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***Wet lease: convenience comes at a cost***

*Synopsis of the relevant rules in the European Union*

**Abstract**

*Wet lease offers many advantages and, therefore, attracts more and more airlines around the world. This model allows airlines to temporarily increase their fleet depending on seasonal fluctuations, prospect new routes or make up for the lack of an aircraft in technical maintenance. However, wet lease also involves significant drawbacks. Beside its high price, it does not go without creating issues in terms of safety, job security and competition. From a safety perspective, some airlines are tempted to rent aircraft from 'trash airlines', often much cheaper, thus creating a safety risk for passengers. From a social perspective, the use of the lessor's cabin crews runs the risk of salary dumping in the country in which the aircraft operates. Also, in specific circumstances, wet leasing may be viewed as a creation of a dominant position by the lessee, leading to a distortion of the competition market. This paper starts by defining the model of wet lease and analyze its main characteristics. It then goes over the legal framework in place to mitigate the above-mentioned issues.*

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## INTRODUCTION

The acquisition of an aircraft requires substantial capital investment, in particular because of the significant cost of most airplanes.<sup>1</sup> Therefore, direct ownership is often unattractive for airlines who prefer to use other forms of acquisition such as ‘leasing’. In addition to offering greater flexibility for airlines, leasing requires low-capital investment.<sup>2</sup>

Leasing mainly takes two forms: ‘financial leasing’ and ‘operational leasing’.

*Financial leasing* is characterized by the fact that the lessor remains the legal owner of the aircraft, even though the economic risks associated with the aircraft are transferred to the lessee for the duration of the contract. As a consequence thereof, the lessee can include the depreciation of the aircraft in its balance sheet. At the end of the contract, the lessee directly becomes the owner of the aircraft or can exercise a purchase option.<sup>3</sup>

*Operational leasing*, on the other hand, is marked by a shorter term and the fact that the lessor retains the economic risk associated with the aircraft, including its depreciation value. The aircraft is not included in the lessee's balance sheet and is returned to the lessor at the end of the contract.<sup>4</sup>

Operational leasing can be divided into two main sub-categories: ‘dry lease’ and ‘wet lease’. The former consists of the simple provision of an aircraft without crew and insurance. The latter consists of a turnkey contract including the aircraft, crew, maintenance and insurance.<sup>5</sup>

In 2005, the European Commission estimated that of the total EU fleet of 5’081 aircraft, 60% were under operational lease, of which 6.6% were under wet lease.<sup>6</sup> Since then, wet leasing has been attracting more and more European airlines, not only for short term rentals, but also for long term rentals, which is a new trend. The wet lease market is expected to grow by around 10% between now and 2022.<sup>7</sup>

The growing interest of airlines for wet leasing deserves our special attention. In this paper, I will start by presenting the main characteristics of wet leases (1.) and analyze some typical provisions of such contracts (2.). I will then sketch the contours of the European legal

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<sup>1</sup> ENDRIZALOVA (2018), p. 642.

<sup>2</sup> SCHUBERT (2017), p. 76. This is particularly true for “operational leasing”, which offers greater flexibility than “financial leasing”.

<sup>3</sup> MENDES DE LEON (2017), p. 471. *See also* HANLEY (2011), p. 155.

<sup>4</sup> *Ibidem*, p. 470.

<sup>5</sup> BOURNONVILLE & GRIGORIEFF (2017), pp. 29 ff. Airlines also opt for long-term wet leasing to increase their operating capacity. Some companies are even specialized in long-term wet leasing: *See* EASA Practical Guide (August 2017), p. 4.

<sup>6</sup> MORRELL (2016), p. 242.

<sup>7</sup> The grounding of the Boeing 737 MAX is not without incidence. Indeed, many companies had to quickly find alternatives to provide flights, whose tickets were already sold, but whose aircraft were no longer authorized to fly: ŽIEMELIS (2019). *See also* PROKOPOVIČ (2018).

framework governing wet leases, in particular with regard to security issues (3.). Finally, I will briefly address the issue of competition law, since recent decisions from European national competition authorities suggest that wet lease could, under certain circumstances, raise competition concerns. (4.).

## **1. THE WET LEASE MODEL**

### **1.1. Characteristics of a wet lease**

A wet lease is a contract between two airlines, usually for a short period, not more than six months to a year, under which the lessor provides the lessee with an aircraft and its crew, while providing technical maintenance and insurance coverage. This against payment of a rent by the lessee. Wet lease is often referred to as ‘ACMI’, for “Aircraft, Crew, Maintenance and Insurance”.<sup>8</sup> When the crew is not made available to the lessee, the contract is referred to as ‘damp lease’ or ‘AMI’ for “Aircraft, Maintenance, and Insurance”.<sup>9</sup>

Wet lease is usually used by airline in specific circumstances, for instance to make up for the lack of an aircraft in technical maintenance, to cope with a seasonal increase in passengers, to assess the potential of a new flight route or to obtain an interim lift prior to taking delivery of new fleet aircraft.<sup>10</sup>

In a wet lease contract, the aircraft is operated under the ‘AOC’ (Air Operator Certificate) of the lessor which must also hold an ‘operating licence’ inherent to its status of air carrier.<sup>11</sup> This means that the lessor has the ‘operational control’ of the aircraft *i.e.* the authority to assess whether safety conditions are met to start a flight and determine the assignment of its cabin crew. The pilot has total discretion over the control of the aircraft as well as the cabin crew and passengers that the lessee must accept.<sup>12</sup> The lessee, for its part, has the ‘commercial control’ of the aircraft and decides on its use. As such, the lessee sells the aircraft’s seats on its own account, provides the flight number and holds the traffic rights.<sup>13</sup>

It is usually the lessor’s responsibility to position the aircraft at the right time and at the agreed location.<sup>14</sup> The lessor must also provide parts for maintenance, prove the lessee that all the necessary insurances have been subscribed and ensure that the crew members will follow the lessee's instructions.<sup>15</sup> On the other hand, the lessee ensures the payment of the costs of fuel, landing, parking and storage of the aircraft. The lessee is also responsible for the costs of

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<sup>8</sup> BOURNONVILLE & GRIGORIEFF (2017), p. 32.

<sup>9</sup> PANCHAL (2017), p. 11.

<sup>10</sup> CASTELLANOS RUIZ (2016), pp. 139-140; BUNKER I (2005), p. 229.

<sup>11</sup> CASTELLANOS RUIZ (2012), p. 156; CHASSOT (2017), p. 93. *See also* Article 2 § 10 and 25 Regulation n° 1008/2008, Article 3 Regulation n° 1008/2008 and Regulation n° 859/2008 EU-OPS 1.165 a) 2).

<sup>12</sup> *See supra* note 10, p. 140.

<sup>13</sup> CASTELLANOS RUIZ (2012), pp. 155-156. *See also* BOURNONVILLE & GRIGORIEFF (2017), p. 32.

<sup>14</sup> BUNKER (2000), p. 68.

<sup>15</sup> *Ibidem*, p. 69.

accommodation, meals and visas for the crew as well as insurance for passengers, baggage and freight.<sup>16</sup>

## **1.2. Differences with dry leasing**

Dry leasing is a simpler form of operational leasing, which is generally used for longer periods of time. Only the aircraft is made available to the lessee without crew, which is provided by the lessee itself.<sup>17</sup> Under a dry leasing contract, both commercial control and operational control belong to the lessee. The leased aircraft is therefore operated through the lessee's AOC, that is, operational control, and the lessee decides on the use of the aircraft, that is, commercial control.<sup>18</sup>

## **1.3. Difference with charter contract**

In a charter contract, a 'charterer operator' makes an aircraft and crew available to a lessee, under the instructions of the lessee, for one or more operations.<sup>19</sup> A charter contract is therefore similar to a wet lease contract, with the difference that the lessee is not an airline, but rather a tour operator, and the lessee does not hold its own operating licenses and permits. The aircraft is operated under the licenses and permits of the charter operator.<sup>20</sup>

## **1.4. Advantages and disadvantages of a wet lease**

Wet leasing can be advantageous in certain circumstances.<sup>21</sup> For the lessee, it allows a temporary increase in capacity without increasing the fleet and crew. Furthermore, given its quick implementation, a wet lease can also make it possible to anticipate the access of competitors to new routes. For the lessor, wet leasing guarantees additional activity during off-peak periods and expands indirectly the presence into new markets without incurring commercial costs.<sup>22</sup>

Nonetheless, wet lease can pose a number of problems in practice, in particular for the lessee. There may be circumstances where:

- (i) the aircraft is delivered with a delay, obliging the lessee to cancel flights;
- (ii) the lessor runs out of spare parts at the place of operation, constraining the aircraft to remain on the ground;

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<sup>16</sup> BELLANDI (2018), p. 217.

<sup>17</sup> FRÜHLING & GOLINVAUX (2017), p. 40.

<sup>18</sup> CASTELLANOS RUIZ (2012), pp. 155-156. *See also* Article 2 § 24 Regulation n° 1008/2008 and Regulation n° 859/2008 EU-OPS 1.165 a) 1).

<sup>19</sup> CASTELLANOS RUIZ (2016), p. 140.

<sup>20</sup> HANLEY (2011), p. 8.

<sup>21</sup> *See* note 10 above.

<sup>22</sup> BELLANDI (2018), p. 217.

- (iii) the lessor's crew carries an excessive number of luggage items causing inconvenience for the passengers;
- (iv) the aircraft is used by the lessor for other airlines notwithstanding the contractual exclusivity; or
- (v) the lessor purchases fuel and other supplies at non-competitive prices and re-invoices them to the lessee.

When such litigious situations occur, the forum elected in the contract, most of the time abroad, makes it difficult for the lessee to bring legal proceedings.<sup>23</sup>

From a safety perspective, the State of registry often encounters difficulties in ensuring supervision of the leased aircraft since the aircraft usually operates in remote airspace over which it does not have jurisdiction.<sup>24</sup> Indeed, Article 83*bis* of the Chicago Convention<sup>25</sup> offers the possibility for the State of registry to delegate its safety supervision obligations to the State in which the lessor has its principal place of business or, if he has no such place of business, his permanent residence. However, this provision finds its limits in case of a wet lease.

*First*, because there is in principle a coincidence between the State where the lessor has its principal place of business and the State of registry of the aircraft, which makes the application of Article 83*bis* of the Chicago Convention useless.<sup>26</sup>

*Second*, because in the rare situations where there is a discrepancy between the State of registry and the State where the lessor has its principal place of business, Article 83*bis* is not adapted to the short term wet lease situation given the substantial time required to set up the transfer, that is, long negotiations between the States concerned.<sup>27</sup>

### **1.5. Additional elements**

In a wet lease, the lessee must be an airline with its own operating licence.<sup>28</sup> In order to obtain such a licence, an EU based airline must demonstrate, *inter alia*, that it has one or more aircraft at its disposal through ownership or a dry lease agreement.<sup>29</sup> Therefore, an airline cannot rely exclusively on a wet lease model at the risk of losing its operating licence and no longer being allowed to carry passengers for remuneration.

When a wet lease is in place, passengers booking a flight with airline 'X' finally find themselves transported by an aircraft of airline 'Y'. In order to avoid confusion and to allow passengers to make their choices in full knowledge of the facts, Article 11 of Regulation n° 2111/2005

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<sup>23</sup> BUNKER makes a very comprehensive list of issues associated with wet lease; See BUNKER (2000), pp.78-81.

<sup>24</sup> SCHUBERT (2017), p. 69; REULEAUX, HANS JAKOBSEN & SAND (2019), p. 547.

<sup>25</sup> Convention on International Civil Aviation signed on 7 December 1944.

<sup>26</sup> CHASSOT (2017), p. 94.

<sup>27</sup> BUNKER (2000), p. 74.

<sup>28</sup> BUNKER I (2005), p. 229.

<sup>29</sup> Article 4 let. c) Regulation n° 1008/2008.

requires passengers to be informed of the identity of the “operating air carrier” *i.e.* the lessee must inform passengers of the identity of the lessor.<sup>30</sup>

## 1.6. Concluding remarks

The wet lease model appears to be a favorable short-term solution for an airline, in particular because of its quick implementation and the flexibility it offers. That being said, given the complexity of the contractual structure of a wet lease contract, the parties should endeavor to define precisely the tasks incumbent on each of them in order to avoid as far as possible any dispute in the performance of the contract. The following chapter will give some examples of typical provisions in a wet lease contract, specifying for each of them which obligations fall upon the lessor and the lessee.

## 2. TYPICAL PROVISIONS OF A WET LEASE AGREEMENT

### 2.1. Rent

In a wet lease agreement, the rent is usually calculated on the basis of guaranteed minimum monthly hours called “block hours”, which must be paid in advance by the lessee, *e.g.* 200 block hours per month. Each block hour corresponds to a fixed amount, *e.g.* 2'000 Euros per block hour.<sup>31</sup> The more the lessee commits to a long-term contract, the lower the hourly rate of a block is. Hours of use in excess of the guaranteed minimum monthly hours are paid as overtime, usually at a lower hourly rate.<sup>32</sup> Most of the time, a compensation system is set up so that if the lessee exceeds the guaranteed minimum monthly hours, overtime can be compensated by unused block hours from previous months.<sup>33</sup>

*“The actual Block Hours performed by the Lessee will be averaged on a [quarterly] basis and the Basic Rent and Extra Block Hour Rent paid with respect to such period shall be reconciled and adjusted accordingly” (emphasis added).<sup>34</sup>*

### 2.2. Maintenance

A wet lease agreement usually provides that maintenance is carried out directly by the lessor.<sup>35</sup> Indeed, the lessor undertakes to provide an aircraft that is properly maintained in an airworthy condition and to operate it in accordance with all applicable rules.<sup>36</sup>

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<sup>30</sup> CASTELLANOS RUIZ (2012), p. 156.

<sup>31</sup> In our example, the lessee would pay each month in advance a fixed amount of EUR 400'000 (200x2000).

<sup>32</sup> BUNKER (2000), p. 71. *See also* CASTELLANOS RUIZ (2016), p. 141. *See also* Article X ACMI Service Agreement.

<sup>33</sup> *Ibidem*.

<sup>34</sup> BUNKER II (2005), p. 265.

<sup>35</sup> CHASSOT (2017), p. 106.

<sup>36</sup> *Ibidem*, p. 107.

In the EU, Regulation 1321/2014 provides that in the case of commercial air transport, the operator is responsible for the continuing airworthiness of the aircraft.<sup>37</sup> For long-term wet leases or when the distance between the parties is significant, maintenance is sometimes carried out directly by the lessee or one of its subcontractors. In such cases, the lessor remains ultimately responsible for the maintenance.<sup>38</sup>

*“[Lessor’s name], pursuant to its statutory and regulatory obligations as the certificate holder, shall have complete and exclusive responsibility for the operation, maintenance and safety of the Aircraft, and for compliance with all applicable Legal Requirements of any Governmental Authority having jurisdiction over the ownership, operation and maintenance of the Aircraft and the ACMI Services to be provided hereunder” (emphasis added).*<sup>39</sup>

### 2.3. Liability

According to Articles 40 and 45 of the Montreal Convention (MC),<sup>40</sup> the “contracting carrier” and the “actual carrier” are jointly and severally liable for damages for which compensation may be claimed under the MC.<sup>41</sup> Towards third parties, this means that an action for damages may be brought, at the option of the plaintiff, against the actual carrier or the contracting carrier, or against both together or separately. It being specified that in a wet lease, the lessor is deemed to be the “actual carrier” and the lessee the “contracting carrier”.<sup>42</sup>

Notwithstanding the legal principle of joint and several liability, some lease agreements provide that the lessee contractually waive any recourse action against the lessor and guarantee the lessor against any claim for compensation.<sup>43</sup> According to CHASSOT, this contractual transfer of the transport risk to the contracting carrier reflects the strong position of the lessor’s vis-à-vis lessees who are often in a hurry to quickly remedy operational contingencies.<sup>44</sup>

*“Notwithstanding the foregoing, [Lessor’s name] indemnification obligations herein (...) are limited to the kinds and amounts of insurance [Lessor’s name] agrees to provide herein, unless such insurance coverage is unavailable through the fault of [Lessor’s name], and except to the extent such obligations arise from the gross negligence or willful*

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<sup>37</sup> Regulation n° 1321/2014, Annex I, M.A.201, let. h). In a case of a wet lease, the lessor is the operator of the aircraft and exercises operational control: See note 12 above.

<sup>38</sup> BUNKER (2000), p. 74.

<sup>39</sup> Article II, Section 2.4 (a) ACMI Service Agreement.

<sup>40</sup> Convention for the unification of certain rules for international carriage by air done at Montreal on 28 May 1999.

<sup>41</sup> These include personal injury, death of passengers, loss of, destruction of or damage to baggage or cargo or delay (Art. 17, 19 and 22 MC).

<sup>42</sup> KOSENINA, (2014), p. 273. See also CHASSOT (2017), p. 102.

<sup>43</sup> CHASSOT (2017), p. 110.

<sup>44</sup> *Ibidem*.

*misconduct of [Lessor's name] or its agents or employees”  
(emphasis added).<sup>45</sup>*

## **2.4. Insurance**

A wet lease agreement provides for the obligation of each party to take out insurance cover for the risks for which it is responsible. The lessor generally insures the aircraft body and liability toward third parties on the surface. The lessee often ensures the damage suffered by passengers, their baggage or goods.<sup>46</sup> A certificate of insurance coverage must be provided by each party indicating that the insurances are in force. Said certificates specify policy numbers, expiry dates and limits of liability.

*“The Party procuring the insurance hereunder shall provide to the other Party hereto prior to the commencement of operations a certificate from the insurers that such insurance is in effect. These certificates shall state policy numbers, dates of expiration, and limits of liability thereunder”  
(emphasis added).<sup>47</sup>*

## **2.5. Concluding remarks**

Unlike the sale of aircraft, there is no standard wet lease contract offered by IATA or other organizations.<sup>48</sup> The provisions of a wet lease agreement are unique and mainly depend on the will of the parties and the nature of the services they wish to implement. In any case, the parties will have to attach particular importance to the dispute resolution provision. Indeed, a forum elected in a foreign country with failing or complacent state courts may, for instance, make it difficult for the lessee to bring legal proceedings. In this context, the establishment of an independent arbitration court based in a third country and composed of arbitrators specialized in aviation law may be an appropriate solution to ensure greater speed of process and competence than a state court.

## **3. SECURITY APPROVAL UNDER EUROPEAN LAW**

### **3.1. EU legal regime**

European law contains specific rules applicable to wet lease contracts, the purpose of which is essentially to control the safety aspect of aircraft leasing. Two Regulations are mainly applicable to wet leases: Regulation n° 1008/2008 and Regulation n° 859/2008.

### **3.2. Between two EU airlines**

When two European airlines wish to conclude a wet lease contract, the principle of freedom of

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<sup>45</sup> Article VIII, Section 8.1 ACMI Service Agreement.

<sup>46</sup> *Ibidem*, pp. 111-112.

<sup>47</sup> Article VIII, Section 8.5 ACMI Service Agreement.

<sup>48</sup> CHASSOT (2017), p. 105.

operation applies, subject to the observance of safety rules.<sup>49</sup> Indeed, according to Regulation n°1008/2008, “Community air carriers may freely operate wet-leased aircraft registered within the Community except where this would lead to endangering safety”.<sup>50</sup> In this context, the lessee, and only the lessee, is responsible for obtaining a prior safety approval “in accordance with applicable Community or national law on aviation safety”.<sup>51</sup>

Said approval is issued by the competent authority of the State in which the lessee's principal place of business is situated.<sup>52</sup> The competent authority approves the wet lease agreement after ensuring that the lessor meets continuing airworthiness requirements and air operations in accordance with applicable European rules.<sup>53</sup>

### **3.3. Between an EU airline and a non-EU airline**

#### **3.3.1. Potential situations**

When one of the two airlines do not fall under European jurisdiction but is an extra-European airline, two situations must be distinguished. Those are discussed in sub sections 3.3.2 and 3.3.3 below.

#### **3.3.2. EU lessor and non-EU lessee**

The first situation is where the lessor is a European airline and the lessee is not from the European Union. In such a situation, European law does not require any approval and control of the operation is left to foreign national law.<sup>54</sup>

#### **3.3.3. Non-EU lessor and EU lessee**

The second situation is where the lessor is a non-European airline and the lessee is a European airline. In this situation, European law is applicable and introduces a protectionist approach. Indeed, in addition to the prior safety approval provided for in Article 13 § 2, the lessee must apply for a “prior approval for the operation from the competent licensing authority”.<sup>55</sup> For such approval to be granted, the operation must meet not only safety criteria, but also restrictive economic expediency.<sup>56</sup>

From a safety perspective, the lessee shall demonstrate that:

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<sup>49</sup> GRELLIÈRE (2019), p. 252.

<sup>50</sup> Article 13 § 1 of Regulation n°1008/2008.

<sup>51</sup> Article 13 § 2 of Regulation n°1008/2008 and Regulation n° 965/2012 ORO.AOC.110 a).

<sup>52</sup> Article 3 of Regulation n°965/2012 and ORO.GEN.105.

<sup>53</sup> Regulation n° 965/2012 ORO.AOC.110 a), 4). *See also*, CHASSOT (2017), p. 97.

<sup>54</sup> GRELLIÈRE (2019), p. 253.

<sup>55</sup> Article 13 § 3 of Regulation n°1008/2008. The authority may or may not coincide with the authority issuing the safety approval provided for in Article 13 § 2. *See also* CHASSOT (2017), p. 98.

<sup>56</sup> GRELLIÈRE (2019), p. 253.

- (i) the non-EU airline holds a valid AOC issued in accordance with ICAO Annex 6;
- (ii) the non-EU airline safety standards are equivalent to those imposed by EU law; and
- (iii) the aircraft has a standard CofA<sup>57</sup> issued in accordance with ICAO Annex 8 of the Chicago Convention.<sup>58</sup>

From an economic expediency perspective, the lessee shall demonstrate that one of the following needs exists:

- (i) an exceptional need such as a special oversized cargo or a need for additional capacity for the prospection of new markets. If so, the lease is granted for a maximum of 7 months and may be extended once for a new period of 7 months maximum.<sup>59</sup>
- (ii) a seasonal capacity need which cannot be met by wet leasing an aircraft in the European Union. Such situations may occur when there is no suitable aircraft on the EU market. If so, the approval is granted for one or more seasons and may be renewed.<sup>60</sup>
- (iii) a need to overcome operational difficulties and it is not possible or reasonable to lease an aircraft registered within the EU. This will be the case, for example, in the event of a breakdown or mechanical incident bringing the aircraft to a standstill. In such a case, the approval is granted for the time necessary to overcome the operating difficulty.<sup>61</sup>

Even if the above conditions are met, the competent authority may refuse to grant its approval if there is no reciprocity as regards wet leasing between the Member State concerned and the third country where the wet-leased aircraft is registered.<sup>62</sup>

### **3.4. Concluding remarks**

The regulatory system set up by the European Union puts EU and non-EU airline on an equal footing when it comes to safety. The requirement for non-EU airlines to meet European safety standards certainly increase passenger safety by preventing the later from flying on aircraft that do not comply with safety standards. From an economic perspective, the exhaustive list of situations in which EU airlines can call on non-EU airlines and the principle of reciprocity reflect the protectionist nature of European law on wet leasing with third countries. Although

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<sup>57</sup> The CofA certifies that a given aircraft meets the technical standards in force: *See* SCHUBERT (2017), p. 70.

<sup>58</sup> Article 13 § 3 let. a) of Regulation n° 1008/2008; Regulation n° 965/2012 ORO.AOC.110 c) 1-3). This approval overlaps with the security requirements laid down in Article 13 § 2: *See* CHASSOT, pp. 98-99.

<sup>59</sup> Article 13 § 3 let. b) i) Regulation n° 1008/2008. *See also* Guidance for leasing and code sharing (2015), p.8.

<sup>60</sup> *Ibidem*, let. ii) Regulation n° 1008/2008. *See also* CHASSOT (2017), p. 99.

<sup>61</sup> *Ibidem*, let. iii) Regulation n° 1008/2008. *See also* GRELLIÈRE (2019), p. 254.

<sup>62</sup> Article 14 § 4 of Regulation n° 1008/2008.

this practice certainly prevents the expansion of a free market for wet leasing, it nevertheless protects European aircraft personnel from certain abuses such as salary dumping.

#### 4. COMPETITION LAW ISSUES

##### 4.1. General context

At first glance, competition law has little to do with wet lease. However, two recent decisions of European national competition authorities, in Germany and England respectively, suggest that in certain wet leases, the contracting parties would be well advised to seek the approval of the competition authorities (in addition to the security approval, *see* 3. above).

In these two decisions, the national competition authorities have considered whether, by means of the wet lease, the lessee took over the lessor's market position and thereby acquired a dominant position.

##### 4.2. Germany: Lufthansa/Air Berlin case

In 2016, Lufthansa and Air Berlin entered into a wet lease agreement for the rental of 38 aircraft (Airbus A319 and A320) over a period of 6 years, including a renewal option. The 38 aircraft were all dry leased by Air Berlin from third parties. Prior to the wet lease, the transaction provided that Lufthansa would dry lease 10 aircraft and sub-lease them to Air Berlin and acquire 15 aircraft to dry lease them to Air Berlin. The remaining 13 aircraft would continue to be dry leased by Air Berlin from third parties. The transaction neither involved the transfer of slots nor the transfer of contractual relationships of Air Berlin's customers. Also, the transaction did not cover the transfer of specific routes previously operated by Air Berlin.<sup>63</sup>

In a nutshell, the German “*Bundeskartellamt*” decided that the transaction could potentially create a dominant position of Lufthansa on the market in so far as (i) the wet lease could be considered as an acquisition of part of Air Berlin by Lufthansa (ii) a 6-year lease period was exceptionally long and (iii) the lease of 38 aircraft represented a significant part, representing almost a quarter of Air Berlin's fleet, thus strengthening Lufthansa's position on the market for flights to and from Germany.<sup>64</sup>

In the case at hand, however, the “*Bundeskartellamt*” considered that Lufthansa did not take over Air Berlin's market position and thereby acquired a dominant position, in particular because no transfer of slots, routes and customers between Air Berlin and Lufthansa was part of the transaction.<sup>65</sup>

##### 4.3. England: Aer Lingus/CityJet case

At the beginning of 2018, CityJet decided to cease its flight operations and focus solely on wet leasing. In this context, Aer Lingus and CityJet entered into a framework agreement providing

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<sup>63</sup> Decision of the German competition authority (2017), pp. 1-2.

<sup>64</sup> *Ibidem*, p. 8.

<sup>65</sup> *Ibidem*, p. 2 and 8.

for (i) the wet lease of several CityJet aircraft, (ii) the loan to Aer Lingus of CityJet slots (between LCY and DUB), for the duration of the contract, and (iii) the automatic transfer to Aer Lingus of customers who had already booked a CityJet flight from LCY to DUB.<sup>66</sup>

The British Competition and Markets Authority (CMA) considered that the transaction had to be treated as a merger.<sup>67</sup> In essence, the CMA argued that the combination of a wet lease agreement with a transfer of slots and customers on a particular route amounted to Aer Lingus taking over the market position of CityJet, referring to the principle of economic continuity. Through this operation, Aer Lingus acquired the ability to control price, quality of service and timing of operations, which were previously controlled by CityJet. The CMA considered that the transaction was likely to have an impact on the competitive structure of the air market between London and Dublin. After the operation, Aer Lingus became the only airline to operate on this route.<sup>68</sup>

In the case at hand, the CMA nevertheless accepted the transaction considering that (i) if no merger had taken place, CityJet would have ceased to provide scheduled flights between LCY and DUB in any case whereas CityJet decided to cease its flight operations, (ii) no other airline would have had the ability or strategic intent to enter into an agreement with CityJet and provide scheduled passenger services on the LCY-DUB route, and (iii) the transaction did not create a more anti-competitive result than if CityJet had simply withdrawn from the LCY-DUB route.<sup>69</sup>

#### **4.4. Concluding remarks**

A short-term wet lease of a limited number of aircraft is unlikely to be considered a prohibited concentration in most European jurisdictions. That being said, BURNSIDE AND DE BACKER consider that the contracting parties must be particularly vigilant when the wet lease (i) covers all or a large part of an airline's fleet (e.g. a quarter), (ii) is of long duration, (iii) includes the transfer of slots to the lessee, even temporarily, and (iv) involves the transfer of contracts or customer files to the lessee.<sup>70</sup>

In such cases, the transaction should be reported to the national competition authority, which could, as the case may be, prohibit the transaction. In this context, the parties may decide to provide for the approval of the competent competition authority as a condition precedent to the entry into force of the wet lease.<sup>71</sup>

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<sup>66</sup> Decision of the CMA (21 December 2018), pp. 3-4.

<sup>67</sup> Under UK competition rules, a merger occurs, in particular, when two companies cease to be distinct. See Enterprise Act 2002, s. 23: <https://www.legislation.gov.uk/ukpga/2002/40/contents> (last accessed 7 July).

<sup>68</sup> *Ibidem*, pp. 7, 11-12.

<sup>69</sup> *Ibidem*, pp. 14-20.

<sup>70</sup> BURNSIDE & DE BACKER (2019), pp. 313-314.

<sup>71</sup> *Ibidem*, p. 315.

## 5. CONCLUSIONS AND RECOMMENDATIONS

On July 2014, the McDonnell Douglas MD-83 of the Spanish airline Swiftair, wet leased to Air Algérie, crashed between Ouagadougou and Alger killing all 116 passengers and crew on board. Two years later, on May 2018, the Boeing 737 of the Mexican company Global Air wet leased to Cubana de Aviación, which had been forced to ground its fleet of Antonov An-158s due to a lack of spare parts, crashed shortly after take-off from Havana, killing 112 of the 113 occupants of the aircraft.<sup>72</sup> Although these disasters were essentially due to human error, they potentially suggest that the wet lease model consists in the lease of ‘trash planes’ by unscrupulous airlines, which has probably not helped the reputation of this business model in the aviation industry.

However, after this brief overview of the applicable rules, it appears that European legislation has made it possible to alleviate safety by imposing safety approvals (*see* 3. above). Furthermore, the protectionist system put in place for wet leases involving non-EU countries certainly prevents the expansion of a free market for wet leasing but is a good solution to avoid salary dumping on the European leasing market. As for the system of joint and several liability provided for in the Montreal Convention between the lessor and the lessee, it offers appreciable security for passengers since these have the possibility to bring action against either the lessor or the actual carrier, that is, the lessor, or the contracting carrier, that is, the lessee, or against both together or separately.

At the EU level, there is no precedent in which the European Commission's Directorate General for Competition has considered a wet lease to fall within its merger control.<sup>73</sup> That being said, a new trend towards long-term wet leases taking into account competition law concerns seems to be taking hold in some European countries. As a consequence thereof, airlines will have to be more and more vigilant being that the long duration of a wet lease contract may lead competition authorities to consider the agreement as a prohibited concentration.

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<sup>72</sup> *See* CEAIAC final report (2016) and Cuban CEIAA final report (2020).

<sup>73</sup> BURNSIDE & DE BACKER (2019), p. 306. The authors also put forward a few hypotheses explaining the potential incompetence of the European Commission's Directorate General for Competition with regard to wet leasing, these are (i) the aircraft and crew remain under the control of the lessor (operational control), (ii) the duration of a wet lease is generally limited and (iii) the assets, even in combination, can be mere inputs and not amount to a business to which a market presence can be attributed.

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