

## LEGAL ASPECTS & ISSUES OF AIRCRAFT LEASE AGREEMENTS IN MALAYSIA

### Introduction

Aircraft leasing has become a cornerstone of the aviation sector. By offering a financially viable and adaptable approach compared to outright aircraft ownership, leasing allows airlines to swiftly respond to market fluctuations and expand their operations without substantial upfront costs. This article examines the complexities of aircraft lease agreements, delving into their different structures, essential terms, and the potential issues for parties to consider.

### Types of Aircraft Lease

In the aircraft leasing industry, the two most common types of leases are dry lease and wet lease where each type of lease caters to different operating requirements.

#### (a) Wet Lease

A wet lease is a lease of an aircraft by the lessee where the aircraft is operated under the Air Operator Certificate (“**AOC**”) of the lessor. It is normally a lease of an aircraft with at least one crew member, operated under the commercial control of the lessee and using the lessee's airline designator code and traffic rights.

Also known as an ACMI lease[1], the lessor provides the aircraft, crew, maintenance, and insurance to the lessee.[2] The lease of an aircraft, depending on the arrangement between the lessor and lessee, may come together with either flight crew or cabin crew (also known as a “**damp lease**”), or with an entire aircraft crew consisting of both flight and cabin crew members.[3]

In a wet or damp lease arrangement, the lessor assumes operational control of the aircraft operations. Aircraft operations must be in compliance with the requirements in the lessor's air operator certificate for the duration of the lease.

### Regulatory requirement for wet lease

There are different regulatory requirements based on aircraft registration and the nature of the lease.

For a Malaysian-registered aircraft leased to a foreign operator (“**wet or damp lease-out**”), the Malaysian regulatory requirements will apply. Notably, the Malaysian lessor retains operational control, even in damp leases where the lessee provides the crew.

This arrangement ensures that the qualifications and operational control of the crew under the Malaysian lessor are aligned with their operations policies.[4]

Conversely, when a Malaysian operator leases a foreign-registered aircraft (“**wet or damp lease-in**”), the regulations of the aircraft’s country of registration will apply. In this scenario, the foreign lessor maintains operational control throughout the lease term. Similar to lease-out agreements, damp leases involving foreign aircraft require careful alignment of crew qualifications and operational procedures with the lessor’s operations policies.[5]

### (b) Dry Lease

A dry lease is a lease of an aircraft by the lessor where the aircraft is operated under the AOC of the lessee. It is normally a lease of an aircraft without crew, operated under the custody and the operational and commercial control of the lessee, and using the lessee’s airline designator code and traffic rights. In this set-up, the lessee will provide their own crew, maintenance and insurance.[6]

### Regulatory requirement for dry lease

Similar with wet lease, for a dry lease-out of a Malaysian-registered aircraft to a foreign operator without change of aircraft registration (“**dry lease-out**”), the regulatory requirements related to Malaysian-registered aircraft will apply. The lessee will be responsible for the operational control of the aircraft under its AOC during the term of the lease.[7]

For dry lease-in of foreign-registered aircraft by a Malaysian operator without change of the aircraft registration (“**dry lease-in**”), the foreign regulatory requirements related to the foreign-registered aircraft will apply. The Malaysian operator will be responsible for the operational control of the aircraft during the term of the lease.[8]

## **Legal Aspect of an Aircraft Leasing Agreement**

Aircraft leasing agreements encompass various legal and commercial considerations included to mitigate the risks and maintain commercial upsides.

Some of the key clauses commonly found in such agreements include, but are not limited to:

## Redelivery Clauses

Redelivery clauses outline the conditions under which the aircraft must be returned to the lessor at the end of the lease term. These clauses are critical for protecting the lessor's interests in maintaining the aircraft's value.

A commercial aircraft operating lease sets forth processes for redelivery of the aircraft upon lease expiry in an effort to avoid unnecessary delays, which can be costly.[9]

These processes consist of inspecting the aircraft and related documentation to confirm that the lessee has fulfilled its obligation to return the aircraft to the lessor in accordance with the redelivery conditions set forth in the lease. Upon satisfactory completion, the lessor executes a return acceptance certificate confirming that the aircraft and related documentation complies with such redelivery conditions.[10]

## Quiet Enjoyment

A quiet enjoyment clause is essentially the right granted to a lessee to have full, uninterrupted use of the aircraft without the intrusive and costly requirements from the lessor during the entire lease term.[11] Without such a clause, the lessor may impose restrictions which may include excessive inspections on the aircraft during the term lease, unnecessary information requests, or limitations on aircraft utilisation. Such restrictions may limit the lessee's ability to operate the aircraft efficiently and generate profits.

Therefore, the inclusion of such a clause is important to ensure a smooth and productive relationship between the lessor and lessee. It ensures the lessee operates without undue interference, maximising their ability to leverage the aircraft for its intended purpose and generate revenue.

## Insurance

Another important consideration in drafting an aircraft lease agreement is to include an insurance clause. The two broad types of insurance typically required are liability insurance and hull insurance.[12]

The lessee is generally responsible for procuring and maintaining both types of insurance. This arrangement effectively transfers the risks associated with aircraft operation and use to the lessee.

Hull insurance protects the lessor's asset by covering the aircraft's value in case of physical damage or loss, including engines, parts, and records. Liability insurance on the other hand safeguards the lessor and other parties by covering general legal liabilities arising from third-party, passenger, and baggage claims.

## Force Majeure

At the outset of the COVID-19 pandemic, it became evident that a force majeure clause is of paramount importance in an aircraft leasing agreement.

Force majeure is defined as certain acts, events or circumstances beyond the control of the parties, for example, natural disasters or the outbreak of hostilities. A force majeure clause is commonly found as an agreed term between the parties to the agreement to deal with situations over which the parties have little or no control and that might impede or obstruct performance of the contract.[13]

In the context of aircraft leasing agreements, a force majeure clause may be crucial for navigating unforeseen disruptions. While airlines are typically obligated to make lease payments regardless of circumstances ("**hell or high water**" clauses), unforeseen circumstances such as a global pandemic can severely impact their operations. Including a force majeure clause may provide a potential avenue for relief such as delayed payments, lease modifications, or even temporary suspension of the lease entirely. This ensures some level of fairness and comfort for both the lessor and the lessee in addressing unforeseen disruptions during extraordinary events.

### Governing Law and Dispute Resolution

Another critical component of any aircraft lease agreement is the determination of the governing law and dispute resolution. This provision dictates the legal framework that will interpret and enforce the terms of the aircraft lease agreement. Typically, the governing law is selected to align with the jurisdiction where the lessor is based or where the aircraft is registered.

The clause should clearly outline the process for resolving any disputes that may arise, which often involves arbitration or litigation in the courts of the governing jurisdiction.

## **Issues in Aircraft Leasing**

### Condition of the Aircraft on Delivery/Redelivery

In an aircraft leasing agreement, the term "*delivered on an as is, where is basis*" is commonly found where it signifies that the aircraft is accepted in the condition it presently exists or as found on inspection immediately prior to purchase or lease, even if damaged or defective, without modification and without any express or implied warranties. [14] Such clause shifts the risk of the aircraft's condition to the lessee, making a pre-delivery inspection of the aircraft crucial for the lessee to identify potential problems and negotiate solutions before delivery.

While this approach may appear harsh on the part of the lessee, such term is consistent with the legal principle of Caveat Emptor ("**buyer beware**") [15] and often employed in aircraft transactions to streamline the process and allocate risk transparently. However, parties may negotiate modifications to this standard "as is" condition, such as including specific warranties or representations about the aircraft's condition or providing for post-delivery inspections and remedies.

## Continued Impact from Pandemic

The COVID-19 pandemic severely impacted the aviation industry, leaving a lasting impact on airline companies' operations and finances. While fleets are no longer grounded as widespread as they were during the height of the pandemic, the industry's recovery remains fragile. It cannot be denied that such impact left a huge dent in the market, with lingering issues such as the surge of oil prices,[16] and the soaring of the aircraft lease rates due to supply chain issues.[17]

While force majeure clauses may provide relief on the same, the widely accepted inclusion of a hell or high water clause impose an absolute obligation on the lessee, irrespective of the circumstance, to pay the rent or lease to the lessor.[18] This creates a challenging situation for airlines struggling financially due to the pandemic's lingering effects.

The potential for any future pandemics underscores the need to re-evaluate the legal remedies for airline lessees. Incorporating provisions that permit temporary lease payment relief without triggering default penalties should become a negotiation priority.

## Fleet Maintenance

Ensuring effective fleet maintenance is susceptible to potential challenges that come with the rising maintenance cost due to increasing price for parts, labour, and fuel.[19] Unexpected repairs, caused by vehicle breakdowns or component failures, further exacerbate these financial burdens.

## Conclusion

Aircraft lease contracts are sophisticated legal arrangements crucial to the global aviation business. These contracts offer advantages but also involve intricate legal and financial aspects. Negotiation, thorough due diligence, and consistent oversight of lease terms are essential for both aircraft lessors and lessees to maximize benefits. As the aviation industry continues to evolve, well-crafted lease agreements will play an increasingly important role in defining the future of airlines.

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