Frustration in the context of aircraft leasing - *Wilmington v SpiceJet*

By Christopher Loxton

The recent case of *Wilmington Trust SP Services (Dublin) Limited & Others v SpiceJet Limited* [2021] EWHC 1117 (Comm) demonstrates the difficulty parties face in convincing English courts that they should be permitted to escape their payment obligations on the basis that a contract has been frustrated.

The case concerned three 10-year aircraft leases entered into between the Indian low-cost carrier, SpiceJet, and a number of leasing entities connected to Goshawk Aviation ('the Lessors'). The first lease related a Boeing 737-800 aircraft which SpiceJet had had significantly restricted use of due to the Covid-19 pandemic. The second and third leases related to Boeing MAX 8 aircraft which had been grounded in India following two fatal accidents involving similar type aircraft operated by Lion Air and Ethiopian Airlines respectively.

The Lessors applied for summary judgment on amounts outstanding from SpiceJet, including basic rent and maintenance reserves. SpiceJet in turn counter-claimed for the return of a security deposit that it alleged had been wrongfully drawn down by the Lessors.

The Lessors relied upon on the 'hell or highwater' provisions in clause 4(c) of the leases, which provided:

> *"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."

In respect of the first aircraft, SpiceJet argued that the restrictions imposed by the Indian Government in light of the Covid-19 pandemic made it illegal to operate the aircraft and that the payments under the lease should be suspended for the duration of the illegality.

The illegality defence was given short shrift by Julia Dias QC (sitting as a Deputy High Court Judge), firstly, because SpiceJet had actually operated the aircraft at times during the pandemic, and secondly, because all risks and maintenance under the dry lease had been assumed by the airline given the clear terms of the 'hell or high water' clause and therefore it was "impossible" to interpret the lease terms such as to suspend rent during the period of the pandemic.

In relation to the second and third aircrafts, SpiceJet ran a frustration defence based on the two aircraft having been grounded since early 2019 by decree of the Indian Directorate General of Civil Aviation (DGCA) following the two fatal accidents in 2018 and 2019.
If the lease agreements were found to have been frustrated then they would come to an end, with the parties' obligations discharged, and any sums paid over after the contract's frustration becoming repayable under the Law Reform (Frustrated Contracts) Act 1943.

SpiceJet's frustration defence was put on the basis that the purpose of the leases were for the commercial use of the aircraft to provide passenger transport, and the grounding of the aircraft frustrated that purpose.

The Judge began by reciting the commonly adopted test set out in *In The Sea Angel* [2007] 2 Lloyd's Rep 517, namely whether, through no fault of either party, performance of the contract has been rendered 'radically different' from the obligation undertaken. In *The Sea Angel*, the Court of Appeal held that this required the application of a multi-factorial approach:

"*Among the factors which have to be considered are the terms of the contract itself, its matrix or context, the parties' knowledge, expectations, assumptions and contemplations, in particular as to risk, as at the time of contract, at any rate so far as these can be ascribed mutually and objectively, and then the nature of the supervening event, and the parties' reasonable and objectively ascertainable calculations as to the possibilities of future performance in the new circumstances. Since the subject matter of the doctrine of frustration is contract, and contracts are about the allocation of risk, and since the allocation and assumption of risk is not simply a matter of express or implied provision but may also depend on less easily defined matters such as ''the contemplation of the parties'', the application of the doctrine can often be a difficult one. In such circumstances, the test of ''radically different'' is important: it tells us that the doctrine is not to be lightly invoked; that mere incidence of expense or delay or onerousness is not sufficient; and that there has to be as it*

were a break in identity between the contract as provided for and contemplated and its performance in the new circumstance."

The Judge stated that she was prepared to assume that the 'hell or highwater' clause did not necessarily operate to exclude the possibility of frustration, however, the clause's language made it clear that SpiceJet had assumed all the commercial risk relating to the airworthiness of the leased aircraft.

The Judge further held that in the context of a 10-year lease the grounding of the aircraft for appropriately 10% of the term (at the time of counting) did not amount to a change of circumstances which renders performance of the leases 'radically different'.

Interestingly, the Judge left open the prospect that if the DGCA's grounding decree became permanent, or even if the ban remained for a further three years or so, SpiceJet might be able to successfully argue at that later point that the leasing agreements had been frustrated.

The Court therefore awarded the Lessors summary judgment for c.US$25 million. This amount did not include the claim of US$4.2 million for restoration of the security deposit in respect of the first aircraft as the Judge held that SpiceJet's counter-claim could proceed to trial on the basis that it had a reasonable argument that the Lessors' drawdown of this deposit was "impermissible and unjustified" in accordance with the terms of the lease agreements.

Of particular note, and of interest to distressed airlines, was the Judge's decision to order a stay of execution of the summary judgment for 16 months for the parties to undertake ADR. The rationale for the stay being principally that of SpiceJet's the precarious financial position meaning any requirement to pay the judgment sum promptly might result in its insolvency which would be contrary to the Lessors' interests.

Points to note

The decision in *Wilmington v SpiceJet* will come as little surprise to those familiar with the earlier case of *SalamAir SAOC v LATAM Airlines Group SA* [2020] EWHC 2414 (Comm). In that case Foxton J dismissed an injunction application made by the SalamAir to restrain LATAM from making demand under three letters of credit. The letters of credit had been given by the airline by way of deposit to secure the performance by SalamAir of its obligations under the three aircraft leases.

SalamAir v LATAM also involved 'hell or highwater' clauses in the leases. Foxton J 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. He noted that there were three years left to run on the leases in question, at the time the Omani government imposed the travel restrictions, meaning the aircraft would likely be operated again during the leases' term, and therefore the effect of the restrictions had not frustrated the leases.

Also of note is the recent case of *Bank of New York Mellon (International) Ltd & Ors v Cine-UK Ltd & Ors* [2021] EWHC 1013 (QB) in which Master Dagnall gave summary judgments to the landlords of commercial premises in their

claims for payment of rent due since the outbreak of the Covid-19 pandemic and imposition of restrictions in March 2020.

Among other arguments raised, the Master rejected the tenants' contention that their leases had been "temporarily frustrated" during the periods in which the premises were forced to close. In doing so, he set out a distillation of the principles of frustration as they relate to property leases which will be of particular use to aviation practitioners in circumstances where an aircraft lease does not contain a 'hell or highwater' clause, and therefore the principles repeated here for reference[1]:

> "*a. In principle, the doctrine of frustration applies to leases – see the majority in Panalpina[2];*
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> *b. An enforced closure of the premises arising from matters outside the control of the parties is such a supervening event as is capable in principle as giving rise to the frustration of commercial leases such as these and especially where, as here, the user clauses only permit in practice what have become impossible uses – see Panalpina itself;*
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> *c. However, it is only in a "rare" or "very rare" case that such a supervening event will have such a consequence (see Panalpina and the Sea Angel above). As to this:*
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> *i. Has the situation become so "radically different" that the present situation is so outside what was the reasonable contemplation of the parties as to render it "unjust" for the contract to continue (see Panalpina per Lord Wilberforce, The Sea Angel and Canary Wharf);*
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> *ii. There are relevant to this: the original term of each Lease, the likely period of the disruption and the likely remaining term of the Lease once the disruption has ended (Panalpina per Lord Wilberforce and Lord Roskill), and:*
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> *1. This should be considered at each relevant point in time looking prospectively forward as to what reasonable commercial people would conclude was the likely length of the disruption (see Embriacos and the other cases cited by Treitel);*
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> *2. The court must consider this first quantitatively but then qualitatively as to whether there is such a "radical difference" (see Lord Wilberforce in Panalpina);*
>
> *3. The court must also consider all this in terms of whether this new situation justifies a departure from the agreed allocations of risk, and where in the context of a lease the essential agreement is that the*

[1] Found at paragraph 209 of the judgment.

[2] The case of *National Carriers v Panalpina* [1981] AC 675 ("Panalpina") concerned. a road closure that prevented commercial premises which had been let for 15 years for being used after 10 years for some 18-20 months after which the lease would still have another 3 years to run. The tenant contended that the lease had been frustrated but this contention was rejected by way of summary judgment by a Master which was eventually upheld by the House of Lords.

> *Tenant has agreed to pay the rent except in defined circumstances. This is where the parties have allocated the risks of disruption e.g. by reason of fire, generally to the Tenant (Lord Wilberforce in Panalpina).”*

As these cases all illustrate, frustration remains incredibly difficult for defaulting parties to successfully rely on. Whilst *Wilmington v SpiceJet* did not rule out the possibility of frustration occurring in future, for example in a scenario where an operational ban continue for a significant portion of a lease’s term, it is a warning to airlines and other operators of the strict obligations contained in such leases, particularly those with ‘hell or high water’ clause (these being the norm).

Whilst lessors will welcome the recent decisions of the High Court, it will be interesting to see whether airlines and other struggling operators seek to rely on the *Wilmington v SpiceJet* decision to apply for stays execution in similar cases where they are found to be liable to pay debts due.

Christopher Loxton

christopherloxton@3harecourt.com