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The Boeing-Iran Air Deal: Walking the Line

The Joint Comprehensive Plan of Action (the **JCPOA**) between Iran, the P5+1 and the European Union created a framework for the easing of international nuclear-related sanctions against Iran in exchange for commitments by Iran to impose meaningful limits on the development of its nuclear program.[1] The JCPOA was finalized on July 15, 2015, adopted on October 19, 2015, and subsequently implemented on January 16, 2016 (**Implementation Day**).[2] As a key element of its various agreements under the JCPOA, the United States committed to allow for the sale of commercial passenger aircraft and related parts by U.S. persons to Iran beginning on Implementation Day.[3]

The civil aviation commitment was achieved by the issuance of a Statement of Licensing policy (the **SLP**) by the Office of Foreign Assets Control of the U.S. Department of the Treasury (**OFAC**). The SLP announced a "favorable" licensing policy under which U.S. and non-U.S. persons could request authorization from OFAC to engage in otherwise prohibited transactions for the sale of commercial passenger aircraft to Iran. The SLP stated that as of Implementation Day "specific licenses"[4] could be issued on a "case-by-case" basis to U.S. persons and, where a jurisdictional nexus to the United States otherwise existed, non-U.S. persons, to engage in the following activities:

> (1) export, re-export, sell, lease or transfer to Iran commercial passenger aircraft for exclusively civil-aviation end-use,
>
> (2) export, re-export, sell, lease or transfer to Iran spare parts and components for commercial passenger aircraft, and
>
> (3) provide associated services, including warranty, maintenance, and repair services and safety-related inspections, for all the foregoing, provided that licensed items and services are used exclusively for commercial passenger aviation.

The favorable licensing climate created by the SLP is limited to certain types of aircraft. Thus, aircraft that may be approved "include" wide-body, narrow-body, regional and commuter aircraft used for commercial passenger aviation.[5] Aircraft that are ineligible for licensing under the SLP "include" cargo aircraft, state aircraft, military aircraft and aircraft used for general aviation purposes.[6] The use of the term "include" to designate both eligible and ineligible aircraft suggests that each list has a built-in accordion feature by which additional aircraft types may be added.

Recent Accolades

For the 7th year in a row, Vedder Price is ranked Band 1 in *Chambers USA-Transportation: Aviation Finance*. Team members ranked in this category are Dean Gerber (Band 1), Ronald Scheinberg (Band 1), Joshua Gentner (Band 2), Geoffrey Kass (Band 3) and Jeffrey Veber (Band 3).

For the 4th year in a row, Vedder Price is ranked Band 3 in *Chambers USA-Transportation: Shipping/Maritime: Finance*. Shareholder Francis X. Nolan, III is ranked Band 2.

In its inaugural year, *Chambers High Net Worth: Private Aircraft Guide* ranks Vedder Price Band 1. Individual Shareholders Edward Gross (Band 1), Derek Watson (Band 1) and David Hernandez (Band 2) are recognized as leading lawyers for private aircraft and wealth management in key jurisdictions around the world.

Legal 500 2016 ranks Vedder Price Tier 1 in *Asset Finance and Leasing*, recognizing *Leading Lawyers* Dean Gerber and Geoffrey Kass and recommending Denise Blau, Mehtap Cevher Conti, Joshua Gentner and Raviv Surpin.

Expert Guides Best of the Best USA 2016 includes Vedder Price's Dean Gerber, Francis X. Nolan, III, Ronald Scheinberg and Jeffrey Veber. Associates Mark Ditto and Michael Draz are recognized in *Expert Guides Rising Stars 2016*. In total, *Expert Guides* names 17 Global Transportation Finance team attorneys.

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On March 24, 2016, in order to facilitate trade deals contemplated by the JCPOA, OFAC issued a general license (**General License I**) that allowed U.S. persons to "enter into, and to engage in all transactions ordinarily incident to the negotiation of and entry into, contracts for activities eligible" for licensing under the SLP. By issuing General License I, OFAC gave persons seeking to engage in licensed transactions the corresponding right to negotiate them.

In June 2016, Iran Air[7] and Boeing announced that they had reached a landmark deal by which Boeing would sell to Iran Air 80 commercial passenger aircraft with a list price value of $17.6 billion and deliveries starting in 2017.[8] The memorandum of agreement between the parties further expressed Boeing's intent to lease 29 new Boeing 737s to Iran Air. Negotiated under the umbrella of General License I, and in close coordination with the U.S. government, the terms of the deal will undergo extensive governmental scrutiny, and deal completion will be subject to the terms of any specific license granted by OFAC pursuant to the SLP.

Although touted by the State Department as the "type of permissible business activity envisioned" by the JCPOA,[9] the Boeing-Iran Air deal has not been uniformly welcomed in the United States as a JCPOA success story. Almost as soon as it was announced, the deal was denounced by various think tanks and political leaders who were previously on record as opposing the JCPOA.

Representatives Jeb Hensarling, a Republican from Texas, and Peter Roskam, a Republican from Illinois, wrote a letter to Boeing on June 16, 2016, stating that American companies "should not be complicit in weaponizing the Iranian regime," and seeking additional information to determine the national security implications of the deal.[10] Of specific concern to the Congressmen was the prospect that aircraft sold to Iran Air could be used for impermissible purposes or sold, leased or transferred to persons or Iranian governmental units with whom commercial activity remains off limits.[11] In a similar vein, Representative Brad Sherman, a Democrat from California, separately urged the Obama administration to block the sale until Iran "gets out of the business of supporting terrorism."[12]

On July 7, 2016, the Monetary Policy and Trade Subcommittee of the House Financial Services Committee held hearings on the deal entitled "The Implications of U.S. Aircraft Sales to Iran." Several bills were quickly introduced in Congress aimed at suppressing the deal or making it off-limits to U.S. EXIM Bank financing or financing by U.S. financial institutions. Three such measures were approved by the House Financial Services Committee on July 13, 2016.[13] Meanwhile, on July 7, 2016, the Financial Services and General Government Appropriations Act, 2017,[14] passed the House by a vote of 239–185. Two amendments to the bill, also aimed at blocking the deal and introduced by Representative Roskam, passed by voice vote.[15]

So what is going on? Although the commercial and economic importance of the Boeing-Iran Air deal for both parties is clear, as is the need for the United States to deliver on its JCPOA commitments, political opposition to the deal has gathered steam since the deal was announced in June. At this time it remains to be seen whether Congressional blocking efforts will be successful or whether they will survive Presidential veto. However, given the difficult political and legal environment through which the deal must inevitably travel, Boeing will be forced to walk the line between the permissible and impermissible, and the certain and uncertain, even if the deal is eventually approved.

Speaking Engagements

September 8 - 9: **2016 Annual ABA Meeting, Subcommittee on Aircraft Finance, Boston.** Shareholder Adam Beringer will lead a presentation covering recent developements in the aircraft lessor securitization space.

September 8 - 9: **2016 Annual ABA Meeting, Subcommittee on Leasing, Boston**. Shareholders Edward Gross and Denise Blau will lead a panel discussion on implications of the characterization of personal property financings documented as leases, as moderator and panelist on tax and commercial law.

September 12 - 13: **Iranian Aviation Forum, London**. Shareholder David Hernandez will speak on a panel called "The Legal Panel: Questions and Answers for Operators and Investors."

September 13: **Capital Link's New York Maritime Forum, New York**. Shareholder John Bradley will lead a panel discussion on investing in container leasing.

September 15-16: **2016 Annual ABA Forum on Air & Space Law, Atlanta**. Shareholder David Hernandez will be on a panel discussing "Destinations: Navigating Trade Sanctions in Emerging Markets (Iran, Cuba & Others)."

September 20 - 21: **15th Annual Marine Money Ship Finance Forum, Singapore**. Shareholder Ji Woon Kim will lead a panel discussion of alternative shipping finance solutions.

October 29 - November 2: **NBAA 2016 Tax, Regulatory & Risk Management Conference, Orlando**. Shareholder David Hernandez will lead a presentation on "Business Aviation in Challenging Jurisdictions."

October 11: **8th Annual Greek Ship Finance Forum, Athens**. Shareholder John Bradley will speak on matters related to ship owning and formation of capital for shipping.

For starters, unlike Cuba, Iran remains a State Sponsor of Terrorism in the eyes of the United States government,[16] and this fact sticks out like a sore thumb since the designation carries with it enhanced sanctions and controls over dual use items such as commercial aircraft. Optically, it does seem strange that a State Sponsor of Terrorism, such as Iran, should benefit from a favorable licensing policy involving commercial aircraft. Indeed, when asked whether the United States had ever authorized aircraft sales to a State Sponsor of Terrorism, State Department spokesman John Kirby said that he was not aware of any precedent.[17]

Second, in the complex alignment of nations, non-state actors, factions and interests in the Middle East, Iran very much remains an adversary of the United States and its allies, principally Israel. The embarrassing incident occurring just days before Implementation Day in which members of the Islamic Revolutionary Guard Corps captured and released American sailors in the Persian Gulf provides one striking example.[18] Iran's recent tests of ballistic missiles capable of reaching Israel provides another.[19] For many, the very thought of selling commercial aircraft to a dangerous adversary seems incomprehensible.

Third, the JCPOA left in place all U.S. legal authorities, non-nuclear sanctions, embargoes and export controls involving Iran, other than those specifically addressed by the JCPOA.[20] Moreover, the JCPOA does not preclude the imposition of additional non-nuclear sanctions in the future. Accordingly, the Boeing-Iran Air deal will be surrounded on all sides by non-terminated sanctions (as well as any newly imposed sanctions) that will require skillful maneuvering. For example, although "financial payment services" may be considered "ordinary and incident" to a licensed deal, [21] and although OFAC may consider license applications for a U.S. financial institution "to finance the sale of a particular commercial passenger aircraft,"[22] it is somewhat uncertain as to how such services or financing can be achieved if "U-turn" transactions are prohibited and the deal cannot be "dollarized" through access to the U.S. financial system.

Fourth, as is clear from the SLP, any specific license issued in connection with the Boeing-Iran Air deal will include "appropriate conditions to ensure that licensed activities do not involve, and no licensed aircraft, goods or services are re-sold or re-transferred to, any person on [OFAC's list of Specially Designated Nationals]" (the **SDN List**). Although Iran Air is no longer on the SDN List, the concern for some is that future events may cause OFAC to re-designate Iran Air, or that Iran Air may decide to transfer the aircraft to any one of the hundreds of entities, including some airlines, which remain on the SDN List, in breach of transfer restrictions contained in the licensed deal documents.

The United States has expressly stated that should it "determine that licensed aircraft, goods or services have been used for purposes other than exclusively civil aviation end-use, or have been re-sold or re-transferred to persons on the SDN List, the United States would view this as grounds to cease performing its commitments under Section 5.1.1 [of Annex II to the JCPOA] in whole or in part."[23] In other words, if Iran Air gets caught violating the terms and conditions under which a specific license is issued, the United States could presumably undo the deal by revoking any license previously issued to Boeing; depending on a number of factors, including timing, such action could result in substantial financial jeopardy to Boeing and other U.S. interests.[24]

The JCPOA celebrated its one-year anniversary on July 15th. In commemoration of the event, Secretary of the Treasury Jack Lew stated that the United States is meeting its commitments under the deal, but remains "clear-eyed" that the JCPOA did not resolve, and was not intended to resolve,"concerns outside of the nuclear arena."[25] It is these other "concerns" that are at the root of the current political opposition to the Boeing-Iran Air deal. However, as the deal was obviously intended as a major deliverable by the United States under the JCPOA, and as it does have the support of the Obama Administration, the deal is expected to survive the political crucible and obtain required governmental approvals. Boeing, meanwhile, will be walking across a treacherous field filled with obstacles that could delay and threaten the deal.[26]

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Events

Vedder Price sponsored the **22nd Annual Chi-Stat Reception** on June 8th at Navy Pier. Chi-Stat celebrates Chicago's commercial aviation presence and was attended by over 850 industry leaders, including aviation finance, marketing and consulting professionals.

We had a great time hosting the **3rd Annual Women in Transportation Finance Reception** last May in New York. Over 40 women attended the event held at The Raines Law Room and had a great time networking, sharing experiences with one another and most importantly, learning how to make delicious cocktails! Thanks to all who attended and we can't wait for next year!

EASA Part-NCC: What Do Financiers Need to Know?

Private aviation in Europe will soon be subject to heightened regulatory standards following the implementation of Regulation (EU) No. 800/2013 (the **Regulation**). From August 25, 2016, operators of "complex motor-powered aircraft" for noncommercial operations (**NCC**) must comply with the standards imposed by the Regulation. Financiers of these aircraft have kept a cautious eye on how the Regulation might affect their investment in these aircraft and whether action needs to be taken to mitigate any potential adverse exposure.

The purpose of this article is (i) to provide an explanation of the Regulation and what it means for private aviation, (ii) to analyze how the Regulation will affect aircraft financiers and (iii) to suggest measures to be taken by such financiers to mitigate any potential adverse exposure created by the Regulation.

Background

Aviation regulators have typically afforded greater protection to fare-paying "commercial" passengers than to those willing to undertake the risks associated with "private" flying. In most jurisdictions, operators may operate an aircraft only for the purpose of commercial air transport under an air operator's certificate (**AOC**); this brings greater regulatory standards and scrutiny than for traditional private operations. While the European Commission has recognized that it is not possible to implement a "one size fits all" approach[1] to regulation across private and commercial aviation, there has been a growing appetite among stakeholders to raise the standards of private aviation closer to those required for commercial air transport. As EASA noted in response to industry comment on its initial proposals, "many stakeholders requested that NCC rules should be aligned with commercial rules . . . *The Agency acknowledged that such an alignment would be in the interest of safety in particular for such operations that involve commercial and noncommercial flights and this request has been accepted where appropriate*".[2]

The justification for EASA's approach appears to be based on two broad premises. First, that bona fide private aircraft owners who enter into a management relationship with an aircraft operator, where the former has no knowledge of the relevant regulatory standards, should not be subjected to lesser safety standards and regulatory oversight than those who are substantively receiving the same service, albeit falling under the remit of the rules relating to commercial air transport. Second, to those persons who are not passengers voluntarily choosing to be subjected to the risks involved in private flying (i.e., crew members and those on the ground), the distinction between private and commercial air transport is not relevant, and the same inherent

risks apply to those persons (and property) whether or not the operation of the aircraft is subject to (a) the heightened rules for commercial air transport or (b) the less-stringent rules relating to private flying.

Applicability: "Complex Motor-Powered Aircraft for Noncommercial Operations"

The Regulation applies to "complex motor-powered aircraft" conducting "noncommercial operations" (together, an **NCC Operation**), which phrases have distinct meanings:

Complex Motor-Powered Aircraft

A "complex motor-powered aircraft" is an aeroplane: (i) with a maximum certified take-off mass (**MTOM**) exceeding 5,700 kg, or (ii) certified for a maximum passenger seating configuration of more than 19, or (iii) certified for operation with a minimum crew of at least two pilots or (iv) equipped with (a) turbojet engine(s) or more than one turboprop engine[3] (although the European Commission and the EASA Committee recently agreed on a derogation to allow noncommercial operators of twin turboprops with an MTOM of less than 5,700 kg to operate under Part-NCO instead).[4] To put this into context, the MTOM of a Bombardier Challenger 605 (a popular mid-range jet aircraft) is 19,500 kg, and even the Eclipse 550 (which is a "very light jet"), which has an MTOM of 2,722 kg and is certified for operation with a single pilot, is classified as an NCC aircraft by virtue of the fact that it is propelled by two turbojet engines. Most aircraft suitable for conventional or typical business or private luxury use are likely to fall into the NCC category.

Noncommercial Operations

Unless a particular flight falls into a special-purpose category such as aerial photography, police or air-ambulance flights, a "noncommercial operation" will generally be a flight which is not a "commercial operation." A commercial operation is "*any operation of an aircraft, in return for remuneration or other valuable consideration, which is available to the public or, when not made available to the public, which is performed under a contract between an operator and a customer, where the latter has no control over the operator.*"[5] What constitutes "*valuable consideration*" for flights made available to the public is generally well understood; it could be a payment in kind and need not involve a direct exchange of money.[6]

The reference to operations "*not made available to the public . . . where the latter has no control over the operator*" is troublesome because the term "control" is not defined in the regulatory framework. It does, however, serve as a useful guide to carve out those instances in which a customer does have some control over the operator, such as in a typical owner/manager/operator scenario, and would also likely cover fractional ownership schemes. EASA has provided the following guidance:

> *the legislator has not further specified the term "control". It is therefore EASA's view that it should be understood in a wider sense, i.e. the term is not limited to operational control. In this sense, control could for example also encompass financial control, control of management decisions etc. This notion of the definition is for example particularly valid for managed operations or fractional ownership. These are operations where an aircraft is owned by one or several persons who contract a management company to manage operations and continuing airworthiness. It then depends on the specific contract between the owner(s) and the management company how much control the owner(s) still have over the operation*.[7]

It is therefore clear that most aircraft that are suitable for conventional or typical business or private luxury use and which are operated privately will be affected by the Regulation.

Who Is the "Operator"?

It is critical to establish who the "operator" is for the purpose of the Regulation because the operator is the accountable party that needs to be compliant with the Regulation. However, the Regulation is not particularly helpful for the purposes of definitively establishing the identity of the operator.

The operator is "*any legal or natural person, operating or proposing to operate one or more aircraft.*"[8] To see why this is troublesome, let's take an ordinary private jet management scenario as an example: Wealthy Person, a high-net-worth individual (who knows nothing about aircraft), is the beneficial owner of an aircraft which is subject to a finance lease from Big Bank. Wealthy Person (or Wealthy Person's special-purpose company) has entered into a management agreement for the aircraft with Experienced Manager, which provides all of the services required to operate the aircraft, except that certain dispatch services are subcontracted to Dispatching Agent. Wealthy Person uses that aircraft for

private business and family use only. This is, therefore, an NCC Operation.

Who is the operator? Is it Wealthy Person, Big Bank, Experienced Manager or Dispatching Agent? At the outset, we can say that Big Bank is not the operator (even though it is the legal owner pursuant to the finance lease), as the financier could not be said to be "operating or proposing to operate" the aircraft.[9]

We might assume that Experienced Manager is the operator, as that entity would normally employ the pilots and have the ultimate operational oversight for the aircraft. The definition of "*noncommercial operations*" similarly makes a natural distinction in a management agreement–style relationship between the customer and the operator.

But what if, for structuring or personal reasons, Wealthy Person employs the pilots, Experienced Manager employs the remaining crew and provides scheduling support, and Dispatching Agent provides dispatch, airworthiness management and maintenance services. Which entity is "*operating or proposing to operate*" the aircraft? The Regulation leaves this open. While any of these parties could be the operator under the Regulation, only one party is permitted to be the operator under the Regulation. If Experienced Manager is an AOC holder but is acting in a private capacity, then it would be logical (but not necessary) to assume that the Regulation would treat Experienced Manager as the operator, as certain exceptions are made for AOC holders under the Regulation, and they would necessarily already have many of the systems and manuals in place to comply with the Regulation.[10] But there is nothing stopping Wealthy Person from insisting that he is the operator and making the declaration to the relevant aviation authority that he is so. Indeed, at a domestic level in the UK, it is commonplace for AOC holders to state that the owner is the "operator" for a given flight to allow them to "flip-flop" between commercial and private operations and remain in compliance with domestic operations rules.[11] The consequences of this characterization are crucial.

Key Changes, Increase in Standards and Aircraft Managed by AOC Holders

While this article does not seek to explore the increased technical standards imposed by the Regulation in any great detail, a basic grasp of some of the other fundamental changes is important:[12]

1. **Management System:** The operator must have in place a management system which sets out, among other things: (i) channels of responsibility and accountability (including designating an "accountable manager"); (ii) the overarching philosophies relating to safety; (iii) identification of hazards; (iv) how personnel are made aware of their duties; and (v) compliance monitoring.[13] Generally, the Regulation requires that "the management system shall correspond to the size . . . nature . . . and complexity of [the operator's] activities,"[14] meaning that it should be a bespoke—and not an "off-the-shelf"—system.

2. **Operations Manual:** Distinct from the management system, the operator must have in place an operations manual which sets out all necessary instructions, information and procedures for all aircraft to be operated and for operations personnel to perform their duties (so, for example, limitations relating to flight time, flight duty periods and rest periods for crew would be set out in the operations manual).[15]

3. **Minimum Equipment List (MEL):** The operator must establish an MEL, which is effectively a list of instruments and technical functions without which the aircraft could not be safely operated. The MEL will identify whether a flight could be safely performed or not if any instrument or function is inoperative at the commencement of such flight (and what is to occur in the event of an inoperative instrument or function).[16]

4. **Declaration:** Prior to commencing an NCC Operation for a given aircraft, the accountable manager of the operator must make a declaration (the **Declaration**) to the relevant aviation authority that it has complied with the requirements of the Regulation. The form of this declaration is quite simple and is set out in Annex II to the Regulation. The Declaration need be made only once.

Operators of aircraft that previously did not have any of items numbered 1 to 3 above in place will now need to implement these items and inform their national aviation authority that they have done so and that they are compliant with the Regulation by submitting the Declaration. AOC holders that are performing private operations are not required by the Regulation to submit a Declaration, as they are already deemed to be compliant by virtue of the fact that they are required to comply with the minimum standards imposed upon an AOC holder.[17]

The Effect on Industry as a Whole

While it remains to be seen, it is most likely that the Regulation will affect two categories of operators significantly: (1) small aircraft management firms that do not hold an AOC and (2) in-house aircraft management departments of organizations that manage a fleet of jets for that organization alone (though this type of department is less common). The Regulation represents a genuine and significant change to the way in which these entities are managed, and the cost of implementing the changes accorded by the Regulation may be significant. AOC holders will likely not suffer the same implementation costs, since they will already (largely) be compliant with the Regulation.

As a result, these categories of operators may be affected in the following manner:

1. small aircraft management firms may consolidate in order to compete;
2. more organizations that own and manage their own jets may engage third-party operators to manage their aircraft; and
3. AOC holders may see more aircraft placed under their management and take advantage of economies of scale, whether by virtue of consolidation with smaller operators or where aircraft owners decide to relocate their aircraft elsewhere.

The Effect on Financiers

While it has been suggested that financiers will be directly affected by the introduction of the Regulation, it is implausible to suggest that a financier (whether as a lender or a finance-lessor) that is carrying on conventional business could have any direct liability under the Regulation as a matter of European law.

That being said, the Regulation will have an indirect impact on financiers. Firstly, a financier will need to do its due diligence on the aircraft manager in any given transaction to ensure that the manager is capable of meeting its obligations under the Regulation. If the managers are established AOC holders, then the level of scrutiny might be less than that of a non-AOC holder that has implemented its operations manual and management system for the first time as a result of the Regulation; financiers need to be comfortable that the operator is operating the aircraft in compliance with all applicable laws. The consequences of a failure to do so could be wide ranging, including (i) invalidity of insurance coverage (for the operator at least, even though the financier should benefit from a breach-of-warranty endorsement), (ii) competent authorities placing preferential liens over the aircraft as a matter of domestic law and (iii) the negative publicity that might ensue.

Secondly, the financier should be fundamentally clear as to who the operator is and, consequently, who is providing the Declaration pursuant to the Regulation. It may therefore be sensible, where a third-party manager is not an AOC holder, to oblige that entity in the relevant tri-partite agreement to submit the Declaration and declare itself the operator and to include a covenant not to alter that position without the prior consent of the financier. At the very least, in this sort of scenario, the financier should request to see a copy of the Declaration and make it a condition of the finance document to do so.

Lastly, financiers should continue to ensure that they insist on adequate insurance protection (usually in the form of an AVN67B endorsement) so that any breach of the Regulation by the operator (or insured if different) is covered by the breach-of-warranty protection afforded to financiers therein. It is important that any financier is actively aware of who the operator is and if such operator is capable of complying with the Regulation (and acting on it appropriately if not).

Conclusion

There is general consensus that a harmonization of standards across private and commercial aviation is a welcome step, if not unwanted from some operators. The manner in which EASA has done so has caused issues; aside from being uncertain in a number of areas, it will likely cause economic impact to industry. Financiers, however, should not be alarmed by the Regulation or its impact. They should, however, continue to remain diligent and aware of who in their ownership and management structures is doing what, and when.

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The Unjustly Enriched Seller of an Aircraft Asset: Mistakes in Sale and Purchase Transactions

The trading of aircraft assets, be they whole aircraft, engines or other parts, between industry participants such as institutionalized leasing companies is as dynamic, legally complex and fraught with intense negotiation between interested parties as it has ever been.

Legal teams work (tirelessly!) to prepare tightly drafted documentation on behalf of their clients, attempting to prescribe recourse for every likely and unlikely eventuality which may arise during the course or following the completion of a sale and purchase transaction.

On occasion, however, despite the seemingly meticulously drafted documentation, unforeseeable events can occur and result in a potentially significant loss or cost accrual for one of the involved parties. In the unlikely event that the documentation does not provide for a remedy or guidance for correcting the issue, in the absence of goodwill between the transaction participants, the aggrieved party may be left with no choice but to initiate litigation.

This article briefly explores (i) some of the stakes in an aircraft sale and lease novation transaction, (ii) the mistake of a lessee making a lease payment to the prior lessor after closing, (iii) the concept of unjust enrichment as the likely (but not necessarily exclusive) source for a cause of action and (iv) the associated remedy of restitution.

The Stakes in a Leased Asset Sale Transaction

A purchase of an aircraft asset is normally concluded by the execution of a sale and purchase agreement between the selling and purchasing entities (the **SPA**). To illustrate the stakeholders in a common purchase and sale transaction and a mistake that could lead to unjust enrichment, an example is provided below.

To keep this example as straightforward as possible, we will assume that the selling entity under the SPA (the **Seller** or the **Existing Lessor**) is the full legal and beneficial owner of an aircraft asset and that it is also the lessor of that asset under a lease agreement (the **Lease**) between itself and a third-party airline (the **Lessee**).

The purchasing entity under the SPA (the **Purchaser** or the **New Lessor**) is not only purchasing the metal asset itself, it is also purchasing the economic benefits, including the stream of rental payments, under the Lease.

If the transaction is governed by English law and the sale of the asset is a straight metal sale (as opposed to an assignment of a beneficial interest under a trust or the sale of an aircraft-owning company), the document that will govern the transfer of the Lease will be a novation and amendment agreement (the **Novation**). The execution of the Novation by the Existing Lessor, the New Lessor and the Lessee will be a condition precedent to the sale of the asset under the SPA. The Novation would contain provisions pursuant to which the New Lessor promises to assume the role and the rights of the Existing Lessor under the Lease and the Lessee promises to perform all of its obligations under the Lease in favor of the New Lessor.

The Novation will ordinarily contain a provision called the **Effective Time** which will govern the time at which the operative provisions of the Novation become effective and a new lease agreement is constituted between the New Lessor and the Lessee. It will also typically contain carefully drafted provisions stating that all payments made by the Lessee under the Lease that are attributable to the period prior to the Effective Time shall be made by the Lessee to the Existing Lessor even if they fall due or are paid after the Effective Time[1] and that all payments under the Lease that fall due and are attributable to the period after the Effective Time will be paid by the Lessee to the New Lessor.

These provisions will be the subject of deliberate and intense scrutiny by the legal teams of both the Existing Lessor and the New Lessor, each wanting to ensure that its client does not fall victim to a misinterpretation of the provisions of the Novation by the Lessee, an unintentional payment processing error, a careless mistake or negligence on the part of the Lessee, any of which could have significant implications for the economic benefits of the transaction for the Seller or Purchaser (or both), such as a significant variation in the purchase price of the asset in question.

How then, do payment-related mistakes still occur?

The Mistake

An example of a mistake in these circumstances occurred when an airline (the Lessee in the example) which was leasing an engine from an operating lessor (the Seller in the example) that was selling the engine to another operating lessor (the Purchaser in this example), mistakenly paid maintenance reserve amounts (**MRs**) to the Seller after the sale had concluded.

The engine was the subject of an SPA which provided that the total amount of the purchase price to be paid by the Purchaser to the Seller would be reduced by the total amount of MRs and security deposit held by the Seller at the time of the sale. Both the Seller and the Purchaser had been of the understanding that the engine was off-wing and in storage during the three months preceding closing, and therefore MRs did not accrue during those months.

At closing the total amount of the purchase price was reduced by an amount equal to the MRs for the engine held by the Seller on the closing date.

Later that month, the Lessee paid MRs to the Seller for three months preceding closing because it realized that it had made a mistake as to the engine which it had communicated to the Seller and the Purchaser as being off-wing. The engine that was the subject of the sale was in fact on-wing and MRs had accrued during those three months.

As the transaction had already closed, the Seller stood to benefit from a significant windfall amount that, but for the Lessee's mistake, would have been deducted from the purchase price on the closing date.

Crucially, there was nothing in either the SPA or the Novation that governed to whom MRs that were attributable to the period prior to the Effective Time should be paid. As the rent, MRs, and security deposit were built into the calculation of the final purchase price, it was considered satisfactory to include a generic provision in the Novation stating that all amounts payable by the Lessee under the Lease would be paid to the New Lessor irrespective of whether such amounts accrued or were attributable to the period prior to or after the Effective Time.

Not only was the Lessee mistaken in communicating that the engine was off-wing and therefore not accruing MRs, it paid the Seller after the Effective Time even though it had signed a Novation stating that all amounts payable under the Lease should be paid to the New Lessor.

Because the Seller in this case was a conscientious and reputable person, it paid the windfall over to the Purchaser even though it was not under a contractual obligation to do so. But what action could the Purchaser have taken here if, following closing, the Seller looked to retain its fortune?

The Cause of Action

The precise structure, scope and nature of the law of unjust enrichment has been and remains the subject of contested academic thinking and debate and its rise is partially attributable to what in essence was a very academic coup. There is a multitude of references to various legal academics throughout the relevant case law. However, all seem to agree that the decision that gave unjust enrichment unequivocal judicial approval as a distinct legal category in England is *Lipkin Gorman (a Firm) v Karpnale Ltd*[2] where Lord Goff pointed out that:

> *it [the plaintiff's claim] is founded simply on the fact that . . . the third party cannot in conscience retain the money – or, as we say nowadays, for the third party to retain the money would result in his unjust enrichment at the expense of the owner of the money.*

Unjust enrichment now sits firmly in the spectrum of the law of obligations alongside the laws of contract and torts.

There are four main requirements that must be proven by the plaintiff for a claim of unjust enrichment to stand a chance of success. These have been consistently expressed and referred to in case law since *Lipkin Gorman* including, for example, in *Banque Financière de la Citè v Parc (Battersea) Ltd*[3] and more recently, *Bank of Cyprus UK Limited v Menelaou*.[4] These requirements are that:

1. the defendant has been enriched;
2. his enrichment is at the claimant's expense;
3. his enrichment at the claimant's expense is unjust; and
4. there is no applicable bar or defense.

The third component of an enrichment needing to be unjust has proven to be the most difficult to discern. The concrete list of unjust factors differs from textbook to textbook and from decision to decision. Professor Burrows, for example, includes mistake, duress, ignorance, undue influence, exploitation, legal compulsion, necessity, failure of consideration, etc. in the range of viable factors.[5] There is evidence to suggest that mistake of fact is one of the more commonly provable causative factors for demonstrating the injustice of a particular enrichment.[6] Professor Birks has stated that where one person pays money to another while laboring under a causative mistake of fact or law, he or she may be entitled to restitution on the ground of mistake.[7]

Reverting to the example set out in the preceding part of this article, the onus would be on the Purchaser to prove that the Lessee had made a mistake of fact in paying the MRs to the Seller after the Effective Time (which resulted in the unjust enrichment) notwithstanding the fact that this was contrary to what it had signed up to do under the Novation.

The standard of proof is quite a low one. In particular, it does not matter that the Lessee was negligent or careless in making the mistake; the Purchaser would still be entitled to restitution. The Purchaser's case would be supported by the fact that it had suffered a loss because, had the Lessee not miscommunicated the off-wing status of the engine, the purchase price which the Purchaser paid to the Seller at closing would have been reduced by the exact amount by which the Seller was enriched after the Effective Time.

Conclusion

The purpose of this article has been to demonstrate that although transacting parties go to great lengths to protect their pre- and post-closing positions attempting to account for all eventualities in the applicable transaction documentation, mistakes that fall outside the protective ambit of such documentation can still occur. However, in such cases, the law will attempt to step in to reverse the detriment imposed on the aggrieved party, be it through a claim for unjust enrichment, the remedy of restitution or another ground entirely.

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Thought Leadership

GETTING THE DEAL THROUGH

Getting The Deal Through has published *Aviation Finance & Leasing 2016,* which includes Aircraft operating leases New York law or English law? an article co-authored by Shareholders Tom Zimmer and Neil Poland, and a jurisdictional chapter on U.S. law co-authored by Tom Zimmer and Associate Laura Bond.

Past Speaking Engagements

June 14 - 15: **27th Annual Canadian Airline Investment Forum**, **Toronto**. Shareholder Kevin MacLeod spoke on a panel "The Future of Capital Market Deals" that discussed recent developments in aviation capital markets.

June 14 - 15: **Corporate Jet Investor Asia 2016, Singapore**. Shareholder David Hernandez led the presentation titled "Structuring Deals in Asia – the View from the U.S." discussing managing import and export issues, how to work with U.S. government agencies on deals in tougher jurisdictions, and why companies do not want to violate any U.S. sanctions.

June 21 - 23: **29th Annual Marine Money Week, New York.** Shareholder Francis X. Nolan, III moderated the panel, "New Sources of Credit for Shipping," covering an array of topics including asset-backed lending solutions for shipping and the first "FinTech" platform for ship finance.

July 6 - 7: **2016 International School of Corporate Jet Finance, London.** Shareholders Edward Gross, David Hernandez and UK partner Derek Watson presented on multiple topics including valuing a jet, debt finance, and lease versus loan considerations.

The Boeing-Iran Air Deal: Walking the Line

1 The full text of the JCPOA can be accessed on the U.S. State Department's website. See http://www.state.gov/e/eb/tfs/spi/iran/jcpoa/.

2 JCPOA ¶34iii. "Implementation Day" was fixed as the date on which, simultaneously with the issuance of a report verifying implementation by Iran of certain nuclear-related measures, the EU and the United States would take the actions to which each had committed.

3 This trade commitment was one of the very few features of the JCPOA designed to benefit U.S. persons and companies.

4 A license is "an authorization from OFAC to engage in a transaction that would otherwise be prohibited." See OFAC FAQ No. 74 (https://www.treasury.gov/resource-center/faqs/Sanctions/Pages/faq_general.aspx#licenses). As distinguished from a general license, which "authorizes a particular type of transaction for a class of persons," a specific license is a "written document issued by OFAC to a particular person or entity, authorizing a particular transaction in response to a written license application." *Id*.

5 OFAC, *Frequently Asked Questions Relating to the Lifting of Certain U.S. Sanctions Under the Joint Comprehensive Plan of Action (JCPOA) on Implementation Day* ¶J.2 (last updated June 8, 2016) (**JCPOA FAQs**).

6 *Id*.

7 As part of the U.S. commitments under the JCPOA, OFAC removed Iran Air from its List of Specially Designated Nationals and Blocked Persons (the **SDN List**) on Implementation Day. Some observers have found this removal of Iran Air to be puzzling since its original SDN List designation was "not related to Iran's nuclear program" and in view of the Obama Administration's "commitment to retain non-nuclear sanctions." *See* Testimony of Mark Dubowitz, *The Implications of U.S. Aircraft Sales to Iran*, Hearings before House Financial Services Committee, Monetary Policy and Trade Subcommittee, Washington D.C., at 8 (July 7, 2016) (**Dubowitz Testimony**).

8 The Boeing-Iran Air deal followed the January 2016 announcement by Airbus that it had struck a $25 billion deal to sell 118 commercial aircraft to Iran Air. *See* C. Johnston, *Airbus signs $25bn deal to sell 118 planes to Iran, BBC News* (January 28, 2016) (http://www.bbc.com/news/business-35434483).

9 K. Wong, *State Department "welcomes" Boeing deal with Iran Air*, The Hill (June 21, 2016) (http://thehill.com/business-a-lobbying/284329-state-department-welcomes-boeing-deal-with-iran-air#disqus_thread).

10 The full text of the letter can be accessed on Representative Hensarling's website. *See* https://hensarling.house.gov/media-center/press-releases/letter-to-boeing-american-companies-should-not-be-complicit-in.

11 Boeing responded on June 23rd, stating, matter-of-factly, that it has fully complied with U.S. law and that it is working closely with the U.S. government, and is indeed following its lead.

12 K. Wong, *Top Democrat wants Obama to block Boeing's deal with Iran*, The Hill (June 30, 2016)(http://thehill.com/business-a-lobbying/286080-top-democrat-urges-obama-administration-to-stop-iran-air-deal).

13 See H.R. 5711, 114th Cong., 2d Sess. (July 11, 2016); H.R. 5729, 114th Cong., 2d Sess. (July 12, 2016); and, *No Ex-Im Assistance for Terrorism Act*, H.R. 5715, 114th Cong., 2d Sess. (July 11, 2016).

14 H.R. 5485, 114th Cong., 2d Sess. (2016).

15 See https://www.congress.gov/bill/114th-congress/house-bill/5485/amendments.

16 See http://www.state.gov/j/ct/list/c14151.htm.

17 J. Heretik, State Department Can't Defend Selling Airplanes to a State Sponsor of Terrorism, *The Washington Free Beacon* (June 21, 2016)(http://freebeacon.com/national-security/state-department-cant-defend-selling-airplanes-state-sponsor-terrorism/).

18 M. Koren, "What Led American Ships into Iranian Waters?", *The Atlantic* (January 18, 2016) (http://www.theatlantic.com/international/archive/2016/01/iran-navy-gulf/424566/).

19 T. Hume and A. Hajihosseini, *Iran fires ballistic missiles a day after test; U.S. officials hint at violation*, CNN (March 9, 2016)(http://www.cnn.com/2016/03/09/middleeast/iran-missile-test/).

20 U.S. Departments of Treasury and State, *Guidance Relating to the Lifting of Certain U.S. Sanctions Pursuant to the Joint Comprehensive Plan of Action on Implementation Day*, Section VII (January 16, 2016) (**JCPOA Guidance**).

21 JCPOA FAQs ¶ J.3.

22 JCPOA FAQs ¶ J.5.

23 JCPOA Guidance, at 30.

24 See Dubowitz Testimony, at 8–9.

25 Statement by Treasury Secretary Lew on the Anniversary of the Joint Comprehensive Plan of Action, July 14, 2016 (https://www.treasury.gov/press-center/press-releases/Pages/jl0516.aspx).

26 See R, Gladstone, *Delays Threaten to Unravel Iranian Plans to Buy 200 Jetliners*, N.Y. Times (July 22, 2016) (http://www.nytimes.com/2016/07/23/world/middleeast/iran-boeing-airbus-sanctons.html?_r=0).

EASA Part-NCC: What Do Financiers Need to Know?

1 NPA 2009-02g, para. 2.3.3. (emphasis added)

2 CRD OPS II, 30 August 2011, para. 43.

3 Regulation (EC) No. 216/2008, Article 3(j).

4 Part-NCO is a less-stringent standard that is outside the scope of this article.

5 Regulation (EC) No. 216/2008, Article 3(h). (emphasis added)

6 CAA Circular, "Summary of the Meaning of Commercial Air Transport, Public Transport and Aerial Work," September 2014, para. 4.3.

7 http://easa.europa.eu/the-agency/faqs/flight-standards.

8 Regulation (EC) No. 216/2008, Article 3(h). (emphasis added)

9 However, the position may be different in a repossession scenario.

10 For example, if an AOC holder is operating the aircraft, it does not need to provide the declaration, which is discussed further in this article.

11 See the Air Navigation Order 2009.

12 There are also technical changes imposed by the Regulation which are not explored in this Article.

13 Regulation (EC) No. 965/2012, ANNEX IV, ORO.GEN.200.

14 Regulation (EC) No. 965/2012, ANNEX IV, ORO.GEN.200.(b).

15 Regulation (EC) No. 216/2008, ANNEX IV, 8.b.

16 Regulation (EC) No. 216/2008, ANNEX IV, 8.a.3.

17 Regulation (EC) No. 800/2013, Article 1(26)(b).

The Unjustly Enriched Seller of an Aircraft Asset: Mistakes in Sale and Purchase Transactions

1 This will also be the exact time at which the sale of the asset under the SPA will conclude.

2 [1991] 2 AC 548.

3 [1998] 2 WLR 475, 479.

4 [2015] UKSC 66.

5 Andrew Burrows, *The Law of Restitution* (3rd edition, OPU 2011).

6 Alastair Hudson, *Equity & Trusts* (3rd edition, 2003).

7 Peter Birks, *Unjust Enrichment* (2nd edition, 2005).

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