MAX 8 aircraft had remained grounded since early 2019 by decree of the Indian Directorate General of Civil Aviation (the "**DGCA**") following the two fatal accidents involving the aircraft in 2018 and 2019. Additionally, the ability of SpiceJet to operate the Boeing 737-800 aircraft had been severely limited by travel restrictions imposed in India as a result of the Covid-19 pandemic. These issues combined to cause SpiceJet to default on the basic rent and other payments required by the leases.

During the summary judgment hearing, SpiceJet did not deny that it had not paid the basic rent and other payments required in accordance with the terms of the leases. It did however raise five defences, as well as its counterclaim, and it also contended that there was a compelling reason for the matter to proceed to trial. One of the defences raised by SpiceJet was that its lease of the two Boeing 737-MAX 8 aircraft had been frustrated as result of the general ban imposed by the DGCA, which meant that the aircraft could not be operated by SpiceJet at all. It was this line of argument that comprised the majority of SpiceJet's submissions during the hearing and which we are chiefly concerned with for the purpose of this update. Interestingly, SpiceJet did not run a frustration argument in respect of the first aircraft lease, which had been impacted by Covid-19 operating restrictions.

As had happened in *SalamAir*, SpiceJet sought to argue that the common purpose of the leases had been to provide it with aircraft for commercial use, and that this purpose had been frustrated by the fact that the aircraft could not be operated. This was disputed by the Claimants who argued instead that the objective common purpose of the lease was simply for SpiceJet to hire the aircraft in return for payment of rent. On the Claimants' interpretation, the actual operation of the aircraft by SpiceJet was none of their concern as the lessor's sole obligation under the terms of each of the leases was to ensure quiet enjoyment. Of these two interpretations, the Court was in fact prepared to assume that SpiceJet's interpretation was correct, particularly given that one of the provisions of the leases permitted the sub-leasing of the aircraft to only commercial air carriers and operators.

The Claimants then sought to rely on the "hell or highwater" provisions in clause 4(c) of the leases, which stated as follows (emphasis added):

> ***"Lessee's obligation to pay all Rent hereunder shall be absolute and unconditional and shall not be affected or reduced by any circumstances, including, without limitation: … (ii) any defect in the title, airworthiness or eligibility for registration under Applicable Law, or any condition, design, operation, merchantability or fitness for use of, or any damage to or loss or destruction of, the Aircraft."***

On this point, the Court stated that it was prepared to assume that such a clause would not necessarily operate to exclude the possibility of frustration in the circumstances faced by SpiceJet. However, the Court also accepted that, as a result of the wording used in clause 4(c), there was a clear allocation of risk to SpiceJet relating to the airworthiness of the leased aircraft, even if the fact that the issue in this case arose from a manufacturer's defect in the Boeing 737-MAX aircraft itself, which caused the two crashes in 2018 and 2019, and which in turn might mean that there was another dimension to the question that was absent in other recent cases involving the interaction of frustration with "hell or highwater" clauses. One notable example of such a case is *ACG Acquisition XX LLC v Olympic Airlines SA*[4], where the issue as to airworthiness was instead related to maintenance that could have been performed by the airline lessee and for which it had assumed responsibility under the lease.

Notwithstanding that slight hesitation, the Court had no trouble in finding that under the leases, which were for 10 years, SpiceJet had assumed the entire commercial risk. In the Court's view, if SpiceJet was not to be released from any responsibility to pay rent to the Claimants in the event of a total loss, it would be very hard to see how a temporary suspension imposed by the DGCA could allow SpiceJet to escape its obligations. This was made even more difficult by the fact that, at the time of the claim, the suspension of operations by the DGCA had only lasted for approximately 10% of the lease term. In the Court's view, this left the performance of SpiceJet's obligations firmly in the "more onerous" camp, rather than in the "radically different" camp, which meant that the defence of frustration could not succeed. Interestingly, the Court did indicate that, if the ban imposed by the DGCA had been for a longer

[4] [2012] EWHC 1070 (Comm)

period of time, for example if the ban was still in place in another three years' time, then it could potentially amount to frustration.

> ***"I am far from saying that these leases can never be frustrated. It may be (I express no view one way or the other) that if there is still no sign of the ban being lifted in, say, three years' time, that might amount to frustration."***
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> Para. 65, *Wilmington Trust SP Services (Dublin) Limited & Others v Spicejet Limited*

As a final twist, although the Court did find for the Claimants on the majority of their claims, it also granted a stay of execution for a period to allow the parties to engage in mediation or another form of alternate dispute resolution. Foremost among the reasons for granting this stay was the fact that SpiceJet's finances were shown to be in such an unhealthy state that if the judgment was allowed to be enforced immediately, it would likely force the carrier into insolvency, in which case the Claimants would have to pursue their claims in the liquidation and, as unsecured creditors, potentially receive little to nothing from SpiceJet. On the other hand, the Court took a commercial view that the Claimants would potentially stand a better chance of recovering a greater proportion of the debts owed to it by giving SpiceJet an opportunity to recover financially and that the stay of execution would give the parties an opportunity to engage in negotiations to try to reach some form of compromise in the meantime.

## Wilmington Trust SP Services (Dublin) Limited & Others v SpiceJet Limited

As these two cases demonstrate, frustration remains a difficult case for defaulting airline defendants to plead successfully. Even amidst the economic cataclysm caused by the Covid-19 pandemic and the Boeing 737-MAX crashes, the English courts have been unwilling to release lessees from their obligations to pay rent and maintenance reserves through reliance on the doctrine of frustration and have upheld the sanctity of "hell or highwater" clauses.

However, as *SpiceJet* illustrates, the Courts have not ruled out the possibility of frustration occurring in future, for example in situations where operational bans continue for a significant portion of the underlying contract. This may appear to offer some slim hope to lessees stuck with aircraft that they are unable to operate, but these cases should serve as a timely warning to airlines that they cannot expect to rely on frustration as a legal silver bullet even in circumstances that are both unforeseeable and extreme.

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