



# INTERNATIONAL JOURNAL FOR LEGAL RESEARCH AND ANALYSIS

Open Access, Refereed Journal Multi Disciplinary  
Peer Reviewed Edition :

[www.ijlra.com](http://www.ijlra.com)

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INTERNATIONAL JOURNAL FOR LEGAL RESEARCH & ANALYSIS

ISSN

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# **IMPORTANT CLAUSES THAT SHOULD BE A PART OF AIRCRAFT LEASING AGREEMENT AND THEIR SIGNIFICANCE: AN ANALYSIS**

AUTHORED BY: SHREYA JAGADISH

## **Introduction**

The global aircraft leasing sector is crucial for airlines, with lease agreements defining rights and obligations. These agreements are designed to ensure clarity, limit risks, and facilitate smooth operations. This study examines eight key provisions in aircraft leasing agreements, analyzing their specific purposes and potential variations based on lease type and other relevant factors. These complex financial instruments protect the interests of both the lessor and lessee, necessitating meticulous drafting. The research paper highlights the significance of a few clauses and their potential variations based on specific circumstances.

### **1. Identification of Parties and their payment provisions**

Identifying parties in a leasing agreement is crucial for establishing the legal relationship between the Lessor (owner) and Lessee (tenant). The Lessor is the party owning the property and granting the right to use it to the Lessee. At the same time, the Lessee is the party occupying and using the property in exchange for rent and fulfilling the specified obligations. The clause explicitly defines the Lessor and Lessee, removing any ambiguity about who is bound by the terms of the agreement. This clarity is essential for legal documentation, communication, and responsibilities throughout the lease term.

Identification of parties is also essential to determine whether the parties are persons or legal entities. Entities must include their business name, registered address, and authorized representative information. Identifying each participant by name and their specific engagement emphasizes their roles and obligations when there are many owners or occupants. The "Identification of Parties" clause establishes a clear and unambiguous contractual relationship between the Lessor and Lessee, which is necessary for effective communication, proper enforcement, and legal clarity throughout the lease period.

The lease agreement outlines the Lessee's unconditional obligation to pay rent and fulfil all Lease terms, except in cases of Lessor breaching the Lease terms. Lessee must cooperate with Lessor for any transfer, assignment, or funding arrangements. Furthermore, Lessee is responsible for maintaining technical records in line with the Aviation Authority, Maintenance Program, EASA Part M, and air operations standards. The Security Deposit is refundable within 30 days post-Lease term, contingent upon Lessee meeting all obligations. The lease payment, associated tax benefits, and potential maintenance payments are considered when assessing cash flows. The lease permits subleasing the aircraft, and transferring engines and parts within the Lessee's aircraft fleet. For dry leases, the Lessee must include the aircraft on its operating certificate, maintain registrations and insurance, and remit monthly rental and maintenance payments. An end-of-lease payment is required from the Lessee, although if the aircraft's maintenance status improves upon return, the Lessor might owe the Lessee. The method for calculating the end-of-lease payment varies depending on the circumstances.<sup>1</sup>

## 2. Aircraft Description and Condition

Including the Aircraft Description and Condition clauses within an aircraft leasing agreement holds significant importance. This agreement section should contain comprehensive details about the aircraft, specifying its serial number, model, and any unique identifiers that precisely identify the leased asset. It should also outline the current condition of the aircraft at the commencement of the lease term. Documentation of the aircraft's condition and maintenance records is crucial to mitigate potential disputes between the Lessor and Lessee. By clearly delineating the state of the aircraft at the lease initiation, the agreement minimizes disagreements about the condition of the aircraft during the lease period and upon its return. It helps establish a baseline against which any wear and tear or alterations during the lease term can be measured.<sup>2</sup>

Maintenance records included in this clause ensure that both parties are aware of the aircraft's maintenance history, compliance with aviation authorities' regulations, and adherence to safety standards. This transparency is vital for the Lessee to understand their responsibilities regarding the maintenance and upkeep of the aircraft during the lease period. By incorporating a detailed Aircraft Description and Condition clause, the leasing agreement becomes a crucial document for

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<sup>1</sup> Guzhva, V., Raghavan, S. and D'Agostino, D.J., 2018. *Aircraft leasing and financing: Tools for success in international aircraft acquisition and management*. Elsevier.

<sup>2</sup> (2017) *Guidance material and best practices for aircraft leases - IATA*. Available at: <https://www.iata.org/contentassets/b94a0e7f14694efe8b72ca1b73052f05/ac-leases-4th-edition.pdf>

referencing the condition of the aircraft. It assists in determining any necessary maintenance or repairs during the lease term and plays a fundamental role in assessing the aircraft's condition upon lease termination. This section safeguards both parties' interests, providing a clear framework to manage potential disputes related to the aircraft's state, thus ensuring a smoother and more transparent leasing process.<sup>3</sup>

### 3. Maintenance and Repair Responsibilities

The Maintenance and Repair Responsibilities clause is a crucial part of an aircraft leasing agreement, defining the responsibility of the Lessor or Lessee for scheduled and unscheduled maintenance. This clause ensures the aircraft's continuous airworthiness and effective cost management throughout the lease term. It prevents ambiguities or disputes regarding maintenance obligations, safeguarding the operational integrity of the aircraft. It also impacts the financial aspect of the lease, as different lease variations allocate maintenance costs differently.<sup>4</sup> Understanding and outlining these variations is crucial for both parties, affecting budgeting and financial planning throughout the lease term and influencing the overall cost-effectiveness of the lease arrangement. Therefore, a detailed Maintenance and Repair Responsibilities clause is essential in an aircraft leasing agreement.

### 4. Insurance Requirements:

In an aircraft leasing agreement, the Insurance Requirements clause holds substantial significance. This clause specifies the necessary insurance coverage to safeguard against multiple aircraft operation risks, including hull damage, passenger liability, and potentially unforeseen war or political risks. The importance of this clause lies in ensuring comprehensive protection against various contingencies. Adequate insurance coverage is imperative to mitigate potential financial losses arising from damages, accidents, or liabilities during the lease term. By explicitly delineating the insurance requirements, both the Lessor and Lessee establish a framework for risk management, ensuring that the aircraft is adequately protected against a range of potential perils.<sup>5</sup>

The variations in insurance coverage levels are contingent on several factors, such as the type of

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<sup>3</sup> Lessard, M., Evans, R. and Prus, M.J. (2019) *Comparative analysis from Top Ranked Lawyers Aviation Financing & Leasing*. Available at: <https://www.pillsburylaw.com/images/content/1/2/124782.pdf>

<sup>4</sup> *Supra* note 3

<sup>5</sup> Walter W. Eyer, *Sale, Leasing and Financing of Aircraft*, The , 45 J. AIR L. & COM. 217 (1979)

lease agreement, the age of the aircraft, and the operational routes undertaken. For instance, different lease types (wet lease, dry lease) may necessitate varying insurance coverage responsibilities, with some leases placing the onus on the Lessee to procure insurance. In contrast, others might stipulate the Lessor's involvement in obtaining specific coverages.

Furthermore, the age of the aircraft and the operational routes it traverses can impact the required insurance levels. Older aircraft may have different insurance requirements compared to newer ones due to their inherent risks and maintenance considerations. Similarly, operational routes, especially those involving regions with geopolitical uncertainties or heightened risks, may necessitate specialized coverage against war or political perils.

By incorporating a detailed Insurance Requirements clause, the leasing agreement ensures that both parties know their insurance coverage obligations. It provides clarity on the types, levels, and responsibilities concerning insurance, reducing ambiguity and potential disputes during the lease term.<sup>6</sup> Ultimately, this clause acts as a fundamental tool for risk mitigation and financial protection for both the Lessor and Lessee, thereby maintaining the integrity and stability of the leasing arrangement.

## 5. Force Majeure

"Force majeure" is a contractual condition that permits both parties to be released from contractual obligations that could not be fulfilled due to triggering events beyond their control, such as war, acts of God, strikes, and riots. If any of the triggering events occur, the contractual party relying on the force majeure clause must prove the occurrence of such event referred to in the clause and that such incident prohibited, hindered, or delayed the performance of the contract. Furthermore, the party relying on the clause must demonstrate that circumstances beyond its control caused the failure to meet its contractual duties and that reasonable actions were made to avoid or mitigate such an event or its consequences.

In general, the courts will examine the force majeure clause's drafting to decide if it is broad enough to include the triggering event and whether it has influenced the execution of the parties' contractual obligations under the contract. Furthermore, the contractual party relying on the force

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<sup>6</sup> *Ibid.*

majeure clause must comply with the clause's requirements in order to activate the clause, for example, if notice is required to be given to the counterparty, such notification requirements must be met. If the aircraft lease agreement includes a force majeure clause, whether or not it can be activated due to the COVID-19 pandemic depends on whether an "epidemic" is stated as the triggering event in the lease agreement. Although the COVID-19 pandemic is beyond the Lessee's reasonable control, it would be unusual to find a force majeure clause in a standard aircraft lease agreement that allows the Lessee to avoid rental payments if the Lessee is forced to cancel flights and ground its fleet.<sup>7</sup>

## 6. Regulatory Compliance

A Regulatory Compliance clause in an aircraft leasing agreement is essential. This paragraph requires both the Lessor and Lessee to closely conform to aviation regulations, which include acquiring and maintaining all relevant permits, licences, certifications, and compliance with applicable laws and standards.

This clause is significant because it serves as a shield against legal and operational problems. Adherence to aviation regulations is critical for maintaining the leased aircraft's airworthiness, safety, and legality.<sup>8</sup> The clause guarantees that both parties are aware of their responsibilities in completing all relevant regulatory standards during the lease period by expressly articulating the obligations linked to regulatory compliance.

Compliance with aviation rules is a multidimensional issue that includes obtaining and renewing permits and licences, following safety measures, meeting maintenance standards, and adhering to governmental or aviation authority orders. Failure to comply with these standards can result in harsh penalties such as fines, aircraft grounding, or even legal action, which can disrupt operations and incur significant expenses for both parties.<sup>9</sup>

Furthermore, the Regulatory Compliance clause serves as a safeguard, limiting the risks

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<sup>7</sup> *Navigating the terms of an aircraft lease agreement amidst the COVID-19 pandemic* (2020) Lexology. Available at: <https://www.lexology.com/library/detail.aspx?g=a209b123-8420-4a3a-a842-0a71f303bae1>

<sup>8</sup> Sarin, N., Aggarwal, R. and Ahmed, S.T. (no date) *Aviation Financing & Leasing*. Available at: <https://sarinlaw.com/wp-content/uploads/2020/04/INDIA-Chambers-Global-Practice-Guide-Aircraft-Finance-Leasing-2019.pdf>

<sup>9</sup> Davis, John Milan. "The Use of Performance Indicator Systems in Public Higher Education." 2003, <https://core.ac.uk/download/235420580.pdf>

associated with noncompliance. It emphasizes the necessity of maintaining legal and operational integrity while establishing a transparent and compliant leasing environment. This clause aims to avoid misunderstandings or disagreements between the Lessor and Lessee regarding their respective obligations, ensuring that both parties are committed to meeting regulatory standards and acting within the boundaries of the law.

In essence, a robust Regulatory Compliance language in an aircraft leasing agreement is a critical mechanism for encouraging adherence to aviation laws, mitigating legal risks, and upholding operational standards. It protects the rights of the Lessor and Lessee and strengthens the reputation and validity of the lease arrangement within the aviation sector.

## **Conclusion**

Each clause in an aircraft leasing agreement forms a vital piece of the puzzle, ensuring a smooth and secure flight for both the Lessor and Lessee. From clearly defined identities and responsibilities to comprehensive risk mitigation strategies, every clause is crucial in minimizing ambiguity, fostering transparency, and safeguarding financial interests. The clauses analyzed here – identification of parties, aircraft description, maintenance, insurance, force majeure, and regulatory compliance – represent just a handful of the vital elements that orchestrate a successful leasing arrangement.

By prioritizing meticulous drafting and careful consideration of each clause, parties can confidently navigate the complex aircraft leasing world. Remember, a well-crafted agreement acts as a roadmap, guiding both parties towards a mutually beneficial and efficient leasing experience, ultimately allowing them to focus on what they do best – keeping the skies accessible and the industry in motion.

It, therefore, emphasizes the collaborative nature of a successful aircraft leasing agreement, where each clause serves as a bridge between the Lessor and Lessee, fostering a partnership committed to mutual success and safe operations. By highlighting the agreement's role as a roadmap, the conclusion reinforces the importance of clarity and transparency in crafting a lease that will withstand time and unforeseen circumstances.