RECENT DEVELOPMENTS IN THE TRANSPORTATION LEASING AND FINANCE INDUSTRY IN THE US

In this article, we highlight recent regulatory developments and enforcement actions, legislation and other developments in the United States impacting the US transportation equipment leasing and finance industry.

We have focused on commercial law, aircraft and vessel finance issues in this article, as there have been fewer significant rail finance developments in this past year.

Of particular importance are the regulatory enforcement trends that are emerging across the sectors. This enforcement trend could have very significant implications for both US and non-US lessors and financiers, as well as operators who participate in the US air and marine financing market.

Wright Brothers Aircraft Title and Aircraft Guaranty Corporation. The ongoing criminal prosecution of the owners and certain individuals associated with Wright Brothers Aircraft Title ("WBAT") and Aircraft Guaranty Corporation ("AGC") has been a wake-up call to much of the US aviation industry and banks and other trust companies.[1]

The allegations by the pertinent government agencies included, among others, drug trafficking, money laundering and failure to comply with US federal laws applicable to the permanent export of aircraft and conspiracy to commit export violations. It is the latter of those allegations that has caused the most consternation among industry participants as some scramble to ensure they understand and remain in compliance with US regulations applicable to the permanent export of aircraft.

Furthermore, the US government has now made it clear that it holds the registered owner of the aircraft responsible for complying with the aircraft export reporting obligations imposed on aircraft owners even if the registered owner is a trust company.

As support for this position and the position that such obligations cannot be delegated to third parties, the prosecution cited the Federal Aviation Administration ("FAA") Non-Citizen Trust Policy Clarification ("NCT Policy")[2] that an owner of an aircraft on the US registry cannot avoid a regulatory obligation imposed on it by the FAA simply by entering into a private contract (such as a trust agreement) with another party.

As a result of this case, the FAA in cooperation with the US Department of Commerce's Bureau of Industry and Security ("BIS") and the US Customs and Border Protection ("CBP") has been investigating thousands of aircraft for export compliance.[3] This tsunami of investigations, criminal prosecutions, civil penalties, aircraft seizures, freezing funds and other enforcement actions have forced the industry to become sensitised to long existing, but often ignored, obligations related to the permanent export of aircraft including the straightforward, but frequently overlooked, responsibility to file an Electronic Export Information ("EEI") with the Automated Export System ("AES[4]").

In many cases, noncompliance may be attributable to a failure by the parties to recognise that an aircraft is deemed to be permanently exported from the United States if it is not permanently returned to the United States within one year of the date of export. In such a situation, the parties to a transaction must determine, based on the facts of the matter, who the responsible party is for making the EEI filing (either the US Principal Party in Interest or the Foreign Principal Party in Interest) and ensure that such export filings are made in a timely and proper manner.

Illegal charter enforcement. The US government has been actively taking enforcement actions against illegal charter operators in the aviation industry. Although the requirements for chartering are not new, the reported violations and related enforcement actions have increased in the past year. In particular, the National Air Transport Association ("NATA") has reported a 40% increase in illegal charter operations in the aviation industry in the United States in 2021 with some of the increase being attributable to those who chose to rely on private and not commercial aviation with the hope of mitigating the risks associated with the Covid-19 pandemic.[5]

The FAA has been collaborating with the National Transportation Safety Board and the CBP to stop these illegal operations. Numerous civil penalties have been issued in 2021 against operators in violation of the US regulations including more than US$1.2m in just one week in August, and reports of up to US$13m in civil penalties since January 2020.

Efforts to educate both the public and the private aviation industry are also being undertaken by industry members including domestic and foreign trade associations who are members of the Air Charter Safety Alliance organised in December 2020.[6]

From a US perspective, it is critical that aircraft owners, lessors, lessees and financiers understand the operational requirements under Parts 91 and 135 of the Federal Aviation Regulations ("FARs")[7] and that proper lease documentation and certifications are in place to support compliant aircraft charter operations. Eliminating these illegal chartering operations is important to ensure the safety and security of the passengers.

From a financier's perspective, not only are passenger safety and collateral values a concern, but the ability to collect on insurance claims and reputation are also at risk when a borrower engages in illegal operations. Although proper due diligence and documentation at the start of a transaction can mitigate some of this risk, ongoing reporting and diligence on customer operations is also important to ensure compliance.

The Jones Act and restrictions on "sales foreign." In the maritime space, the US government now appears to be taking a more aggressive stance in its enforcement of the Jones Act,[8] the century-old US cabotage law that, with a few exceptions, restricts the transportation of merchandise by water, or by land and water, between points in the United States (often referred to as "coastwise trade") to vessels built in the United States and owned and crewed by US citizens.[9] Similar laws apply to other US coastwise trades, including the transportation of passengers.[10]

In one recent case, a US District Court refused to grant a temporary restraining order to prevent CBP from issuing additional fines against two shipping companies for their alleged continuing violations of the Jones Act when fines for previously alleged violations threatened to exceed US$350m.[11] In addition, new legislation continues to clarify the broad application of the Jones Act as new offshore technologies evolve.

The William M. (Mac) Thornberry National Defense Authorization Act for Fiscal Year 2021 ("NDAA 2021"), which became law in January 2021, clarifies that renewable energy installations on the US Outer Continental Shelf are "points in the United States" within the meaning of the Jones Act,[12] and that as a result, certain vessels engaged in the construction, operation and maintenance of offshore wind energy installations on the US Outer Continental Shelf are subject to the Jones Act and must be built in the United States and owned and crewed by US citizens.

With certain exceptions, US maritime law does not allow a person, without the approval of the US Maritime Administration ("MarAd") acting for the Secretary of Transportation, to "sell, lease, charter, deliver, or in any other manner transfer, or agree to sell, lease, charter, deliver, or in any other manner transfer, to a person not a citizen of the United States, an interest in or control of" a US flagged vessel.[13] Each "charter, sale, or transfer of a vessel, or of an interest in or control of a vessel, in violation of [this requirement] is void."[14]

Having found that bareboat charters often transfer too many of the risks and benefits of the ownership of a US flagged vessel to non-citizens, MarAd has generally resisted approving bareboat and demise charters while granting standing approval to all charters of US flagged vessels to persons who are not citizens of the United States, except "bareboat or demise charters of vessels operating in the coastwise trade."[15]

Some bareboat and demise charters can be difficult to distinguish from other charters, including time charters, and questions can arise whether charters of US flagged vessels engaged in coastwise trade, including US flagged cruise vessels operating between US passenger terminals, qualify for MarAd's standing approval.

The same January 2021 legislation that clarified the application of the Jones Act to certain vessels engaged in the construction, operation and maintenance of wind energy installations on the US Outer Continental Shelf also requires MarAd to make publicly available information about and create an opportunity for public comment on each request it receives for a determination that the charter of a US flagged passenger vessel to a person that is not a "citizen of the United States" is subject to MarAd's standing approval.[16]

The new legislation has already created some controversy, as established US passenger vessel operators may now review and comment on requests for determinations that the charters of US flagged passenger vessels to non-citizens fall within MarAd's standing approval and more easily challenge MarAd's determinations that these charters are not bareboat charters otherwise subject to greater scrutiny.

Choice of law. A recent California bankruptcy court memorandum of decision in the *In re Zetta Jet USA, Inc.*[17] case held up a choice of law provision in a set of aircraft leases, allowing the aircraft lessor to avoid a recharacterisation of its leasing transaction. The economic terms of the purported leases were calculated in such a way that the lessor would be repaid for its entire investment in the aircraft.

Under the Uniform Commercial Code (the "UCC"), these lease transactions would likely have been recharacterised as a secured loan financing despite being documented as leases. However, the contracting parties included provisions in their aircraft leases stating that they were to be governed by English law and under English law, the transactions retained their characterisation as lease transactions.

Although the bankruptcy trustee argued that the UCC was the correct choice of law rule, the aircraft lessor disagreed, arguing that federal common law choice of law rules should apply in Ninth Circuit bankruptcy cases and as such the Restatement (Second) of Conflict of Laws should determine the enforceability of the choice of law provisions. Ultimately, the court agreed and

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applying this analysis determined that English law should be applied.

It was surprising that the aircraft lessor did not argue, and the court did not address the applicability of the Convention on International Interests in Mobile Equipment (the "CTC") and the Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment (the "Cape Town Protocol") and together with the CTC, the "Cape Town Treaty".

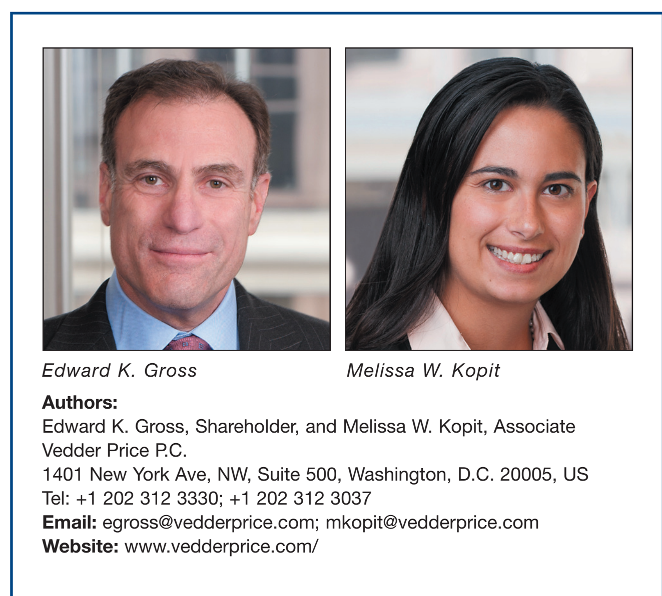
Article VIII of the Cape Town Protocol upholds the contractual choice of law chosen by the parties in agreements covered by the Cape Town Treaty. If the court had instead performed its analysis by applying the Cape Town Treaty, this would have preempted any contrary statutory or common law considerations. Parties can take comfort that under either analysis their choice of law will likely be upheld; it is also important that parties understand the different recharacterisation ramifications between the choice of either English law or New York law to govern their lease agreements.

FAA Registry modernisation. We have previously reported on the events leading up to and the progress with respect to the modernisation of the capability and functions of the FAA Registry (the "Registry") following the US Government Accountability Office ("GAO")'s May 2020 report (the "GAO Report").[18] Although this modernisation effort was initially scheduled to be completed as of October 5, 2021, the initial version of the database is now scheduled to be operational in the fall of 2022.[19]

Notes:

The authors would like to thank their colleague, John Imhof Jr., who contributed the maritime update in this article. Please note that the content of this article has been updated through September 30, 2021. In addition, the article represents the views of the authors only, and it does not represent the views or professional advice of Vedder Price P.C.

1 *United States v. Debra Lynn Mercer-Erwin et al.*, Case No. 4:20-CR-212 (E.D. Tex.).
2 *See* Policy Clarification for the Registration of Aircraft to US Citizen Trustees in Situations Involving Non-US Citizen Trustors and Beneficiaries, 78 Fed. Reg. 36,412 (June 18, 2013).
3 *See* David Hernandez, *Aircraft Exports from the United States following the Aircraft Guaranty Corporation Trust Indictment: Avoiding Civil, Criminal Penalties and Aircraft Seizures* (Apr. 5, 2021) (https://www.vedderprice.com/aircraft-exports-from-united-states-following-aircraft-guaranty-corporation-trust-indictment).
4 Note that prior to July 2, 2008, rather than EEI, reporting was done via a paper Shipper Export Declaration filed with the AES.
5 *See* Kerry Lynch, *Illegal Charter Reports Spike as Market Heats Up* (Sept. 2021) Business Jet Traveler (https://www.bjtonline.com/business-jet-news/illegal-charter-reports-spike-as-market-heats-up).
6 *See* Regulations and Compliance: Avoiding Illegal Charter, The Air Charter Ass'n(https://www.theaircharterassociation.aero/compliance/illegal-charter).
7 14 C.F.R. Part 91; 14 C.F.R. Part 135.
8 *See* Bob Rust, *No Mercy for Jones Act Scofflaws, Says US Customs,* TRADEWINDS, Sept. 15, 2021 (subscription required) (https://www.tradewindsnews.com/law/no-mercy-for-jones-act-scofflaws-says-us-customs/2-1-1067664).
9 *See* United States Merchant Marine Act of 1920, as amended, 46 U.S.C. § 55102(b).
10 *See* Passenger Vessel Services Act of 1886, as amended, 46 U.S.C. § 55103.
11 *Kloosterboer Int'l Forwarding v. United States*, Case No. 3:21-cv-00198-SLG (D. Alaska), Order re Motion for Temporary Restraining Order and Preliminary Injunction (Sept. 28, 2021); see also Cliff White, *Judge denies Kloosterboer International Forwarding, Alaska Reefer Management Request for Relief from CBP Fines*, SEAFOODSOURCE, Sept. 29, 2021 (https://www.seafoodsource.com/news/business-finance/judge-denies-kloosterboer-international-forwarding-alaska-reefer-management-request-for-relief-from-cbp-fines).
12 *See* NDAA 2021, Pub. L. 116-283, § 9503 (2021), which amends Section 4(a)(1) of the Outer Continental Shelf Lands Act of 1953, as amended, 46 U.S.C. § 1333(a)(1), to provide that the "laws and civil and political jurisdiction of the United States are extended, to the same extent as if the outer Continental Shelf were an area of exclusive Federal jurisdiction located within a State, to installations and other devices permanently or temporarily attached to the seabed, which may be erected thereon for the purpose of exploring for, developing, or producing resources, *including non-mineral energy resources*…." (emphasis added); *see also* John E. Bradley and John H. Geager, *Silent but Deadly: Congress Passes Wind on the OCS*, Vedder Price Global Transportation Finance Newsletter, Apr. 2021 (https://www.vedderprice.com/-/media/files/vedder-thinking/publications/2021/04/gtfnewsletterapril2021-v12.pdf).
13 46 U.S.C. § 56101(a)(1)(A).
14 Id. § 56101(d).
15 46 C.F.R. § 221.13(a)(1)(iii).
16 *See* NDAA 2021 § 3502(b), which provides that "[f]or fiscal year 2020 and each subsequent fiscal year, [MarAd] shall make publicly available on an appropriate [MarAd] website (1) a detailed summary of each request for a determination, approval, or confirmation that a vessel charter for a passenger vessel is encompassed by the general approval of time charters issued pursuant to [46 U.S.C. § 56101] or regulations [including 46 C.F.R. § 221.13(a)(1)] prescribed pursuant to such section; and (2) [MarAd's] final action … with respect to such request, after the provision of notice and opportunity for public comment."
17 *In re Zetta Jet USA, Inc*., No. 17-BK-21386 (Bankr. C.D. Cal. Oct. 15, 2020).
18 *See* Edward K. Gross, Erich Dylus & Jillian Greenwald, *Recent Developments in the Transportation Leasing and Finance Industry in the US*, World Leasing Yearbook (2020).
19 The FAA Civil Aviation Registry – CARES Initiative, at https://www.faa.gov/about/initiatives/cares (last updated Sept. 17, 2021).



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