



# AVOIDING UNNECESSARY DISRUPTION CONTRACTUAL RISKS POSED BY PASSENGER-TO-FREIGHTER CONVERSIONS

by Justin deBettencourt

## ***Takeaways***

- Increased air cargo revenue has been a bright spot for the aviation industry during the COVID-19 pandemic
- As a result of the increase in air cargo demand and the drop-off in passenger demand, aircraft operators are increasingly converting passenger aircraft into freighters
- The conversion process should be approached carefully to make sure it does not violate lease documents and create contractual liability



## Fall in passenger demand due to COVID-19

Over the past two years, COVID-19 has presented a significant challenge for the aviation industry as passenger demand has fallen in response to the worldwide pandemic. Although the introduction of vaccines suggested a brighter future for air travel, the recent rise of the Delta and Omicron variants of the coronavirus may dampen expectations of a robust increase in passenger demand. In the midst of this uncertainty, one of the few bright spots for the aviation industry during the pandemic has been an increase in air cargo revenue. According to estimates from the International Air Transport Association, air cargo will rise to 36 percent of carriers' revenue this year, up from 12 percent in 2019.

## A switch to freight

To meet this increased demand and in response to the reduction in air passenger travel, passenger aircraft are being converted into freighters. For example, in May 2021, it was reported that Boeing was adding two production lines to convert Boeing 737-800s into freighters. Conversions can be temporary or permanent, and may include cabin removal, the installation of cargo loading systems, the plugging of windows, reinforcements and other modifications. In some instances, manufacturers have published service bulletins laying out possible cargo conversion solutions, such as Airbus with its A330 and A350 aircraft. However, there are legal risks posed by the passenger-to-freighter conversion process.

## Contractual concerns

Aircraft operators seeking to convert passenger aircraft into freighters must ensure that the new contemplated use is permitted by the lease. In addition, the conversion process will require that modifications be made to the aircraft. A lessee must review the lease carefully to make sure that modifications are permitted. Aircraft lessees may also need the aircraft lessor's consent prior to making any modifications depending on the wording of the lease. Moreover, an aircraft lease agreement commonly requires the aircraft to be redelivered at the end of the lease in its initial configuration. Any modifications made to the aircraft as part of the passenger-to-freighter conversion process may have to be reversed unless the modifications are acceptable to the lessor. As a result, an aircraft lessee should engage the lessor early in the process to make sure the lessee avoids violating the lease and obtains any necessary consent.

If a passenger-to-freighter conversion occurs resulting in a violation of the lease, an aircraft lessor could pursue a claim for breach of contract. In the United States, such a claim is likely to be made under state law. While each state's law is different, in general, a lessor will only need to establish that a lease existed, the language of the lease was breached, and the lessor was damaged as a result. If a contractual violation is established, the lessor would still have to prove its damages at an arbitration or in a court and each state's law could approach the damages calculation differently.

## **Insurance and regulatory risks of conversion**

Separate from contractual liability between a lessee and lessor, passenger-to-freighter conversions may also implicate insurance considerations as the policy for the aircraft may not permit the carriage of cargo, especially dangerous goods. Moreover, the financing arrangements for the aircraft could limit the ability to carry cargo. Therefore, if a lessor receives a request for consent to a passenger-to-freighter conversion, the lessor should review the financing documents to determine if a lender's consent to such a conversion is required before they can consent to the conversion process.

Moreover, depending on the conversion process used, and the cargo contemplated, there may also be regulatory challenges posed by the conversion process, especially for permanent modifications. Aircraft conversion programs are regulated by the FAA and other international regulatory agencies, such as EASA.

## **Rising tide of litigation**

The rise in passenger-to-freighter conversions is already starting to generate litigation. For example, on May 25, 2021, Mammoth Freighters sued multiple defendants in federal court in California, alleging that the defendants stole valuable, confidential, and proprietary information belonging to Mammoth Freighters to develop a competing business converting large passenger aircraft into cargo freighters. As conversions increase in response to the increased air cargo demand, it is inevitable that litigation surrounding the conversions will increase as well.

As a result, before undertaking any conversion, an aircraft lessee should carefully review its lease to make sure the conversion, and the necessary modifications, are contemplated by the lease. A lessee should engage with the aircraft lessor early in the process to make sure the lessor is aware of the conversion contemplated and to obtain the consent of the lessor as required by the lease. Likewise, if a lessor receives a request from an aircraft lessee for the lessor's consent to a passenger-to-freighter conversion, the lessor should carefully review its insurance and financing documents to make sure the conversion is permitted. Although the increase in air cargo demand is a bright spot for the industry, aircraft lessees and lessors alike should make sure they carefully manage their risk during the conversion process.

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