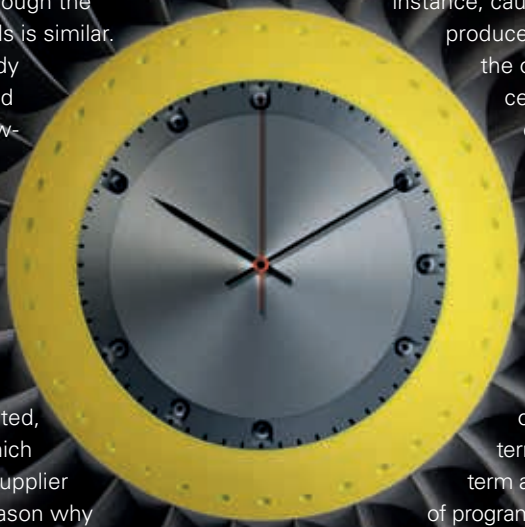
Powering regionals by the hour

As hourly usage agreements become more commonplace for smaller regional aircraft, Simon Phippard, Of Counsel at Bird & Bird, examines the possible implications for operators of historic shortcomings with the model

Hourly usage or 'power-by-the-hour' agreements (HUAs) have become a well-known feature of in-service support for large commercial aircraft. Although the terminology varies, the structure of brands is similar. Having become prevalent in the wide-body market, HUAs are actively being promoted by the suppliers of new generation narrow-body aircraft engines, and they are increasingly available in regional and turboprop markets. Historically, overhaul options have been greater for operators of smaller aircraft, but it is clear that the engine OEMs are using long-term agreements to provide more competitive offerings to their customers, to increase the likelihood of their product being selected, or to capture a part of the aftermarket which they did not previously enjoy. While the supplier is usually the engine OEM, there is no reason why an independent MRO with appropriate capability, access to spares and understanding of the fleet should not provide a comparable service.



Engine choice

The question for regional and short-haul operators is the extent to which shortcomings of the historic model are being repeated. In the wide-body market, an operator may have a choice of engine which gives it an additional negotiating lever at the point of aircraft and engine selection. This is not typically available for operators of turboprop and regional aircraft. But a commitment to a long-term support arrangement should give an operator better pricing and, in particular, predictability of cost of engine maintenance.

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The traditional risk transfer in an HUA is well known. The supplier commits to conduct a specified level of engine shop overhauls in accordance with the maintenance programme. The operator commits to paying charges based largely on hours flown, but there may be calendar-based or cyclic elements, if, for example, life limited part (LLP) replacement is included. The hourly rate varies according to the intensity of utilisation: shorter stage lengths increase the rate but higher levels of operation below an engine's full power may reduce it. If the engines are driven harder, the operator pays a higher rate that should reflect greater revenue capability.

In all engine HUAs, it is vital to ensure that the service covers all scheduled and unscheduled overhauls apart from those, for instance, caused by operator misuse. The desire to produce shorter agreements actually enhances the operator's need to pay close attention to certainty of pricing, escalation formulae, cover for management or repair of external accessories and commitments on life or replacement price for parts (such as LLPs) which are outside the basic hourly rate.

Agreement expiry

Additional challenges arise at the end of the term of an HUA. Most suppliers' offerings expire at the end of a calendar term. This is not always related to a lease term and there have been recent examples of programmes offered for mid-life regional and turboprop engines without reference to the operator's intended term of use of the aircraft. Without a commitment to meet lease re-delivery conditions or to allow enrolment in a comparable programme with a subsequent operator with variation only for utilisation profile, the value and marketability of the engine will be reduced.

Furthermore, if there is no protection available to a lessor upon HUA expiry, or following default, and the lessor has not collected maintenance reserves, the lessor may recover an engine with substantial time burnt and no funds held towards the next shop visit. Again, this will affect marketability, since enhanced reserves will need to be collected in a follow-on operation. Some suppliers offer programmes for large engines whereby, following default or expiry of an HUA, the lessor has the benefit of sums accrued since the last shop visit. However, not all operators provide such offerings, and what we have seen in the regional and turboprop market often provide even less comfort.

There are many good reasons for adopting services of this nature but, if inappropriately negotiated and drafted, they can store up problems in the longer term. In particular, the effect on investors and the implications for residual value can be significant. However, none of these are issues which, if the right requirements are addressed at the appropriate time, should cause any parties more than temporary difficulties. ■