Diary dates

The 12th Beaumont International Aviation Conference
25-26 June 2014
Grange St. Paul’s Hotel
10 Godliman Street, London

Our 2014 programme highlights will include topics such as:
– The aviation insurance market in 2014
– Unmanned aircraft systems
– Geographical rounds ups
– Social media
– EU Regulation 261 update

For further information or registration details please email: Elaine Middleton at events.aviation@clydeco.com

We are pleased to be sponsoring the following industry events:

IATA Legal Symposium
24-26 February 2014
The Westin St. Francis
Union Square
San Francisco, USA

Speakers
Heidi Watson and Isabel Ost will be speakers on employment and data/privacy issues respectively
Andrew Harakas will be presenting on Legal Forum

RAAKS – Russian Association of Aviation Insurers
Fifth International Aviation Conference
“Aviation and space insurance in Russia”
27 February 2014
The President Hotel, Moscow, Russia
David Willcox, Speaker

McGill University/PEOPIL
Seventh Annual Conference on International Aviation Law & Insurance
10-11 April 2014
The Law Society, London
David Willcox will be a speaker on “Air Carrier & Manufacturers’ liability: plaintiff’s and defendant’s perspectives”
Remotely piloted aircraft in civil aviation – the roads ahead

Remotely Piloted Aircraft (RPA) technology has become increasingly available for non-military purposes. The number of RPA types has expanded from a few tens to hundreds. They cover a wide spectrum of size and performance, with flight endurances ranging from hours to weeks and ranges in some cases exceeding 7,000 nautical miles.

The potential benefits of RPA in civil aviation have been recognised by, amongst others, the International Civil Aviation Organisation, the US Federal Aviation Administration, the European Aviation Safety Agency and the European Commission. RPA exist that are capable of undertaking long endurance or hazardous flights. They offer cost efficiencies, for example replacing manned aircraft for aerial survey work. Eventually more fundamental improvements in operational efficiencies are foreseen, for example as a result of not having to accommodate crew on board commercial freight aircraft.

This article highlights some of the challenges facing the expansion of RPA operations in civil aviation and looks at two particular initiatives, the US Federal Aviation Administration’s Road Map and the European Road Map.

The three pillars of safety regulation

RPA involve considerations which are novel to civil aviation. The removal of the pilot introduces the need for a remote piloting station and also a link between the pilot and the RPA (the control and communications, or C2, link). The C2 link may be a direct line of sight radio link or relayed (for example through other aircraft or satellites). The removal of the pilot from the RPA gives rise to questions concerning situational awareness and their ability to maintain separations from other aircraft (the “detect and avoid” considerations).

To realise their potential benefit, RPA will have to be fully integrated into the civil aviation system. However RPA have not been developed or operated in accordance with the demanding safety requirements of civil aviation, which they will now have to meet. They will be required to comply under the three pillars of civil aviation safety used in the 1944 Chicago Convention and which are reflected in national regulation: airworthiness certification; pilot licensing; and operating rules (importantly including rules for navigation of the civil airspace).

The rules of navigation in certain airspace classes require pilots to use visual means to ensure separation from other aircraft and to identify and avoid cloud, adverse weather conditions and collision hazards. In the case of RPA, inevitably the pilot will depend on alternative means to comply with these “detect and avoid” requirements (or “sense and avoid” requirements, in FAA terminology).

However, currently RPA cannot demonstrate compliance with those rules. The technology and procedures for detect and avoid purposes have yet to be demonstrated; and the related performance and technical standards have yet to be defined. This illustrates the two broadly inter-related challenges: the need to define the procedural and technical standards to ensure civil safety standards are met; and the need to develop technology and procedures to realise the requisite degree of safety.

Detailed requirements will also have to be defined addressing the novel airworthiness aspects of RPA, such as the remote pilot control station and the C2 link. Loss of the C2 link renders the aircraft without piloted control, and creates a hazard to other airspace users or those on the ground. A number of military heritage RPA are able to fly autonomously in a holding pattern or to designated safe holding airspace, while piloted control is re-established; failing that the aircraft may autonomously fly to a safe area to land or crash. However that scenario gives rise to other considerations: how will the autonomous flight of the RPA be accommodated in congested airspace; and will “safe” volumes of airspace need to be set aside out of busy airspace?
The US

With very limited exceptions, it has not been possible to obtain a civil certificate of airworthiness for RPA.

Non-military operation of RPA, large and small, in the US is limited to use by public authorities such as law enforcement (so called “public” category use). US Customs & Border Protection have operated Predator RPA since 2005. However all such operations are “accommodated” (rather than integrated); they are authorised by the FAA subject to restrictions and mitigation measures that keep them away from populated areas and large volumes of busy airspace.

In November 2013, the FAA published the US Road Map (“Integration of Civil Unmanned Aircraft Systems (UAS) in the National Airspace System (NAS) Road Map”). This sets out the activities to be undertaken by the FAA in conjunction with industry to integrate RPA into the US civil aviation system.

The initial focus is to enable the civil use of small RPA (less than 55lbs or 25kg) and a Notice of Proposed Rule Making is due to be published in early 2014. When brought in to force (some time in 2014-2015), this is expected to enable small RPA to be used in civil (including commercial) operation by accommodating them within limited ranges and below a defined minimum altitude in certain classes of airspace.

The FAA intends to use “pathfinder” airworthiness certification programmes to publish standard airworthiness requirements for civil RPA during the period 2014-2017. Those will include remote pilot stations and C2 links. Two such pathfinder programmes have already produced restricted airworthiness certificates for two types of RPA that have flown in Alaskan airspace.

The stated aim in the US is to accommodate “initial” routine civil RPA operation in the National Airspace System by 2020. However that target is for accommodation using mitigation measures (for example to compensate for the lack of proven “sense and avoid” measures) and the airspace available will inevitably be limited as a result. The Road Map envisages enabling use of ground based “sense and avoid” methods for military and public operation by the end of 2018. The Road Map does not specify a “target date” for enabling airborne measures and the implication is that this may not be achieved within ten years. The achievement of those (particularly the airborne) measures is likely to be a key factor determining the timeline for full civil integration of RPA.

Europe

The picture within the European Union, is slightly different to (and more fragmented than) that in the USA.

Small RPA are allowed by various European states to fly for civil (including commercial) use, subject to being duly licensed by the national aviation authority in question. Again this is by way of “accommodation”; they cannot demonstrate compliance with airworthiness and operating requirements and their access to airspace is limited. Typical restrictions in non-segregated airspace require the RPA to be within (unaided) visual line of sight of the pilot, and generally below 400 ft altitude.

Large RPA operation for civil purposes is non-existent. As yet no RPA have obtained EASA certificates of airworthiness and there are no established means of compliance with operating requirements, such as “detect and avoid”, beyond the (unaided) visual line of sight of the pilot.

The European Road Map was published in June 2013 by the European RPAS Steering Group (consisting of safety oversight and industry bodies, including EASA). It is expected that it will be used to direct regulatory and joint EU/industry initiatives over the next 15 years.

The Road Map focuses initially on enabling the expansion of light (less than 150kg mass) RPA operation within European states during the period 2014-2015. By 2018 it envisages harmonised pan-EU rules that allow the opening up of the European market to commercial light RPA use. Those commercial operations are likely to be limited in range due to restricting the pilot to maintain visual control of the RPA, either directly (line of sight) or through other visual observers.

The Road Map envisages gradual expansion of “accommodation” of civil RPA followed by partial integration into certain classes of airspace and initial limited mixed (ie, manned and unmanned aircraft) operation at aerodromes by 2023. The stated objectives, by 2028, include full integration into all classes of airspace, with regulations enabling “file and fly” operations and remotely piloted commercial freight transport.
Other challenges

Inevitably there are other challenges posed by RPA. The scale of intentional damage that can result from terrorist activity has regrettably been demonstrated. The RPA introduces at least one new element, namely the C2 link, which might be viewed as a new potential vulnerability to terrorist attack. C2 links will need to be protected against jamming or “hacking” and related standards and technology will need to be developed.

Privacy issues have been aired extensively in the US and are the subject of study activities set out under the European Road Map.

A number of questions arise concerning insurance and liability. Liability regimes vary from state to state. Within Europe the tendency is to impose strict liability (ie, without proof of fault on the part of the pilot/operator/owner) for damage suffered on the ground as a result of an aircraft in flight. However the detailed provisions vary; for example certain European states impose limits on the liability, whereas others (such as the UK) do not.

For international flights, the question arises as to whether the Rome Convention 1952 applies and whether it is appropriate when addressing RPA operations. The Convention imposes strict liability for damage on the ground caused by aircraft in flight, subject to limits which are prescribed according to aircraft weight. The Rome Convention makes no mention of RPA; numerous commentators argue (convincingly, in our view) that the Rome Convention should apply to RPA, but this may be challenged before national courts.

If applicable, it has been questioned whether the Rome Convention is fit for purpose with regard to RPA. The Convention is poorly supported and within Europe, the UK, France, Germany and the Netherlands do not apply it. There is also some scope for confusion in the application of its provisions to RPA; liability for ground damage is imposed on the “operator”, but who is the “operator”? The pilot and who controls the pilot may change in the course of a single flight.

Conclusions

Full integration of RPA into civil aviation faces significant challenges. However in the US, Europe and elsewhere the efforts to overcome those challenges are gaining momentum. Whether the timelines envisaged in the US and European Road Maps prove to be realistic remains to be seen, but there appears to be a good chance that there will be an expansion in RPA use over the next decade; and quite possibly remotely piloted commercial freight operations within the next couple of decades.

For further information, please contact Patrick Slomski
Update on the EU emissions trading scheme (ETS)

Developments in the EU ETS continue to perplex, with no sign of the war of words over this highly contentious scheme abating.

The EU's latest position

The European Union, having previously “stopped the clock”, set out its latest position by an announcement/memorandum on 16 October 2013. This stated that international aviation emissions would be covered by the scheme only for the parts of the flights that take place in European air space. This amendment would apply from 1 January 2014 until a global market-mechanism becomes applicable to international aviation in accordance with the intentions of ICAO (see further below).

The main features of the revised EU ETS scheme are:
- All emissions from flights between airports in the EEA will be included in the scheme
- From 2014 to 2020, flights to and from airports outside the EEA will be exempt, except for that part of the flight that takes place within the EEA (meaning 12 nautical miles from the furthest point of EEA territory). Readers familiar with the objections raised by most if not all non-EU airlines to the ETS will recall the allegation of alleged violation of sovereignty by imposing the scheme over flights occurring in non-EEA territory, a point dismissed by the Court of Justice of the European Union in its judgment in the Airlines for America case in December 2011
- Flights to and from developing countries, which emit less than 1% of global aviation emissions, will be completely exempt
- Overflights will continue to be exempt
- Non-commercial operators which emit less than 1000 tonnes of CO2 a year will be exempt
- The next date for the surrender of allowances (for the 2013 trading period) would have been 30 April 2014 (now subject to the two-year compliance cycle referred to below), so the EU Commission is keen to have these amendments to the legislation in force by then. Emissions from flights to and from third countries in 2013 will be fully exempted from the EU ETS, because implementation of the new scheme will require adjustment to monitoring and reporting and the allocation of free allowances

Further, there will be an “extraordinary two-year compliance cycle” for 2013 and 2014, with emissions for these two years only having to be reported by 30 April 2015 in the form of two emission reports, with allowances for these years to be surrendered by 30 April 2015. The Commission will conduct a review following the 2016 ICAO Assembly, to decide on any further actions to be taken with regard to the ETS.

Why has the Commission changed the goal posts in this way?

The ICAO 2013 resolution

On 4 October 2013, ICAO at its general assembly resolved to implement a global market based mechanism (MBM) for international aviation emissions by 2020, with reporting back on possible options by 2016.

The ICAO Council President, Robert Gonzalez, hailed this resolution as an “historic milestone for air transport and for the role of multilateralism in addressing global climate change” but it is hard to see it as anything but an aspiration, with no clear plan in place to achieve the goal. Most commentators seem to agree that the only realistic market-based mechanism option available is a form of emissions trading (carbon offsetting is not technically an MBM), the procedural requirements for which have been developed by the EU. Two years is a long time to come up with options, and a lot of carbon dioxide will have been emitted by 2020.

None of this is a victory for the EU, in fact quite the reverse, and it is reasonably clear that if the EU had followed the exact terms of its “stop the clock” announcement of November 2012 it should have “snapped back” application of the ETS to non-EEA flights. Clearly this was a politically unpalatable option given the hostilities that would be recommenced, including the very real possibility of a trade war, and following the ICAO Assembly most commentators expected the EU to draft new legislation permanently to amend the ETS Directive so as to cover only intra-EU flights. Their actual decision to exempt emissions from that part of flights over non-EU territory was therefore surprising, but logically consistent in addressing one of the main objections raised to the ETS.
The EU’s approach may seem a reasonable compromise, but has itself faced widespread opposition. Environmental groups claim that the scheme is now too watered down – the new proposal covers only 35% of the emissions that would otherwise have been covered by a fully implemented ETS as originally crafted – whilst trade associations such as IATA still object to a scheme that has any extra-territorial scope (ie, still imposing monitoring and reporting, and potentially enforcement action, on non-EU carriers, for their EU flights). Airlines for America has stated that in its view the amended ETS “flies in the face” of the ICAO agreement. Sources familiar with the debate report that the EU may yet consider an extension of the “stop the clock” policy to 2020 in order to give time (and plenty of it…) to ICAO to work on its MBM.

ELFAA action

Amongst these developments, objections have also been raised to the EU’s “stop the clock” mechanism, which was announced in November 2012 and suspended enforcement of the ETS for one year against carrier’s obligations in respect of flights to and from the EEA, whilst leaving the ETS fully applicable in respect of intra-EU flights. This partly appeased international operators but has been objected to by predominantly intra-EU aircraft operators, in particular those represented by the European Low Fares Airline Association (ELFAA) and the European Regions Airline Association (ERAA). ELFAA commenced proceedings in the English High Court, arguing, amongst other points, that the “stop the clock” mechanism is distortive of competition, and was made on political grounds without a proper economic impact assessment. ELFAA registered a stay of proceedings until the ICAO Assembly in October 2013. The path remains open to object to the EU Commissions’ latest announcement.

Conclusion

Approaching two decades since the Kyoto Protocol was signed requesting airlines to work through ICAO to come up with a global solution, and six years since Directive 2008/201/EC included aviation in the EU ETS, the debate on the best way to address emissions from aviation seems far from resolved and as polarized as ever. At the ETS level, the scheme has only been running for two years but has already been significantly amended twice, in reaction to political events and without much assessment of the underlying economic impact or the frustrations for carriers having to deal with constantly changing legislation. Most non-EU airlines still oppose the scheme even in modified form, and many have been instructed by their national governments not to comply with it; whilst many intra-EU carriers support it, but not in its modified form. In the meantime ICAO has committed to implement a scheme in six years’ time, but operators have already waited 16 years for ICAO to provide an alternative to the ETS. Barry Moss, chief executive officer of Avocet Risk Management, says: “Judging by the international response so far consensus concerning the mechanics of a global aviation emissions scheme at the next ICAO general assembly in 2016 seems unlikely”. It is indeed very hard to see a way forward that will have the support of the entire airline industry.

For further information, please contact Mark Bisset
Fume events: the current position

An aircraft is beginning its final approach when the pilots notice an unusual odour in the cockpit. Without warning, the First Officer becomes nauseous and his arms and legs start to feel numb. The Captain starts to experience similar symptoms, although he is less severely affected. Both put on their oxygen masks, but the First Officer is now unable to comprehend or follow what is happening. The Captain decides to land without completing the pre-landing duties as he does not feel able to perform a go-around.

Although this may sound like a scene from a disaster movie, these events happened on a flight from Vienna to Cologne on 19 December 2010. The aircraft was able to land safely, although both pilots were deemed unfit to work for six months. But what was the cause and why did it occur?

Since the inception of high-altitude commercial aircraft, it has been necessary to find ways to provide a continuous supply of pressurised air for the cabin. In earlier jet engines, separate mechanical compressors were used to achieve this. However, it was soon recognised that jet engines heat and compress air as part of the propulsion process, whilst the air is in the forward section of the engine. This pre-heated and compressed air can be “bled off” from the engine and pumped straight into the cabin after being cooled. Since the 1960s, bleed air jets have been used for all commercial airliners with the exception of the Boeing 787 Dreamliner.

Although generally considered safe, bleeding off air from the engines is not risk-free. Bleed air can occasionally become contaminated by pyrolised compounds such as engine oil, de-icing or hydraulic fluid. The contamination can occur through mechanical failures, the overfilling of oil or hydraulic fluid reservoirs, ingestion of de-icing fluid through the auxiliary power unit and even the engine design itself. This is what is commonly referred to as a “fume event”. Although there is currently no agreed definition as to what constitutes a fume event, it may involve hazy smoke in the cabin and is normally categorised by the presence of a strong smell.

Whilst contamination can occur from various substances, the media most often focus on contamination by jet oil. The reason behind this is that, while contamination of bleed air by hydraulic or de-icing fluid can cause short-term irritation to the eyes, nose and throat, these substances are not generally linked to long-term health effects. However, in the case of jet oil, organophosphates are used as “extreme-pressure additives”, which provide lubrication and anti-wear properties to the jet engine in very high temperatures and pressures. Of particular concern is the organophosphate tri-ortho-cresyl phosphate (or TOCP), which is known to be toxic to the nervous system in very high quantities.

The legal regime in relation to fume events

The Montreal Convention 1999 (or the Warsaw Convention 1929, depending on the passenger’s itinerary) would govern claims by passengers against air carriers. The Convention would not apply to claims against manufacturers or other defendants, although carriers may choose to seek indemnity from them.

In Air France v Saks, the US Supreme Court defined an accident under Article 17 of the Warsaw Convention as “an unexpected or unusual event or happening that is external to the passenger” and not “the passenger’s own internal reaction to the usual, normal and expected operation of the aircraft”.

If a court were to find that a fume event was sufficiently serious to constitute an “accident” – in other words that the fume event was “unexpected or unusual” from the passenger’s perspective - then, assuming a passenger could show “bodily injury”, the airline’s liability would be likely to engage.

Cases involving cabin crew

A legal precedent has been set establishing a connection between fume events and long-term health effects in the Australian case, Turner v Eastwest Airlines. Joanne Turner claimed against her former employer, Eastwest Airlines, for injuries she allegedly sustained after being exposed...
to “thick smoke” during a twenty minute fume event on a BAe146 flight to Brisbane on 4 March 1992. Ms Turner, who was five months pregnant at the time of the incident, said that she had immediately started coughing and experienced a burning throat, sore eyes and headache. When her persistent cough failed to improve and became chronic, she brought a claim before the Dust Diseases Tribunal in New South Wales, relying on the applicable workers’ compensation statute, claiming that her former employer had negligently exposed her to fumes, chemicals and dust, which had caused the persistent cough. She sought both economic and non-economic damages in compensation.

The Tribunal found that Ms Turner had been exposed to oil fumes and smoke and determined the cause as an engine oil leak in the auxiliary power unit. The failure of the auxiliary power unit’s oil seal was found to be foreseeable, as was the risk that smoke from leaking oil would enter the cabin. The Tribunal agreed with Ms Turner that the airline did not take reasonable steps to mitigate the risk of an oil leak contaminating the cabin air, despite knowing that the faulty compressor seals could emit vaporised oil into the bleed air system. The auxiliary power unit in question had recently been leaking oil and cabin smells had been reported. However, steps had not been taken to locate and remedy the source of the smells.

The Tribunal held that toxic particles of vaporised engine oil had caused Ms Turner’s long-term adverse health problems and she was awarded approximately USD 129,000. The Tribunal further found that Ms Turner’s symptoms put her at a disadvantage in the labour market and caused her to suffer a loss of earning capacity. Ms Turner was therefore awarded damages for non-economic loss, past and future loss of earnings, medical expenses and out-of-pocket expenses.

Eastwest Airlines appealed to the New South Wales Court of Appeal and then to the High Court of Australia, but lost both appeals (the latter being heard on 3 September 2010). Although this decision is not binding in courts outside Australia, it could have persuasive effect.

In another case involving a member of cabin crew, former American Airlines flight attendant Terry Williams is believed to have been the first person in the US to settle a fume events claim against Boeing. She claimed the manufacturer knew that the MD-82 aircraft and its bleed air system were defective, but did nothing to protect her or the passengers and other crew members from toxic fumes that entered the cabin, as American Airlines flight 843 taxied to the gate at Dallas airport on 11 April 2007. The fume event allegedly caused her to suffer tremors, memory loss and severe headaches amongst other ailments. Details of the settlement are confidential.

Whilst these cases may appear to set a precedent for future claims, it is important to highlight that they are distinguishable from passenger claims, as they are not governed by the Montreal or Warsaw Conventions, as passenger claims are.

**Recent and future claims**

Both flight attendants and passengers have filed toxic cabin air claims in the US courts in recent years. Defendants have included airlines and aircraft manufacturers, as well as aircraft engine manufacturers, manufacturers of air-conditioning and pressurisation systems, aircraft owners and lessors. The courts have yet to consider the merits of these cases, because the claims have either been dismissed or withdrawn.

Such a claim has recently been filed against Delta Airlines and Airbus before the Circuit Court of Arlington County. Christopher Kamyszek, who was a passenger on board a Delta Airlines flight from Salt Lake City to Minneapolis on 16 December 2011, is seeking USD 5 million compensation for alleged loss of enjoyment of life, ability to earn a living and employment, as well as damages for mental pain and suffering and permanent, debilitating physical injury. He claims he was injured by a fume event on board the aircraft, approximately fifteen minutes after take-off. It remains to be seen whether this case proceeds to trial.

It is also possible that passengers in particular may be able to claim that a carrier failed to warn them of the possible presence of cabin air contaminants. In a class action lawsuit against United Airlines in 2004 (In re UAL Corp), the named claimants, Richard and Sharon Dorazio, flew from Los Angeles to Sydney on a United Airlines flight where insecticides were sprayed in the cabin before and during the flight, as legally required for all aircraft entering Australia and New Zealand. It was claimed that Mrs Dorazio became ill as a result of exposure to
the insecticides, and that the spraying of insecticide constituted an Article 17 Montreal Convention accident, because it was unexpected and, had they been warned in advance of the disinfection, no such accident would have occurred, because they would have taken the appropriate action. The court rejected the claimants’ arguments, citing the deep vein thrombosis decisions that have “uniformly declined to find Article 17 accidents in the absence of an airline’s deviation from ordinary operating standards”. It is to be hoped that other courts would follow this reasoning and hold that airlines have no duty to warn passengers about the possibility of fume events or contaminants that may be present during normal aircraft operation.

Conclusion
In light of the growing media coverage and cases of the kind discussed above, it seems likely that further pressure will be applied to the airline industry to address concerns surrounding bleed air and the risks of contamination during fume events.

The Boeing 787 Dreamliner is the only modern commercial aircraft that uses an electric compression system and therefore does not use bleed air from the engines. It is yet to be seen whether or not other aircraft models will follow suit.

What is clear is that there is a growing call to retro-fit contamination detection systems and bleed air filtration to aircraft. Many would like to see organophosphates removed from jet oil altogether, and such oils are already in development. However, given the proven effectiveness of organophosphates as anti-wear agents, it is not clear how widely these new organophosphate free oils will be taken up throughout the aviation industry.

Whatever the final solution, there is likely to be an impact on airlines in the coming years. Should a passenger succeed in proving a causal link between a fume event and health issues, airlines will have to take steps quickly to avoid potentially significant litigation costs.

For further information, please contact Elizabeth Lambert-James or Nicola Williams.
Aircraft re-delivery – don’t make a drama out of a crisis

Re-delivery generally

The matter of re-delivering an aircraft to its owner at the expiry or earlier termination of an operating lease is necessarily a complex one. A well-organised process involving the commercial, technical and often legal resources available to the operator (and similarly both the owner and any third party maintenance provider contracted to work on the aircraft through the redelivery phase) is essential in order to avoid not only difficulties with the phasing-out of the aircraft from revenue service but also circumstances in which the owner of the aircraft might take advantage to the ultimate detriment, usually cost, of the relevant lessee.

Market trends

The flight in recent times of traditional aircraft finance lenders from the aviation finance market has created, in certain segments of the market, a significant shortfall in available capital which is required for the extensive fleet orders that have been placed at this time. Part of that shortfall is being addressed by motivated equity sources, part by the export credit agencies and a portion by the aircraft manufacturers themselves. None is more hungry however than the range of existing and new entrant operating leasing companies, who see huge growth potential in offering sale/leaseback financing for the ‘right’ equipment and jurisdiction and are prepared in order to beat off the significant competition to provide elements of financing also for the pre-delivery payments required to be made by the airlines. Combined with the continually robust levels of operating leasing of used aircraft of the full range of types, this means leasing know-how and leverage will assume even more importance in this next phase of the aviation cycle. Matters relating to the re-delivery of the aircraft to its owner and relevant to the period around the expiry of the contractual term or any earlier termination of the relevant lease are clearly a hugely important aspect of any leasing transaction and therefore should be given priority as regards items to be addressed comprehensively in any lease negotiation.

Preparation and risk management

As mentioned above, organisation and therefore preparation is key to dealing usefully with the range of issues associated with re-delivering an aircraft. That preparation starts ideally with the necessary efforts being made to negotiate a well-balanced and ultimately fair lease agreement which is also clear and unambiguous in respect of its terms and conditions and contains the necessary mechanisms to ensure the interests of the lessee operator are properly protected. The precursor to that is usually a partially-binding ‘Letter of Intent’ or ‘Heads of Terms’ which will seek to contain some of the relevant provisions even at that stage and therefore the same concerns apply to any negotiation of that document also in terms of what it contains.

Techniques

On any level, the ability to secure a fair position for the operator lessee will ultimately depend on the respective bargaining positions and therefore ‘leverage’ of the parties concerned. There are therefore many good reasons to avoid, for example, the scenario which sees a prospective lessee which is desperate to obtain additional capacity by way of a leased aircraft but is severely time-constrained in terms of the aircraft’s required entry into service.

In the event of the opportunity to properly work through a lease negotiation, there are a number of mechanisms and concepts which, if properly addressed in the drafting and clearly understood and disseminated among their teams...
by the respective parties, can go a long way to addressing the inherent imbalance and potential unfairness between the positions of a lessor and a lessee. Several of those are connected from a lessee’s perspective, whether directly or indirectly, with the matter of aircraft re-delivery and the period at the end of the leasing relationship between the parties.

**Redelivery conditions themselves**

Market practice has moved on considerably from when an aircraft was required to be returned to its owner in substantially the same condition as at delivery, “fair wear and tear excepted”. The potential for disagreement when applying such a general concept to specific component conditions is fairly clear. Specific and detailed redelivery conditions should be drafted by those with legal or commercial expertise with continued input from technical post-holders to form part of the lease agreement.

**Compliance with redelivery conditions**

It is still not uncommon that a bona fide dispute occurs between the parties in the course of a re-delivery process for an aircraft, where a lessee maintains that it has complied with the terms of the lease agreement and a lessor or owner disagrees. In some cases the ability of either party to refer the matter to an independent third party with the appropriate know-how (for example, a qualified engineer licensed to cover the relevant aircraft or component type and nominated by the Royal Institute of Aeronautical Engineers) before litigious steps are considered is a genuinely helpful option, particularly in the context of a delayed redelivery which might give rise to certain imbalanced rights as referred to elsewhere in this article. This should hold little fear for a party which intends to act reasonably and with integrity in this regard.

**Lessor rights**

Typically, a lease agreement (which will in almost all cases be provided by the aircraft owner or lessor) will seek to contain provisions whose intention is to maximise any and all leverage possible over an operator in conjunction with the return of its asset. While it is accepted that an aircraft owner is entitled to deal with its property in this way, it is important to balance any attempt to exploit that premise. For example, the lease agreement will typically require enhanced rent (possibly even double the contracted rent amount) to be paid from the time when the aircraft was expected to be delivered until it is actually delivered to the owner, in each case with the aircraft in the required redelivery condition. Where there is a genuine breach by the lessee it is reasonable to ‘incentivise’ the party to complete the redelivery work and avoid paying what is in effect a penalty charge. However, where there is a genuine dispute about the aircraft condition or where a lessor is having difficulty securing a follow-on lessee for its aircraft, then the regime applicable needs to change – for example, an initial grace period from rent, a ‘freeze’ of payment obligations until any dispute is resolved using a technical adjudicator or similar, or a ‘stepped’ approach to increasing rental payment.

**General terms**

While not necessarily connected with the aircraft redelivery at lease expiry or earlier termination per se, a number of other issues dealt with in the lease agreement between the parties will do well to be given similar focus at the outset of discussions, including:

- **Return of security deposits**
  Usually representing a significant cash amount (typically equal to three rental payments) whether held as such by the owner or lessor or by a third party provider of documentary credits as collateral, these need to be returned to the lessee as quickly as possible and independent of any dispute between the parties regarding redelivery conditions (unless the lessee has breached its payment of rent obligations)

- **Maintenance reserves**
  The accumulated reserve amounts should be made available to pay for the costs of redelivery of the aircraft to the owner or the lessee, save for those reserves which genuinely compensate loss of utilisation of aircraft components and consumed life on limited parts. This would have the effect of mitigating any unfair windfall on the part of the aircraft owner or lessor, which is not the purpose of entering into a long term operating lease agreement. In addition, it is worth considering structuring maintenance reserve obligations and rights so that cross-drawing between different reserve accounts is allowed in order to manage cash flows at the relevant times (subject to a certain limited “topping-up” obligation on the part of the airline), particularly across engine components, for which reserves are accrued separately
Lessor solvency

Usually for withholding tax management reasons but often (in the case of new aircraft financing in particular) for risk allocation purposes in the context of a particular financing structure, the lessor or aircraft owner is simply a special purpose company with no assets other than the aircraft or the receivables from the relevant specific lease transaction itself. In this situation, there is a genuine risk of it not being able to perform (admittedly few in number) material obligations to a lessee under a typical operating lease, such as the reimbursement of maintenance reserves to cover the costs of scheduled maintenance during the lease, the return to the lessee of cash security deposits and indeed the ongoing availability of the aircraft itself for the lessee. Mechanisms to consider when looking to mitigate the effects of this risk might include a third party holding cash payments made by the lessee, documentary credits instead of cash to secure the obligations of the lessee generally and a guarantee from a sufficiently creditworthy entity of good standing of the obligations of the aircraft owner or the lessor to the operator under the relevant lease agreement.

Conclusion

These are just a few of the issues we see regularly in the context of aircraft leasing transactions insofar as they relate directly or indirectly to the circumstances of redelivery of the aircraft to its owner. It is difficult to always quantify the value in dealt terms as regards time, management attention and ultimately the costs of external professionals required to solve problems arising. However there is clear and demonstrable evidence from the market, both historically and currently, that an open and organised approach to contemplating the issues in play and implementing mechanisms to deal with them will avoid a difficult situation and turning a strained relationship between the parties into a full-blown crisis.

For further information, please contact Philip Perrotta.
The mortgagee’s duty on the sale of mortgaged aircraft

In this article we discuss the mortgagee’s duty on the sale of mortgaged aircraft under English law (including the recent Alpstream AG and others v PK/GECAS case), and we comment briefly on some equivalent requirements in respect of New York law mortgages, which also are commonly used in aircraft finance.

**English law mortgages and the Alpstream AG and others v PK/GECAS case**

English law aircraft mortgages will usually allow the mortgagee/lender, in a default situation, to exercise ‘self-help’ and sell the aircraft without the need to involve the courts. This can be by private or public sale or auction with or without notice to the mortgagor. However, the mortgagee must consider the mortgagor’s ‘equity of redemption’, ie, that there may be equity in the asset to be returned to the borrower/mortgagor from the sale proceeds after repayment of the loan. The law therefore requires the mortgagee to use its best endeavours to sell the distressed asset for the best price reasonably obtainable, and to act in good faith for proper purposes.

A recent Commercial Court case serves as an example of a breach of duty by a mortgagee when selling mortgaged aircraft to a connected company (Alpstream AG and others v (1) PK Airfinance Sarl (PK) and (2) GE Capital Aviation Services Limited (GECAS) [2013]). The case is of particular interest in so far as it holds that the duty of the mortgagee owed to the mortgagor is also owed to the residual beneficiary of the sale proceeds within the same contractual structure (ie, a junior lender), and explores unlawful means conspiracy within the context of sale of distressed mortgaged assets by the mortgagee to a connected party.

It is worth stressing that the successful claimant in this case was not a mortgagor/borrower (all of which were too far in debt to have suffered any loss), but a junior lender which had provided finance for three of the seven aircraft and which was entitled, pursuant to a ‘waterfall’ security arrangement, to be repaid from any equity in those aircraft after repayment of the senior lenders, ie, any excess sale proceeds.

In very brief outline, the senior lender/mortgagee (PK) sold six of seven repossessed A320s to a connected third party (GECAS) for the purpose of leasing the aircraft to a US airline. A junior lender (Alpstream) which had provided a loan subordinated to the security of PK in respect of three of the seven A320s, and which was not a mortgagee but ultimately was entitled to repayment from surplus proceeds of sale of the aircraft (ie, a residual beneficiary of the sale proceeds within the same contractual structure), successfully claimed that PK and GECAS breached the duty to use best endeavours to sell the distressed asset for the best price reasonably obtainable, and were liable for the tort of unlawful means conspiracy.

Significantly, the fact that the sale by the mortgagee had been to a connected party had the effect of shifting the evidential burden from the mortgagor to the mortgagee which then had to prove that, on the balance of probabilities, it had in fact used its best endeavours to sell the aircraft for the best price reasonably obtainable.

In practice this means that, unless the mortgagee can establish that the “desire to obtain the best price was given absolute preference over any desire” (Tse Kwong Lam v Wong Kit Sen, a 1983 Privy Council case and one of the guiding authorities on sale by a mortgagee to a connected party), the only conclusion can be a breach of duty. Moreover, if it is clear that such onus is not satisfied then “the measure of damages must be the difference between the best price reasonably obtainable [at the relevant date] and the price … paid” (Tse Kwong Lam). This contrasts with the ordinary case where the mortgagor/borrower must prove the breach: “a mortgagee will not breach its duty to the mortgagor if, in the exercise of its power to sell the mortgaged property, it exercises its judgement reasonably and to the extent that that judgement involves assessing the market value of the mortgaged property the mortgagee will have acted reasonably if its assessment falls within an acceptable margin of error” (Michael v Miller [2004]). In a sale to a connected party, there is no “acceptable margin of error.”
For PK and GECAS to be liable for the tort of unlawful means conspiracy, the following had to be proven: (i) actions in furtherance of a common design, (ii) by PK or GECAS, using means which were unlawful, and when they knew they were unlawful, or, with knowledge of the facts, were reckless as to whether they were harmful, (iii) with the intention to cause loss to another, or, deliberately, and knowing that they will cause loss to another as a result.

As regards breach of duty, in outline, the Judge held that PK acted with wilful misconduct (ie, unlawfully) and in breach of its aforementioned duty as mortgagee, and that such duty owed to the mortgagor is also owed to the residual beneficiary of the proceeds within the same contractual structure, being Alphastream (the junior lender in respect of 3 of the aircraft which was entitled to residual equity in respect of those aircraft once PK’s loan had been repaid).

The Judge found that the auction exercise carried out by PK was “(at best) half-hearted” and “somewhat of a charade”. For instance, PK did not take adequate steps to inform potential bidders of the substantial value-enhancing work that was carried out on the aircraft prior to the auction (which was “unprecedented but untrumpeted” and carried out for the purpose of leasing the aircraft to the US airline), to market the aircraft or follow up with interested bidders, or to obtain independent valuations.

The Judge commented that “it was not necessary or impossible for GECAS to advance its determination to purchase the aircraft for the purpose of leasing to [the US airline]... provided that PK could show that the correct value was obtained”, as a result, “there was no point in an auction, certainly not a half-hearted auction, in order to arrive at a price at an auction at which there was no competition”, and “had they simply acted straightforwardly, it would have been upon the basis that they intended, by... March 2010, for PK to purchase, sell to GECAS, transfer to the N register and lease to [the US airline]. It would then have become apparent that GECAS acted with wilful misconduct (ie, unlawfully) and in breach of its aforementioned duty as mortgagee, and that such duty owed to the borrowers but... to the residual beneficiary Alphastream”.

As regards conspiracy, the Judge found that PK and GECAS were liable for conspiracy, to the relevant standard of proof. The Judge commented that his conclusions as to there being a breach by PK of its duty (involving wilful misconduct) owed to the borrowers (and to Alphastream), and the procurement of such breach by GECAS, are sufficient to establish ingredients (i) and (ii) mentioned above. As to the third ingredient, the Judge found that there was “deliberate loss, which both PK and GECAS knew and intended to be caused by the unlawful acts, not only to the borrowers but... to the residual beneficiary Alphastream”.

In respect of the three aircraft in which Alphastream was residual beneficiary, the Judge assessed the equity as USD 42.18 million (value of USD 124.38 million less debt of USD 82.2 million). Before taking into account this equity, the deficit on the mortgage account (recoveries/credits less total debt and cost of maintenance etc. work) was assessed at USD 24.825 million. This deficit would then have been offset against the USD 42.18 million equity in respect of the three aircraft in which Alphastream was residual beneficiary. It was the diminution in value of that equity which was found to be Alphastream’s loss, and Alphastream was awarded damages of USD 10.175 million (being the aggregate of the USD 11.2 million sale price difference, adding additional swap break costs of USD 1.4 million and adjusted by USD 0.375 million for the use of new instead of reconditioned engine fan blades). We understand that PK/GECAS may be planning to appeal the decision.

New York law mortgages

Under the Uniform Commercial Code (UCC) Article 9, the secured party (mortgagee) disposing of collateral has a duty to act in good faith and proceed in a commercially reasonable manner as to all aspects of a disposition. Every aspect of the disposition must be commercially reasonable. UCC § 9-610(b). The duty exists irrespective of whether or not the borrower/mortgagor has surplus equity in the mortgaged asset.

A creditor that fails to proceed in a commercially reasonable manner in disposing of collateral may lose the ability to collect on a deficiency after a foreclosure. With respect to damages for noncompliance, UCC § 9-625(b) specifically provides that “Subject to subsections (c), (d), and (f), a person is liable for damages in the amount of any loss caused by a failure to comply with this article.” Therefore, the general rule is that the creditor may be liable for actual damages for noncompliance with Article 9 of the UCC.
Notably, subsection (d) of UCC § 9-625 provides:

**Recovery when deficiency eliminated or reduced.**

A debtor whose deficiency is eliminated under Section 9-626 [action in which deficiency or surplus is in issue. e.g., where the secured party has disposed of the collateral] may recover for the loss of any surplus. However, a debtor or secondary obligor whose deficiency is eliminated or reduced under Section 9-626 may not otherwise recover under subsection (b) for noncompliance with the provisions of this part relating to collection, enforcement, disposition, or acceptance.

The last sentence of subsection (d) eliminates the possibility of double recovery or other over-compensation arising out of reduction or elimination of a deficiency based on noncompliance with the UCC provisions relating to, inter alia, disposition of collateral. Accordingly, the creditor can be liable to the debtor for disposing of the collateral in a commercially unreasonable manner, but damages should be limited to recovery for the loss of any surplus.

As to who may recover actual damages for noncompliance with Article 9, the UCC provides that “A person who, at the time of the noncompliance was a debtor, an obligor, or held a security interest in or other lien on the collateral may recover damages.” UCC § 9-625(c))

New York law aircraft mortgages commonly contain a provision along the lines that upon the mortgagee giving the mortgagor 15 days’ prior notice, the mortgagee can, “without advertisement”, sell at public or private sale the whole or any part of the collateral. The UCC does not mention advertisement in this context, therefore we have seen borrowers argue that an express right to sell without advertisement runs contrary to the UCC requirement to proceed in a commercially reasonable manner (which on the facts may or may not require advertisement).

As regards private sales, we have seen borrowers object to clauses requiring them to waive any claims against the mortgagee arising by reason of the fact that the price at which the aircraft may have been sold at a private sale was less than the price that might have been obtained at a public sale (or was less than the aggregate amount of the secured obligations). Borrowers have argued that such a waiver is not acceptable on the basis that separating the price from the manner of the sale is artificial, and effectively renders the UCC obligation to proceed in a commercially reasonable manner unenforceable, as it will be precisely the price that would be in dispute.

For further information, please contact Richard Sharman or Nick Magali.
Whose engine is it anyway? Challenges to engine leasing in Denmark

A December 2012 ruling has effectively called into question the validity of engine leases in Denmark. Ruling in relation to the bankrupt regional airline Cimber Sterling, a judge in the District Court of Sønderborg ordered the trustees of the estate to return seven of the nine engines in question to the engine lessors. However, the two remaining engines, both GE CF34s valued at around USD 2 million each, were to be retained by the trustees as on the date of bankruptcy they had been affixed to the Bombardier CRJ200 aircraft for over three months.

Pending the outcome of appeals expected in this case, the ruling of the District Court has troubling implications for the engine leasing industry. If engines are to be viewed as belonging to the aircraft after three months despite being leased by a discrete owner under a separate lease agreement, engine lessors’ confidence in their ownership rights will inevitably be damaged.

The Cape Town Convention disapplies this “doctrine of accession” in jurisdictions where the Convention applies.

For further information please contact Richard Sharman
The issue of international child abductions by parents is a growing problem in the US. According to the US Department of State, reported abductions by parents in the context of child custody disputes have increased by a factor of almost three in the past decade. This rise in parental abductions is a logical outgrowth of multi-national marriages and, by extension, divorces. The US Governmental response to this problem has been limited and “left-behind” parents have sometimes sought to make airlines responsible for preventing abductions. Some parents have commenced litigation in US courts to impose civil liability upon commercial airlines for international parental child abductions. Such litigation has been consistently resolved in favor of the airline, as typified by the recent appellate decision in Bower v. El-Nady.

The scepticism of US courts for such claims is fortunate from the perspective of the airlines and their insurers; if courts were to recognize such claims, airlines could face significant liability exposure in the US. As any parent would appreciate, the value of a child’s companionship is incalculable, and the loss of that relationship is unimaginable. Of course, this has not stopped the efforts of plaintiffs’ attorneys to value the relationship in monetary terms. For example, in one case – Pittman v Grayson – a New York jury awarded the “left behind” parent USD 15 million, payable by the airline, although that judgment was later overturned.

Notwithstanding these successes, airlines continue to face pressure to respond to the government’s failure to address the underlying problem. Just as the problem of international child abduction will likely not go away anytime soon, so too will US litigation against airlines for their unwitting roles in such abductions.

In the US, state courts are tasked with resolving child custody disputes between parents. They do so primarily by issuing court orders, ideally in the child’s best interests, that pertain to the child’s upbringing. Determining where the child will reside, and where the child may (and may not) travel, are fundamental to such child custody orders. Court orders prohibiting parents from travelling internationally with their children are common, so common that many US family courts automatically – without a hearing and even without a Judge’s signature – order both parents to refrain from removing their minor children from the geographic boundaries of the state when a parent commences a divorce or paternity action.

Unfortunately, child custody orders are among the most frequently disobeyed orders issued by US courts. Examples abound of parents abducting their children in violation of a court order. While the US Government has implemented efforts to limit parental child abductions – for example, through the requirement that both parents consent to the issuance of a child’s passport and Department of Justice AMBER alerts distributed to the Transportation Security Administration in verified cases of child abduction – those efforts have inherent limitations and, as a fundamental matter, the US Government essentially has no centralized controls for gathering child custody data and preventing “at-risk” children from leaving the US.

Claims against airlines for parental child abductions are relatively rare, and there are few recently reported cases in US courts that involve the issue. To date, all reported decisions correctly conclude that airlines are not liable for this type of claim. US courts have rejected these claims on two primary grounds. First, courts have concluded that a commercial airline has no legal duty to determine whether a parent is transporting his or her child out of the US in violation of a child custody order. Second, courts have determined that the matter is preempted by the Airline Deregulation Act of 1978 (“ADA”), which prohibits states from enforcing any law “relating to a price, route or service” of any air carrier.”
**Bower v El-Nady**

The legal issues involved in these cases are typified in *Bower v El-Nady*, the most recent US federal appellate court decision in this area. In *Bower*, the First Circuit Court of Appeals affirmed the entry of summary judgment in favor of EgyptAir and dismissed a claim by a “left-behind” father whose two minor sons flew from the US to Egypt with their Egyptian-born mother in violation of a family court custody order.

The father’s efforts in the Egyptian courts to secure the return of the children to the US were unsuccessful and the mother and children remained in Egypt. The father then sued the mother and EgyptAir in the US, claiming that the circumstances surrounding the mother’s travel with her children were so unusual that EgyptAir should have prevented the children’s travel. Specifically, the father claimed that the mother and the children traveled pursuant to one-way tickets; the mother used cash to purchase the tickets (costing almost USD 10,000) at the airport terminal on the same day as the flight and the children’s last names were different from the mother’s last name.

The District Court dismissed the case on summary judgment, holding that EgyptAir did not owe the father any duty of care because he did not purchase a ticket from EgyptAir, nor did he have any relationship – contractual or otherwise – with the airline. The District Court, however, did rule that plaintiff’s negligence claims were not preempted by the ADA because such claims did not relate to the “price, route or service” of EgyptAir.

Plaintiff appealed and the First Circuit Court of Appeals affirmed the dismissal, albeit on different grounds than those articulated by the District Court. Specifically, the First Circuit agreed with EgyptAir that the District Court erred in finding that plaintiff’s claims were not preempted by the ADA. Because plaintiff’s claims essentially challenged the ticketing, check-in and boarding procedures of EgyptAir, the First Circuit held that plaintiff’s claims were sufficiently related to the “service” of an air carrier that they were preempted by the ADA. Because the claim was preempted, there was no need for the court to reach the issue of whether EgyptAir owed a duty to prevent parental kidnapping.

**Other cases**

Prior to the recent *Bower* decision, other US courts have consistently dismissed similar parental abduction claims brought against airlines. These cases include *Pittman v Grayson* from the Second Circuit Court of Appeals, *Braden v All Nippon Airways Co., Ltd.*, an intermediate appellate decision in California state court, and *Ko v Eva Airways Corp* from the District Court for the Central District of California.

**Conclusions**

Notwithstanding, civil actions against airlines by “left-behind” parents are likely to continue. The US Government’s efforts to solve the underlying problem have been limited. International child abductions will likely continue, as will litigation in US courts arising from such abductions. However, airlines and their insurers can take some comfort in the fact that US courts to date have correctly recognized that commercial airlines owe no duty to prevent their passengers from abducting their children and, furthermore, that claims by the “left behind” parent are directly related to an airline’s “service” and are, therefore, preempted by the ADA.

Clyde & Co represented EgyptAir and EVA Airways in the cases noted above.

For further information, please contact Scott Lantry.
Rights and duties arising from bailment and liens

As a reflection of the current economic climate, in the second quarter of 2013 there were 3,978 compulsory liquidations and creditors’ voluntary liquidations in England and Wales added to which 1,315 people per day reported becoming redundant. This highlights customer solvency as a serious risk to maintaining a healthy business, especially those engaged in providing high value services, such as aircraft maintenance repair organisations (MROs).

A common method to protect against such credit risks is to retain possession of an aircraft or spare parts, frequently in the exercise of a lien. However, this is a passive remedy and can cause expensive storage problems, especially where the owner proves absent or recalcitrant. Without ownership rights, a difficult question arises as to how to control mounting expense and ultimately how to dispose of the items. This article reviews the nature of that possession and an option that has rarely been considered – using the Torts (Interference with Goods) Act 1977 to seek to obtain an order for sale.

Why is possession a problem? – bailment and liens

A bailment is a legal relationship related to physical possession of property. It arises where one party (the bailee) voluntarily takes custody of goods belonging to another (the bailor). The bailee/bailor relationship creates independent rights and obligations – so, for example, need not depend upon other legal relationships such as a contract. One of the significant obligations imposed upon the bailee is a requirement to take reasonable care of the goods. Surprisingly, there is very little English case law providing guidance as to how that obligation should be discharged, which will depend upon the circumstances of each case. It is submitted that the bailee is not obliged to take every conceivable precaution to prevent loss or damage but that the obligation requires taking such care of bailment property that a person would take in respect of their own property.

A person – a lienholder or lienee – who retains property belonging to another – the lienor – against a claim for payment generally asserts a lien. A lien provides a legal right to hold the property of another as security for the performance of an obligation, such as in this example, payment of a debt. These rights are generally unassignable and take precedence over other security interests, such as a mortgage over an aircraft. There are several types of lien. One arising by operation of law, a “possessory lien”, is determined by restrictive pre-requisites; in the context of aircraft, asserting such a lien requires possession of it where work, authorised by the owner, has been completed and improves it (ie, there is no lien for pure maintenance). A broader power can be agreed contractually and can therefore remove, for example, the requirement for improvement.

At common law, a lien only provides for a passive right to possession, which gives rise to a bailment relationship, under which preservation of an aircraft requires regular checks and special care if, for example, the aircraft is stored outside.

This raises the question whether the service provider can recover expenses incurred while a dispute unfolds. The traditional position of English law is to deny any claim for expenses incurred for benefits conferred on others, such as for work and labour in preserving the property of another person. However, a relatively recent shipping decision of the Supreme Court in Petroleo Brasileiro S.A. v E.N.E. Kos 1 Limited recognises that exceptions to that rule have become more important than the rule itself. The case concerned the ship owner’s right to withdraw the vessel for non-payment of hire charges and then to claim for the resulting expenses incurred whilst awaiting discharge of the cargo by the charterer. The bailment initially arose by consent but continued once the ship had been withdrawn from the charter. The Court recognised that the ship owner could not escape the continuing duty to take reasonable care of the cargo and unanimously held that the owners could recover their expenses under the law of bailment.
The 1977 Act

Except as otherwise specifically provided by contract, the effect of a lien is limited, specifically it does not confer on the lienholder a power of sale. However, since a lienholder will have possession of the lienee’s property, there will be a bailment relationship. This gives rise to the potential for exploiting the provisions of the Torts (Interference with Goods) Act 1977, under which the issue is whether the provisions relating to “uncollected goods” can apply while the lien operates to prevent collection unless the underlying debt is satisfied.

In dealing with “uncollected goods”, the Act provides a bailee with a statutory power of sale in a variety of circumstances where a bailor is in breach of an obligation to take delivery of the goods (or has failed to respond to a notice to take delivery) and, for example, because the bailor is untraceable or has ceased to exist. A bailee exercising powers of sale under the Act gives a good title to the purchaser as against the bailor and will be liable to account to the bailor for the proceeds of sale (less any costs of sale).

These provisions would adequately assist a bailee in a scenario where the owner of an aircraft had disappeared. However, a bailor who disputes liability to pay a debt will simultaneously assert that he is not in breach of an obligation to take delivery. In this case, relief for the bailee/lienholder is provided through a somewhat complicated procedure where sale can only be authorised by a court. The bailee must apply to the High Court and show an entitlement to sell the property, or that he would be so entitled if he had given any required notice.

While there is very little case authority on this aspect of the 1977 Act, an unreported Court of Appeal case, Irving v Keen [1995], does provide some guidance. The case involved a car sent for repair, the bill for which came to GBP 900 sterling; the owner refused to pay and so the car was retained at the defendant’s premises. The defendant wrote to the claimant threatening to sell but in a manner and form that did not comply with the prescribed form of notice required by the 1977 Act. He did not sell the car at that time but, years later, sold the engine and was eventually successfully sued for the tort of conversion – ie dealing with the car as though it was his own.

In the Court of Appeal Stuart-Smith LJ said:

“It seems to me that the defendant’s mistake in this case was in not serving a proper notice under the 1977 Act and, having done so, in not selling the car. He was fully entitled to retain the car, exercising his lien until the GBP 900 was paid by the plaintiff. He was not entitled, having not complied with the Act, to sell parts of it, or to sell any of it. His obligation was to maintain it and exercise reasonable care with it, and not allow it to become a complete write-off, so that it was no longer a car which could be repaired but just scrap; and that is what he failed to do.”

The clear implication is that the repairer exercising his lien can still serve a valid notice requiring collection with payment. So, the exercise of the lien does not prevent an application under Act, but proper procedure must be followed for a successful application.

Discussion

As the Supreme Court noted in Petroleo Brasileiro S.A. v E.N.E. Kos 1 Limited, many civil law systems already provide a cause of action to recover benefits conferred on others. So, while the development of English law to permit the recovery of charges incurred in providing the required care is certainly not novel, it does reflect a common sense position that will be welcomed by bailees. Bailors will now have to bear in mind that leaving their property in someone else’s possession is not free of financial consequence. It is worth highlighting, as a practical matter, that the burden to prove what comprises reasonable care falls on the bailee and so careful attention to documenting whatever action is taken will be necessary.

Not just as a matter of law, it makes sense that a person in possession of property cannot decide unanimously to use the proceeds of selling it to offset against a debt owed. There has not been a reported case where a lienholder in a debt dispute has obtained an order for sale of an aircraft. However, it is not difficult to imagine circumstances where a court might be inclined to grant such an order, especially where the value of an aircraft diminished over time (eg, for not having been flown or for not having periodic maintenance carried out) as the dispute unfolds. Let alone the legal novelty, there are practical consequences of choosing to seek an order for sale, such as the prospect of finding a buyer and whether the price that might be obtained offers sufficient value against the debt. Nonetheless, the fact that seeking such an order is an option means that those engaged in providing high value services to improve an aircraft can proactively put extra pressure on a debtor to resolve the dispute, rather than simply waiting for a payment to materialise.

For further information, please contact Nick Medniuk
Brief update on topical EU competition law issues

Ryanair/Aer Lingus

In August 2013, the UK Competition Commission (CC) ordered Ryanair to reduce its shareholding in AER Lingus to five per cent from almost 30 per cent. The UK competition authorities had jurisdiction over the acquisition as it conferred upon Ryanair a ‘material influence’ on the running of AER Lingus. It should be noted that the European Commission did not have jurisdiction over the acquisition of this minority stake in AER Lingus as it failed to meet the requisite control test ‘decisive influence’ under the EU merger regulation, although earlier in 2013 the European Commission rejected a revised bid by Ryanair for the whole of AER Lingus. As a result of this case the European Commission is reviewing the merger regulation so as to fill the ‘enforcement gap’ caused by this type of case. An appeal by Ryanair against the CC decision is being heard by the Competition Appeal Tribunal in February 2014.

Alitalia State aid – Ryanair appeal dismissed by European Court but not the end of the saga

In June 2013 the Court of Justice of the European Union (CJEU), dismissing an appeal by Ryanair, upheld a decision of the General Court upholding Commission decisions relating to state aid granted by the Italian Government to Alitalia by way of a loan, followed by administration and subsequent assets sale to a new company comprising a consortium of shareholders. If successful, Ryanair’s challenge would have resulted in the new owners having to repay the EUR 300 million loan from the Italian government.

This new company’s shareholders approved in November 2013 a new rescue plan to address further financial difficulties, involving the issue of shares which may be purchased by shareholders. If all shareholders do not agree to purchase the new shares resulting in a shortfall, the Italian state owned Poste Italiene has stated it will purchase up to a value of EUR 75 million in unexercised stock options. The European Commission stated that if this happens it will investigate the further state involvement under the state aid rules.

Background

In early 2008, with Alitalia threatened with bankruptcy, the Italian Government put together a rescue package comprising a EUR 300 million loan, which legislation subsequently subordinated so that, in the event of Alitalia being liquidated, the loan would only be repaid after all other creditors of Alitalia had been paid off. The value of the loan could therefore count as capital so avoiding insolvency and keeping open the possibility of privatisation. Alitalia was later placed in “extraordinary administration” under Italian law (a procedure designed to protect the company’s assets, goodwill and employees) and the administrator sought potential purchasers. There were complaints by various airlines including Ryanair.

The Italian Government then notified the Commission of the procedure for the sale of the Alitalia group’s assets seeking confirmation that the extraordinary administration procedure did not involve the grant of state aid to the purchasers of the assets and that Alitalia’s liabilities, in particular its liability to repay unlawful state aid, would not transfer to any third party purchasers of assets of the Alitalia group.
A bid for certain assets of Alitalia (69% of the capacity of Alitalia in terms of passengers transported by kilometre) was submitted by Compagnia Aerea Italiana S.p.A. (CAI), a consortium of Italian entrepreneurs and financial institutions, Alitalia keeping the unsold assets and its liabilities (including liability to repay state aid). CAI would also pursue its own strategy and there would be no automatic transfer of employment contracts of Alitalia employees.

In November 2008 the Commission issued two separate decisions. The first found that the loan conferred on Alitalia an economic advantage through state resources that it would not have received in normal market conditions. Also the loan did not fall within any exceptions to the prohibition on state aid, notably the “one time, last time” rule for receiving rescue or restructuring aid, Alitalia having received such aid in 2001. It therefore constituted unlawful state aid and the Commission ordered its recovery from the beneficiary, Alitalia, within four months (Decision 2009/155/EC).

In the second decision on the asset sale, the Commission decided that there would be no economic continuity between Alitalia and the purchasers of its assets so CAI would have no obligation to repay aid, and that the sale of the assets would not constitute State aid to CAI, provided Alitalia’s assets were sold at market price (Aid N510/2008).

Ryanair challenged the part of the Commission’s loan decision ordering recovery from Alitalia, and within a period during which Alitalia’s assets would be sold, as this jeopardised any prospect of recovery of the loan. The General Court held that Ryanair’s challenge was inadmissible, as it had not demonstrated it would be ‘directly and individually concerned’ by the decision to order recovery of the loan from Alitalia and not CAI (a requirement for locus standi to challenge a decision). There was, therefore, no assessment of the substantive issues by the Court raised by Ryanair in respect of the loan decision.

The General Court also dismissed Ryanair’s application for annulment of the asset sale decision on the basis that Ryanair had not demonstrated the existence of “serious difficulties” in assessing the asset sale measures and the Commission had provided sufficient reasons in its decision.

Ryanair further appealed to the CJEU – which is only competent on points of law as opposed to assessment of fact – and it upheld the General Court’s decision that the loan decision had not significantly affected Ryanair’s competitive position, and that the decisions were compatible with the ‘market economy investor principle’, which provides that no state aid is involved where an investment is made by the state on terms that would be acceptable to a private investor. It also did not overturn the General Court’s conclusion that CAI was not the economic successor of Alitalia.

**Comment**

Whilst the Commission’s loan decision recognised that the loan constituted unlawful state aid, the fact that it was recoverable from Alitalia and not CAI, and within a period of four months, when the Commission was aware that the asset sale would take place imminently, meant that there was little prospect of recovery. The Commission stated however and the Courts agreed, that if the asset purchase by CAI gave rise to ‘economic continuity’ between Alitalia and CAI, the Italian state would be obliged to recover unlawful state aid received by Alitalia from CAI. There are detailed reasons why this was found not to be the case.

This case suggests that a sequence of events, involving a loan (even if later found to be unlawful state aid) followed by a partial asset sale allowing a new company to continue much of the original entity’s business but ensuring discontinuity, and hence no liability to repay any ‘aid’, could result in EU state aid rules being avoided. Given the unusual facts in this case, however, this possibility may be more theoretical than real in other circumstances.

For further information, please contact John Milligan.
The company pension scheme – how to get it under control

The straitened economic conditions of recent years have impacted on businesses across the aviation sector and the economy as a whole. One major issue has been the challenge of funding increasingly costly defined benefit (DB) pension schemes.

In a DB pension scheme, each member is promised a retirement pension based on a fixed formula, typically 1/60 x final pensionable salary x years of pensionable service. The scheme is valued by an actuary every three years. If the contributions paid in to the scheme by the employer and the members, adjusted for investment gains and losses, are judged by the actuary to be insufficient to pay the members’ accrued pensions, the employer will need to make increased contributions to make up the deficit.

A DB pension scheme must be distinguished from a defined contribution (DC) pension scheme. In a DC scheme, each member has a personal account into which fixed contributions from the employer and the member are paid. The member’s pension depends on the value of his account at retirement, including any investment gains or losses: no promise is made as to the level of pension, and so no deficit can arise.

Amending the scheme

The simplest – but not necessarily the easiest – means of dealing with a deficit in a DB pension scheme is to amend the terms of the scheme so as to either (1) reduce the scheme’s future liabilities by cutting benefits or (2) increase the scheme’s future assets by increasing members’ contributions.

The law prevents employers from reducing DB benefits which members have already accrued, save in the unlikely event that their consent can be obtained to the reduction. This means that any reduction in benefits will have only future effect – for example, an amendment might provide that members’ pensionable salaries will be capped at a certain level going forward, or that benefits accrued over their future service will incorporate smaller cost of living increases. This would restrain the growth of the scheme’s future liabilities.

The most radical course of action, but one which has been taken by an increasing number of employers over the past decade, is to freeze the pension scheme to all future accrual of benefits. Affected employees would instead be offered access to a DC scheme with a lower contribution rate – in the case of employers which have passed their staging date for automatic enrolment, the scheme would need to satisfy the minimum standards laid down in the automatic enrolment legislation.

Any amendment to a DB scheme is likely to require the consent of the scheme’s trustees. Trustees are under legal duties to safeguard the interests of the scheme members, although this principle must be balanced against the employer’s right to determine its future remuneration policies. It is unusual for trustees to refuse point blank to agree to a proposed amendment, but they may attach conditions to it: for example, they might seek the employer’s agreement to improve the scheme’s funding position, or even agree a “flightpath” whereby the scheme’s liabilities can, over time, be fully funded and bought out (see below).

The governing documentation of DB pension schemes can sometimes contain terms which restrict the employer’s ability to amend the scheme even where the trustees consent. Careful analysis may be needed of such terms. In addition, the affected employees’ contracts of employment may pose difficulties – for example, if the employer is seeking to raise the members’ contribution rate and the current rate is stated expressly in the contracts. In such a case, the employer would need to secure the employees’ individual consent to amend the terms of the contracts.

Finally, an employer which is proposing to cut its DB scheme benefits must undergo a statutory consultation process with the affected employees (or their trade unions or other representatives). The employees must be asked for their views, but they are not required to give their consent in order for the amendment to proceed. The consultation process must last at least 60 days: this can impact significantly on the timetable for implementing an amendment.
Incentive exercises

One form of DB liability management which has become increasingly popular in recent years involves the employer offering incentives to its DB scheme members in return for them agreeing to modify or give up their current DB entitlements.

Some examples of the deals which might be offered to members include:

- Asking members to transfer their DB rights into a DC scheme in return for the employer making an additional lump sum payment into the DC scheme
- Asking members to accept less generous rights to cost of living increases in retirement in return for a higher basic pension
- Asking members to give up their rights to a spouse’s pension on their death in return for a higher basic pension

Whether such a deal would be in any given member’s best interests would depend entirely on that member’s individual circumstances. In order to ensure that members are not treated unfairly, the pensions industry has adopted a Code of Practice governing incentive exercises. This was a voluntary step to forestall Government legislation in the area. The Code requires, amongst other things, that the members in question be given independent financial advice (paid for by the employer) before agreeing to modify their DB rights. While the Code is not legally binding, employers who are considering carrying out an incentive exercise would be well advised to work closely with their advisers to ensure that they do not incur unnecessary risks by failing to comply with it.

De-risking

The most reliable way of divesting a DB scheme of risk is to transfer its liabilities to an insurance company. The insurance company will issue annuity policies to cover the liabilities, which will then become the insurance company’s problem. The difficulty is that the insurance company will need to be paid in order to compensate it for taking on this risk, and this cost will outstrip – often by a large margin – the “normal”, ongoing deficit of the scheme. This is because the insurance company will use conservative discount rates in pricing the annuities and will add in margins to cover its own profits and capital adequacy requirements.

An estimate of the cost of such annuities – known as the “buy-out” cost – will be provided by the actuary in each three-yearly valuation of a DB scheme.

A de-risking exercise of this sort can encompass the entirety of a scheme’s liabilities (a buy-out) or only a portion of them (a buy-in). In some cases, a kind of slow-motion buy-out can be accomplished as increasing portions of the scheme’s liabilities are subject to buy-ins as the scheme’s funding position progressively improves.

One development which may be of interest to smaller schemes is the advent of medically underwritten annuities. These products, which are suitable for schemes of up to 500 members, can offer the opportunity of buying bulk annuities from an insurance company at a relatively lower cost.

Conclusion

Therefore, while the funding of employers’ defined benefit pension schemes can give rise to serious challenges, there are several options available to help employers deal with them.

For more information, please contact Mark Howard
US Court strictly construes standing provision of Montreal Convention

On 19 April 2013, the US District Court for the Central District of California granted defendant’s motion to dismiss on the ground that the plaintiff lacked standing to sue under the Montreal Convention. The matter, QBE Ins. (Int’l) Ltd. v. EVA Airways Corp., 2013 WL 1876429 (N.D. Cal. 2013), arose from damage to a consignment that allegedly occurred during air carriage from the United States to China. The plaintiff, which was the subrogated insurer of the consignment’s owner, filed an action against EVA Airways, claiming that it suffered damages for the repair and replacement of the damaged consignment.

EVA Airways filed a motion to dismiss the complaint on the ground that the plaintiff insurer lacked standing to maintain the action under the Montreal Convention, because it was not the consignor or consignee listed on the air waybill for the subject consignment.

The Court found that the Montreal Convention applied to the case because the subject air waybill provided for transportation of the consignment between the United States and China. To determine plaintiff’s standing to sue, the Court looked to Article 14 of the Montreal Convention. Article 14 provides that “the consignor and the consignee can respectively enforce all the rights given to them … each in its own name, whether it is acting in its own interest or in the interest of another, provided that it carried out the obligations imposed by the contract of carriage.” The Court found that Article 14 should be construed narrowly so that only the consignor and consignee listed on the air waybill have standing to sue under the Convention, even when the consignor or consignee has subrogated or assigned its rights to another party. The court observed, “the plain language of Article 14 of the Montreal Convention indicates that the sovereign state signatories to it contemplated that the consignor and consignee would only be granted the right to sue ‘each in its own’ name, rather than through a third party to whom their rights had been subrogated or assigned.”

This case is noteworthy because it appears to be the first to address standing under the Montreal Convention in a cargo-related case. Prior decisions relating to standing were based on the Warsaw Convention – the predecessor to the Montreal Convention.

This ruling is also significant for its strict interpretation of Article 14. Parties that are neither the consignor nor consignee identified on the subject air waybill, but which nonetheless may have an interest in the claim, are foreclosed from suing for damage to cargo. Such parties may include subrogees, assignees, and other parties that would have a right to sue under local law as a real party in interest based on a legal relationship with the consignor or consignee.

EVA Airways was represented by our Aviation Group in San Francisco.

For more information, please contact Kevin Moon
Cracking the whip: Court of Appeal imposes three line whip on litigants’ compliance with court procedure

In *Mitchell v News Group Newspapers* [2013] EWHC 2355 (QB) the Court of Appeal has, in a ground breaking decision in the post-Jackson era, refused to grant relief from a High Court master’s imposition of a severe penalty as a result of a party’s failure to serve its costs budget in time. In doing so, the Court of Appeal has ushered in a new era of no-nonsense compliance with court rules, practice directions and orders post 1 April 2013. It should leave litigators in the English and Welsh courts in no doubt that in the absence of a good reason, non-trivial breaches are unlikely to be tolerated in future and instead will be severely punished.

Adopting a plainly tougher approach compared with the pre 1 April 2013 regime, this is a new playing field compared to the more relaxed pre-Jackson regime and it is of utmost importance that those involved in court proceedings are aware of the risks of failing to comply with applicable rules and deadlines. Legal representatives would be well advised to heed this warning and avoid suffering court sanctions which could in turn lead to claims by those they represent.

**Background: Master McCloud’s original decision**

The appellant (Mitchell), the former Government Chief Whip and claimant in defamation proceedings, appealed against the harsh sanction imposed by a High Court master for Mitchell’s solicitors’ failure to file a costs budget on time, and her refusal to grant relief from that sanction pursuant to rule 3.9 of the Civil Procedure Rules (CPR).

Mitchell’s solicitors had lodged their costs budget the day before the case management conference (CMC). This was after having been chased via email for the budget by the Master. This late filing was in breach of the pilot scheme in CPR Practice Direction (PD) 51D “Defamation Proceedings Costs Management Scheme” which stipulated that the budget had to be lodged at least seven days in advance of the CMC. Mitchell’s solicitors apologised and initially explained the delay as having been caused by a hold-up in receiving counsel’s costs figures. At the CMC they gave a different excuse: their own pressure of work.

The Master concluded that there were really “no adequate excuses for this breach.” PD 51D did not stipulate the sanction for breach. She therefore applied CPR rule 3.14 by analogy (“unless the court otherwise orders, any party which fails to file a budget despite being required to do so will be treated as having filed a budget comprising only the applicable court fees”) to order that Mitchell was to be treated as having filed a budget limited only to the court’s fees commenting:

“I consider that professionals have now had ample warning for many months that the court would adopt a strict approach to the interpretation of application and rules and orders and it should come as no surprise that, subject to any powers I have to grant relief from sanctions, the sanction I should impose is that the claimant’s budget will be limited to the court fees.”

At a later hearing, Mitchell applied to the Master for relief from that sanction pursuant to rule 3.9, but she refused to grant relief. Instead she held that she had been entitled to consider CPR rule 3.14 and to have regard to the overriding objective which included dealing with cases “justly” and “at proportionate cost” so as to ensure “compliance with rules, orders and practice directions.” She observed that in order to hear the application for relief, it had been necessary for her to postpone a half day hearing in a case involving asbestos claims. Other deserving court users had therefore been adversely affected. As for Mitchell’s solicitors’ breaches, there had been an “absolute failure” by them to engage in discussion of budget assumptions “when
asked”; or to apply for extra time or seek relief informally before “running into time difficulties.” The budget had only been filed at the last minute before the CMC and following prompting by the court after it had reviewed the file by chance.

The Master had little sympathy for the work pressures cited by Mitchell’s solicitors, finding that they “were not unusual for solicitors” and observing that such explanations carry even less weight in the post-Jackson era than they did previously. Although she acknowledged that Mitchell had only been given a few days notice of the deadline, she did not consider it unreasonable to expect the budget to be filed on time. She concluded:

“the stricter approach under the Jackson reforms has been central to this judgment. It would have been far more likely that prior to 1/4/13 I would have granted relief on terms…”

The Court of Appeal’s decision

The Court of Appeal firmly dismissed Mitchell’s appeal both against the Master’s order that the costs budget was limited to court fees and the decision to refuse relief against sanctions under rule 3.9.

In relation to the order that the budget be limited to court fees the Court of Appeal confirmed that:

– There was nothing wrong with the Master’s decision to apply rule 3.14 by analogy. This approach was not unfair as the parties would have known they were at risk of a sanction being imposed. Rule 3.14 was not a “bolt from the blue” but the considered view of the Civil Procedure Rule Committee as to what constituted a proportionate sanction for failure to file a costs budget on time.

– Rule 3.14 was not directed exclusively to parties who had failed to file a costs budget at all and the sanction could also be applied where the costs budget was filed late. Both rules 3.13 and 3.14 were aimed at discouraging the last-minute filing of documents.

– The Master had acted in accordance with the overriding objective in imposing the sanction on Mitchell.

The Court of Appeal also emphasised that the requirement for discussion between the parties was as important as filing documents on time.

As to the challenge under rule 3.9 to the Master’s decision to refuse relief, the Court of Appeal gave the following guidance on the application of that rule to “send out a clear message”:

– The dual aims under rule 3.9 of first, litigation being conducted efficiently and at proportionate cost, and secondly, enforcing compliance with court rules, orders, and practice directions, are of paramount importance and should be given greater weight.

– Rule 3.9 requires the court to consider “all the circumstances of the case” and where a breach is trivial relief should normally be granted provided an application is made promptly.

– Where the breach is not trivial, the burden of persuading the court to grant relief is on the defaulting party and relief should only be granted where there is good reason.

– Good reasons are usually circumstances outside the party’s control such as a debilitating illness or an accident, or a change of circumstances in the litigation which render it unreasonable to expect compliance within the original period.

– Merely overlooking a deadline, because of overwork or otherwise, cannot be expected to amount to good reason. The Court of Appeal commented that “solicitors cannot take on too much work and expect to be able to persuade a court that this is a good reason for their failure to meet deadlines. They should either delegate the work to others in their firm or, if they are unable to do this, they should not take on the work at all…”

– “Well-intentioned incompetence” for which there is no good reason, is equally unlikely to attract relief from sanction where the default is not a trivial one.

– An application for an extension of time made before the expiry of a deadline is more likely to be successful than one made after the event.

The Court of Appeal went on to endorse the approach set out by Lord Dyson, the Master of the Rolls, in the 18th Implementation Lecture on Jackson where he stated:

“The tougher, more robust approach to rule compliance and relief from sanctions is intended to ensure that justice can be done in the majority of cases … this requires an acknowledgment that the achievement of justice means something different now.” (para 27)
It also observed that this new post-Jackson approach must mean that relief will be granted more sparingly than in the past and that the express aim was to remove the previous culture of “delay and non-compliance” even if that led to apparently harsh results in individual cases.

**Conclusion**

This decision is plainly intended to send a clear signal to litigators that post 1 April 2013 a new culture of compliance with the CPR following the Jackson reforms is to be instilled. All legal representatives must take careful note of the Court of Appeal’s pronouncement and ensure that they are completely familiar with all relevant rules, practice directions and orders which apply to their cases and the deadlines which they impose.

UK lawyers must realise that they have entered an era of virtually zero tolerance of missed deadlines and other rule breaches. Infringements which would previously have resulted in a minor judicial rebuke may now result in a serious sanction including dismissal of the claim or the defence. What will pass as a trivial breach is likely to be a circumstance where there has been no more than an insignificant failure and the litigant has otherwise fully complied with the terms of an order or rule, although even here the Court acknowledged that the question of whether a default is insignificant may give rise to disputes.

On an application for relief from sanctions, only the most extenuating of circumstances are likely to attract any sympathy from the court. Over-work, inefficiency or oversight will not be enough.

The prospect of a severe sanction for procedural breaches has now risen considerably. Henceforth, where a breach has taken place or an extension of time is required, opponents are bound to take an uncompromising approach and a flood of applications is inevitable. Applying ahead of time may help but clearly cannot be seen as a general panacea. It remains to be seen just how harsh the courts will be in cases involving different circumstances and rules to those involved in Mitchell.

The Court of Appeal concluded by stating:

“Although it seems harsh in the individual case of Mr Mitchell’s claim, if we were to overturn the decision to refuse relief, it is inevitable that the attempt to achieve a change in culture would receive a major setback. In the result, we hope that our decision will send out a clear message. If it does, we are confident that, in time, legal representatives will become more efficient and will routinely comply with rules, practice directions and orders. If this happens, then we would expect that satellite litigation of this kind, which is so expensive and damaging to the civil justice system, will become a thing of the past.”

**The immediate future?**

This decision will mean that UK practitioners and clients alike may need to bring about changes to their litigation mentality, strategic and tactical planning with an inherent need for to adopt robust reminder/diary systems in order to adhere to deadlines and procedure.

Some commentators have also suggested that this decision may result in more undesirable changes in litigating parties’ attitudes and in some quarters this may manifest itself in ‘sharp practice’ with co-operation deliberately and unnecessarily being withheld between litigating parties resulting in increased litigation costs.

Whilst the judiciary’s underlying intentions should be applauded, in trying to bring about a more efficient and cost effective legal system, the speed at which some practitioners may need to change their in-house practice methods and systems, will no doubt see an initial increase in applications for relief and further likely dispute arising between lawyers and their clients.

As an additional footnote, at the time of this article going to press and despite the Court of Appeal rhetoric in the Mitchell judgment, relief from sanction has been granted in two known cases which are said to have considered the principles contained within the Mitchell authority, namely *Adlington & 133 others v Els International Lawyers LLP (in administration)* wherein HHJ Oliver Jones QC confirmed that the relationship between justice and procedure “has not changed so as to transform rules and rule compliance into trip wires” and found that the failure to comply with an unless order to serve particulars of claim in relation to eight out of 134 claimants in a group professional negligence action was a trivial breach.

Mr Justice Norris in *Forstatter & Anor v Python (Monty) Pictures & Anor* [2013] EWHC 3759 (Ch) has taken the Mitchell decision into account when granting relief from sanctions where a successful party failed to serve a notice of its funding arrangements on form N251. Whilst his judgment was drafted before the Court of Appeal handed down Mitchell, Mr Justice Norris said he took account of the
decision and did not need to revise his draft ruling, “which I consider proceeds upon correct principles”.

Robin Knowles QC, sitting as a deputy High Court judge has also suggested that parties will be wrong to think that the examples given in the Mitchell ruling defined the limits of the decision. In SC DG Petrol SRL & Ors v Vitol Broking Ltd [2013] EWHC 3920 (Comm) [2], the Judge refused to give relief from sanction. He referred first to the Court of Appeal’s statement that the court should seek “to have regard to a wide range of interests”, and not just the case in hand, when considering granting relief:

“I respectfully offer the observation that there are limits to the contribution that a party, especially a non-defaulting party, can usefully make in evidence or argument in respect of circumstances extending beyond the case in hand – for example on what is needed ‘to enforce compliance with rules, practice directions and orders’. “This is pre-eminently an area for the judge. In Mitchell, the Court of Appeal was not putting an enhanced tactical weapon into the hands of non-defaulting parties to the litigation. This is clear from the nature of the factors specified at (a) and (b) of CPR 3.9(1). It is reinforced by the concern of the Court of Appeal to reduce satellite litigation.”

He went on to note that when citing Mitchell, the parties referred him closely to the examples given by the Court of Appeal, with the defendants pressing the point that their case was captured within one or more examples cited by the Court of Appeal.

“I respectfully doubt that is the right approach. The examples are there simply to illustrate the principles described by the Court of Appeal. The court’s inquiry should be guided by the principles.

“My own view is that ideally the jurisdiction to extend time and grant relief from sanctions is one in which (as Lord Templeman urged in The Spiliada [1987] AC 456, HL in relation to service out of the jurisdiction) a judge would not be referred to other decisions on other facts.”

Whilst the judiciary’s approach to the grant of relief post Mitchell is in its infancy, in the post Jackson and Mitchell era of litigation, UK practitioners should adopt ‘best practice’ measures and ensure compliance with court deadline and procedure. Failure to do so may come at an expensive cost.

For further information, please contact Jamie Sorrell.
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