Global Transportation Finance Newsletter

August 2021

In This Issue

The ABC to AFIC and Balthazar: Overview of Aircraft Non-Payment Insurance Products

A number of years have now passed since the terms “AFIC” and “Balthazar” first appeared in the aviation finance market. Since their inception, the Aircraft Non-Payment Insurance (“**ANPI**”) product has been used by many airlines, leasing companies and other market participants as an alternative source of finance for new aircraft beyond the traditional sources of aviation finance, including financings supported by the European Export Credit Agencies and the Export-Import Bank of the United States. However, despite becoming more prevalent and even with the recent notable closings of aircraft financings supported by the ANPI product, many aviation market participants still seem unsure what these ANPI products are or how they work.

The ANPI product is a similar concept to export credit support that provides an insurance policy (rather than a guarantee) to lenders, who rely on the credit of the insurers underlying the ANPI product. At its core, the ANPI product protects investors from payment defaults by obligors (namely, customers predominantly made up of airlines and leasing companies, who for the purposes of this note, shall be referred to as the “**Customer**”). The insurers underlying the ANPI product assume the Customer’s credit risk as well as the residual value, jurisdictional and structural risks of the financing transaction. This note aims to provide a basic ABC overview to AFIC, Balthazar and the ANPI product.

Part A – AFIC

Background

The Aircraft Finance Insurance Consortium, more commonly known as AFIC (“**AFIC**”) was established in early 2017 as an alternative source of funding for new aircraft purchases in the absence of readily available financings of Boeing aircraft supported by the Export-Import Bank of the United States (“**Ex-Im Bank**”) at that time.

AFIC offers an insurance-based aircraft finance product accessed through and managed by Marsh LLC (who acts as exclusive broker). While not expressly designated as a product for Boeing aircraft, this has been the norm (other than a handful of more recent transactions involving new Embraer aircraft). The three direct AFIC insurer counterparties that typically participate on a several basis are: (1) Allianz (rated AA by Standard & Poors (“**S&P**”)); (2) AXIS (rated A+ by S&P); and (3) Sompo International (rated A+ by S&P). Typically, one insurer takes 50% exposure and the other two each take 25%. The insurer who takes 50% will lay 25% of the risk to Fidelis. The insurer counterparties may sometimes vary in order to satisfy insurance licencing requirements of the particular jurisdictions in the transaction.

Lenders take a mixture of single-A or double-A risk of a group of insurance companies (each with a separate exposure). This is one of the key differences between AFIC and ECA deals, whereby the lenders effectively take sovereign risk. While the ratings are slightly lower than ECA deals, such insurer ratings are substantially higher than any airline credit (given all airlines globally are in junk bond territory).

Team News

2021 Aviation 100 Awards DEALS OF THE YEAR

Vedder Price Is Recognized in Multiple Top Deal Awards at *Airline Economics* “Aviation 100 Deals of the Year Awards 2021”

Vedder Price played a key role advising clients in four “Aviation 100 Deals of the Year Awards 2021.” The *Airline Economics* Aviation 100 Deals of the Year Awards 2021 recognizes the most significant deals closed in 2020 from all around the world.

Vedder Price was recognized in the following categories:

Aviation 100 Asia-Pacific Editor’s Deal of the Year

Vedder Price represented Hudson Structured Capital Management Ltd. and its affiliates, as equity investors, in $306M Total Engine Asset Management’s Sunbird aircraft engine asset-backed securitization. The Vedder Price team consisted of Adam R. Beringer, Michael E. Draz, Daniel M. Cunix and Conor A. Gaughan.

VedderPrice

AFIC deals are therefore similar to investment grade loans, although with three credits to analyze. Since each insurer counterparty is liable for their own portion, the lenders will have to assess the risk of default by one or more of the insurers. However, the lenders are focused on the credit assessment of the insurer counterparties, and therefore do not need to be specialized aircraft lenders (the understanding being that a much broader group of lenders would (theoretically) be able to get involved in AFIC deals as compared to traditional aircraft financings).

The Application and Claims Process

The AFIC ANPI product is primarily marketed to airlines and leasing companies. The typical process for applying for an ANPI product through AFIC works as follows:

1. Customer approaches Boeing / Embraer / Marsh and submits initial request for ANPI product
2. Boeing (or other relevant party) instructs AFIC to carry out due diligence on Customer and their request
3. Assuming satisfactory due diligence, AFIC will produce an ANPI term sheet which can be shared as part of an RFP by Customer to lenders/ investors, who respond to Customer with funding proposals

As for the claims process, the following simple steps should be followed:

1. Customer fails to make a scheduled payment (of principal and/or interest)
2. Lender submits notice to AFIC of the missed payment in order for their claim to be processed under the ANPI policy
3. Insurers will pay 100% of the missed payment (with accrued interest) within a specified time frame

If it is assumed that payment defaults will continue after the initial payment default, then the insurer counterparties will agree to pay further scheduled payments (to avoid any mismatching of funding arrangements or broken interest periods). Payments will continue until (a) an agreed set period from the first missed payment or (b) the date of the sale of the aircraft, following which the insurer counterparties will pay the balance of outstanding principal and interest. Once the insurer counterparties make the payments to the lenders, the insurer counterparties will be subrogated to the rights of the lenders in respect of those payments, and the insurer counterparties become entitled to claim from the Customer such payments and to recover such payments in the waterfall on the distribution of any security or sale proceeds.

Documentation and Parties

The documentation process for the AFIC ANPI product involves all parties (i.e. the insurer counterparties, the lenders and the Customer). AFIC's counsel will typically draft the documentation and coordinate closing.

Documentation is similar to those used for Ex-Im Bank deals with the deal typically being structured as a finance lease transaction including the usual security package, with a security trustee being appointed to hold such security for the insurer counterparties and lenders. The insurer counterparties will nominate an insurer representative to be a party to the transaction documents on their behalf, who will have various consent rights. There will also be an insurer intercreditor agreement, which regulates the rights, obligations and voting among the insurer counterparties.

Marsh (together with the insurer representative) will intermediate the negotiation and agreement of the ANPI policy with the lenders. Consideration must be given to insurance law requirements and this is usually dealt with under the insurance contract.

Aviation 100 Americas Lease Deal of the Year

Vedder Price represented Southwest Airlines in the sale and leaseback of 10 Boeing 737-8 aircraft with BOC Aviation. The Vedder Price team consisted of Cameron A. Gee and Matthew P. Larvick (Tax).

Aviation 100 Middle East & Africa Debt Deal of the Year

Vedder Price represented Standard Chartered Bank on a structured loan financing for seven Boeing 787-9 aircraft on lease to Qatar Airways. The Vedder Price team consisted of Neil Poland and Kaiden Basi.

Aviation 100 Americas Capital Markets Deal of the Year

Vedder Price represented Air Canada in all aspects (aircraft finance, securities and capital markets, tax and related matters) of the issuance of a new Series 2020-1C Pass Through Trust Certificate for Air Canada's 2015-1, 2015-2 and 2017-1 Enhanced Equipment Trust Certificate transactions. The Vedder Price team consisted of Clay C. Thomas, John T. Blatchford, Gabriela D. Demos and Matthew P. Larvick (Tax).

AIRFINANCE JOURNAL

Vedder Price Global Transportation Finance Team Recognized in Multiple 2020 *Airfinance Journal* "Deals of the Year"

Vedder Price's Global Transportation Finance team played a key role in three transactions that were awarded "Deal of the Year" by *Airfinance Journal* in 2020. Each year, *Airfinance Journal* recognizes aviation transactions that stand out in terms of innovation, size, timing, pricing and whether the deal creates a new market standard.

Vedder Price was recognized in the following categories:

Part B – Balthazar

Background

Balthazar is the Airbus equivalent of AFIC and was also developed with Marsh, but through Marsh S.A.S. (a different team from Marsh LLC) as exclusive broker (Marsh S.A.S is based in Europe, whereas Marsh LLC is based in the United States). The Balthazar ANPI product was established as an alternative source of financing for new Airbus aircraft in response to the lack of available financings of Airbus aircraft supported by the export credit agencies and the emergence of the AFIC ANPI product. Saying this, perhaps due to Marsh being involved with both ANPI products, the arrangement is fairly similar. While information is not as readily publicly available as compared to AFIC, participating lenders in the product include BNPP, CACIB and Natixis, among others.

Lenders take risk of a group of insurance companies who have a credit rating of at least A- (S&P) (each with a separate exposure as the Balthazar insurer counterparties participate on a several basis). This is one of the key differences between Balthazar and ECA deals, whereby the lenders effectively take sovereign risk. Similar to AFIC, Balthazar deals are similar to investment grade loans, although with three credits to analyze. Each insurer counterparty is liable for their own portion, and the lenders will have to assess the risk of default by one or more of the insurers.

The Application and Claims Process

The Balthazar ANPI product takes a flexible approach in terms of the application process, whereby lenders, airlines and leasing companies may apply as Customers. An airline or a leasing company interested in accessing "Balthazar" can directly approach Airbus who will in turn approach Marsh S.A.S. to test market appetite. Having established a market appetite, an approach will be made to potential bank arrangers.

As for the claims process, upon the occurrence of non-payment of scheduled payment (of principal and/or interest), the lenders are required to give written notice of such occurrence to the insurer counterparties, and the lenders are obliged to provide the insurer counterparties with a proof of loss in support of its claim. The insurer counterparties will then process the claim in a timely and efficient manner and make payment to the lenders. Upon payment of a claim amount, the insurer counterparties may request that the lenders subrogate the insurer counterparties to their rights with respect to the claim amount.

Documentation

The Balthazar ANPI product allows parties to use their own transaction documentation granting some flexibility given the lack of the requirement for a harmonised approach. The documentation process is done by way of two streams (running on track): the first track is just the financing parties (and related financing documents), and the second track is the lenders and the insurer counterparties (and the related insurance policy). Typically, lenders' counsel will draft the documentation (save for the insurance policy) and coordinates with the relevant parties on both tracks of the deal. They will ensure the insurer counterparties' requirements are properly negotiated on the financing side of the documentation. Further, the insurer counterparties will typically not be parties to the financing documents. Instead, they will rely on the subrogation and assignment rights under the insurance policy.

Part C – Reasons for Use

While these ANPI products were developed to help cover the lack of recent ECA financing options, ANPI products also have a number of other positives for both Customers and lenders, including but not limited to:

- helping Customers attract funding at competitive rates due to reduced risk;
- fairly simple transaction structuring (while it functions in a similar way to an export credit supported guarantee, there are no non-commercial constraints on pricing or deal structure (not subject to ECA's dictating terms, for example) which can accommodate a variety of transaction structures (finance lease, operating lease, JOLCO etc.);
- ANPI comes at no additional cost to lenders; and
- helps secure regulatory capital relief for lenders.

Equity Deal of the Year

Vedder Price from its London and New York offices represented lenders and lessors in relation to the Norwegian Air Shuttle group insolvency and corporate re-organisation.

Middle East Deal of the Year

Neil Poland and Kaiden Basi represented Standard Chartered Bank on a structured loan financing for seven Boeing 787-9 aircraft on lease to Qatar Airways in April 2020.

Operating Lease Deal of the Year

Ji Woon Kim, Min Chia and Greg Whillis represented MUFG Bank, Singapore, in the secured financing of the conversion of a passenger to freighter A321 aircraft subject to an operating lease to an Australian airline in December 2020.

Honors & Awards

Vedder Price Recognized in *Chambers USA* 2021

Chambers USA ranked the Global Transportation Finance team in **Band 1** in the category of **Transportation: Aviation: Finance – Nationwide** and **Band 3** in the category of **Transportation: Shipping/Maritime: Finance - Nationwide**

Chambers USA recognized Jeffrey T. Veber as **Band 1**, Geoffrey R. Kass as **Band 2**, Adam R. Beringer as **Band 3** and Ronald Scheinberg as a **Senior Statesman** in the category of **Transportation: Aviation Finance – Nationwide**. Chambers also recognized John E. Bradley as **Band 3** in the category of **Transportation: Shipping/Maritime: Finance – Nationwide.**

While there are clearly many positives, it should be noted that pricing for lenders may be slightly higher than ECA financings given (i) ANPI cover is on a several basis, meaning extended due diligence (in respect of each insurer counterparty) and a somewhat greater risk of default and (ii) ECA institutions are triple A rated sovereign risks. However, lenders do not need to be specialised aircraft financiers since the underlying credit assessment will be the insurer counterparties — this will enable a larger group of investors to participate in ANPI product- supported aviation finance transactions.

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Vedder Price Recognized in *The Legal 500 United States* 2021

Legal 500 recognized the Global Transportation Finance team as a **Top-Tier Firm** in the categories of **Transport: Aviation and Air Travel – Finance and Transport: Rail and Road – Finance**, as well as **Editorially Recommended** in the category of **Transport: Shipping – Finance.**

Geoffrey R. Kass was named to *The Legal 500 United States* **Hall of Fame** and John T. Bycraft, Michael E. Draz and Jeffrey T. Veber were all recognized as **Leading Lawyers**. Raviv Surpin and Clay C. Thomas were recognized as **Next Generation Partners** and Justine L. Chilvers, Jillian S. Greenwald and Joel R. Thielen were recognized as **Rising Star Lawyers**.

Adam R. Beringer, John E. Bradley, Mark J. Ditto, Michael E. Draz, Michael J. Edelman, Cameron A. Gee, John F. Imhof Jr., Geoffrey R. Kass, James Kilner and Jeffrey T. Veber were all recognized as **Editorially Recommended**.

TOP RANKED
Chambers
High Net Worth
2021

Vedder Price Global Transportation Finance Business Aviation Practice and Attorneys Recognized in *Chambers HNW* Rankings 2021

Chambers High Net Worth ranked the Business Aviation Practice **Band 1** for the 6th consecutive year in the category of **Private Aircraft (Global-wide)**.

Edward K. Gross and Derek Watson were recognized as **Band 1** and David M. Hernandez was recognized as **Band 2**.

Put Option Agreements In Aviation Financing

Introduction

In a typical aircraft financing involving a People's Republic of China (the "**PRC**") parent company (the "**PRC Parent**"), (i) the PRC Parent (which is considered to be "onshore" for purposes of this article) (A) forms a special purpose company ("**SPC**") outside of the PRC (which is considered to be "offshore" for purposes of this article) and (B) owns, directly or indirectly, the shares in the SPC; (ii) the finance parties (which are considered to be "offshore" for purposes of this article) make loan(s) to the SPC; (iii) the SPC is (A) the borrower under the financing and (B) the lessor under the leasing arrangement; (iv) the SPC grants security over the aircraft and the leasing arrangement in favour of the finance parties; (v) the SPC leases the aircraft to the airline(s); and (vi) the PRC Parent provides a put option agreement or a guarantee in favour of the finance parties.

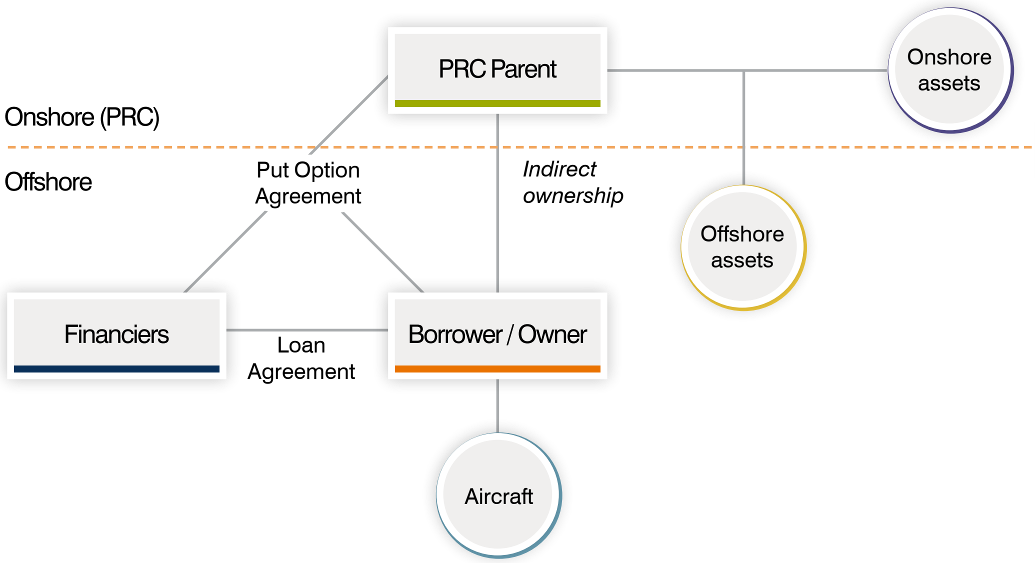
In the context of aviation finance, the put option agreement is a keepwell arrangement which allows the security trustee (the "**Security Trustee**") on behalf of the finance parties to require the SPC, as borrower (the "**Borrower**"), to sell and the onshore PRC Parent to purchase a financed aircraft (the "**Aircraft**") following a loan event of default. The sale proceeds are then applied towards the outstanding loan.

This article will briefly summarise, from an aviation finance perspective, the origins and structure of the keepwell put option agreement and common provisions found therein, as well as a recent development in case law.

Origins and Common Structures Involving Keepwell Put Option Agreements

In a traditional secured asset financing involving a ring-fenced special purpose vehicle borrower, lenders commonly require parent companies to provide guarantees in respect of the obligations of the borrower under the financing. Due to historical *neibaowaidai* restrictions on repatriation of funds under the Administration of Foreign Exchange of the People's Republic of China ("**SAFE**") regulatory framework in the PRC, PRC lessors faced difficulties providing such parent guarantees.

The lack of credit support by the PRC Parent under the parent guarantees presented difficult challenges for lenders involved in these aircraft financings. Enter keepwell put option agreements. Using the put option structure with the pretext of purchasing the Aircraft, the PRC Parent has an ostensibly legitimate reason to transfer funds to an offshore borrower, and such funds can in turn be used to satisfy outstanding loans owed under the financing. Under a purchase option structure, the PRC Parent provides the liquidity support and undertakings to support the offshore aircraft financing by entering into the put option agreement. A typical structure is illustrated below for reference.



While the *neibaowaidai* repatriation restrictions have since been relaxed, put option agreements continue to be popular and widely accepted in the aviation market due to SAFE approval or registration requirements for parent guarantees.

Recent Speaking Engagements

April 28-29, 2021

Ishka+ Investing in Aviation Finance Europe

Vedder Price Shareholders Kevin A. MacLeod and Dylan Potter presented at the Ishka+ Investing in Aviation Finance: Europe event on April 28 and 29, 2021.

Mr. MacLeod participated in the Live Q&A discussion "When will the aircraft ABS deal flow pick up?" on April 28, 2021.

Mr. Potter participated in the Q&A discussion "Buying at the bottom of the market: M&A and aircraft trading opportunities" on April 29, 2021.

June 10, 2021

NBAA GO Aviation Tax & Regulatory Compliance Seminar

Vedder Price Shareholder David M. Hernandez presented at the National Business Aviation Association (NBAA) GO Aviation & Tax Regulatory Compliance Seminar on June 10, 2021. Mr. Hernandez presented the session titled "Aircraft Dry Leasing Best Practices."

June 21, 2021

33rd Annual Marine Money Week 2021

Shareholder John F. Imhof Jr. presented at the 33rd Annual Marine Money Week 2021, "A Golden Age for Shipping" on June 21, 2021. Mr. Imhof moderated the panel "The Expanding Role of 'Financial' Shipowners."

Deal Corner

Vedder Price Advised Initial Purchasers on $540 Million Secured Notes Offering by MAPS 2021-1 Trust

Vedder Price represented Deutsche Bank Securities, Goldman Sachs & Co. LLC, Citigroup and Natixis, as the initial purchasers of $540.12 million of secured notes issued by MAPS 2021-1 Trust, which is the third aviation ABS transaction in the MAPS ABS program. The Vedder Price team was led by Jeffrey T. Veber, Vice Chair of the firm's Executive Committee, member of the firm's Board of Directors and Global Transportation Finance Shareholder, Kevin A. MacLeod, Shareholder and Head of the New York Capital Markets Group and Matthew P. Larvick, Tax Shareholder, with support from Global Transportation Finance Associates Daniel M. Cunix, Majk Kamami and John G. Munyon.

A word of caution - it is important to bear in mind that in an enforcement scenario, a put option agreement will require a financier to prove breach of an undertaking by the PRC Parent while a PRC Parent guarantee would be a debt claim. The latter is typically understood to be much easier to establish in court.

Common Elements of a Keepwell Put Option Agreement

Keepwell agreements typically contain the following elements, the principal one being the put option documenting mechanics for the sale of the Aircraft, and the finance parties' corresponding recovery of outstanding debt:

Sale of Aircraft (the put option): Following a loan event of default, the Security Trustee can notify the PRC Parent that it is exercising its put option in respect of the Aircraft. The PRC Parent will then typically be given a certain grace period of thirty (30) to sixty (60) days to purchase (or procure purchase of) the Aircraft (the "**Sale Period**"). Similar to conventional sales, the PRC Parent is required, in fairly short order, to pay a purchase price deposit (the "**Deposit**") to secure its purchase obligation. The Deposit will typically be an estimate of the outstanding amount due under the loan (the "**Secured Obligations**") calculated on such date. Upon the expiry of the Sale Period, the Aircraft will be sold for an amount equal to the Secured Obligations owed by the Borrower under the financing as of such date. Upon consummation of the sale and purchase pursuant to the put option agreement, the sale proceeds are deposited to the Borrower's account charged in favour of the Security Trustee, and the Deposit returned to the PRC Parent. If the Aircraft is not sold within the Sale Period, the Security Trustee may apply the Deposit in satisfaction of the Secured Obligations and if the Deposit is insufficient, file a claim against the PRC Parent for the remainder as damages for breach of contract.

Covenants and representations: Covenants and representations required from the PRC Parent typically fall into the following categories:

(i) *Ownership*:

The PRC Parent is typically required to maintain 100% direct or indirect ownership of the Borrower. There may also be restrictions on the ownership of the PRC Parent itself.

(ii) *Financial*:

Similar to guarantees, the PRC Parent typically has to satisfy certain financial requirements in relation to its net worth as well as liquidity, and in connection with this, regularly provide updated audited financial statements. As an added precaution, the PRC Parent may also be required to covenant that it will ascertain the Borrower has sufficient funds to satisfy its Secured Obligations (while also being clear that this covenant is not a guarantee).

(iii) *Regulatory*:

Specific PRC approvals and authorisations pertaining to SAFE classification and compliance with foreign exchange requirements are usually detailed in the Put Option Agreement. Aside from the standard sanctions and anti-money laundering requirements, recent U.S. trade regulations designed to control the export of certain U.S. products and technologies to certain end users (including some in the PRC) have also led to inclusion of export control covenants.

The above are in addition to the usual suite of legal representations and undertakings pertaining to authorization, due execution, valid and binding obligations, etc. which are typically also covered in legal opinions.

Jurisdiction and governing law: While put option agreements may be governed by PRC law, parties tend to prefer to use English (or Hong Kong) law as the assessment of damages under common law tends to be clearer. Additionally, this reduces the risk of re-characterisation by PRC courts. Further, put option agreements commonly include and are subject to Hong Kong arbitration provisions. Enforcing Hong Kong arbitration awards or judgements in the PRC tend to be (relatively) easier than those of other jurisdictions due to the bilateral Arrangement Concerning Mutual Enforcement of Arbitral Awards between the PRC and Hong Kong (as supplemented in November 2020) and the Arrangement on Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Matters by the Courts of the Mainland and of the Hong Kong Special Administrative Region. Accordingly, Hong Kong arbitration or courts tend to be the dispute resolution mechanism of choice.

Vedder Price Counseled SKY Leasing on $663 Million Secured Notes Offering

Vedder Price represented SKY Leasing a full-service aircraft leasing company, in connection with the issuance of $663 million of secured notes by SLAM 2021-1 Limited and SLAM 2021-1 LLC. The Vedder Price team included Shareholders Raviv Surpin, Clay C. Thomas, Kevin A. MacLeod and Associates Simone M. Riley, Daniel Spivey and Lisa Clark.

Vedder Price Advised DLL in $1 Billion Securitization Transaction

Vedder Price represented DLL in its closing of DLLAA 2021-1, a U.S. securitization transaction issuing notes totaling $1 billion. The notes are backed by loans and leases secured with agricultural equipment originated by AGCO Finance, a joint venture between DLL (51% ownership) and AGCO (49% ownership). Global Transportation Finance Shareholder Edward K. Gross and Head of the New York Capital Markets group Kevin A. MacLeod led the team from Vedder Price, which also included Associate Jonathan M. Rauch.

Vedder Price Advised Air T, Inc. in New $408M Aircraft Asset Management Business

Vedder Price represented Air T, Inc. an American holding company that operates a group of independent, yet interrelated, aviation businesses, in the formation of a new aircraft asset management business, Contrail Asset Management and a new aircraft joint venture, Contrail JV II LLC, capitalized with up to $408 million in equity capital. Global Transportation Finance Shareholders Mark J. Ditto, Adam R. Beringer and Investment Services Group Shareholder Cody J. Vitello led the Vedder Price team, which also included Associates Jillian S. Greenwald and Adam S. Goldman.

Recent Cases

There have been two recent PRC cases in relation to keepwell agreements. For completeness, while these do not contain a keepwell put option, these are understood to apply to keepwell agreements in general as these cases essentially involved a PRC Parent undertaking to provide financial support to the indebted subsidiary and should be informative for keepwell put option agreements commonly used for aviation financings.

Peking University Founder Group Company ("**PUFG**"):

On 19 August 2020, the bankruptcy administrator of PUFG rejected claims submitted by BNY Mellon as trustee under the keepwell deeds provided by PUFG in support of bonds issued by its subsidiaries. Prior to the rejection, administrators indicated they might require "a valid judgment or arbitral award" confirming PUFG's liability under the keepwell deeds in order to make their determination. While BNY Mellon was provided the opportunity to appeal the relevant PRC court (and hopefully obtain such 'valid judgment'), due to difficulties from a timing and cost perspective, BNY Mellon did not take this route. It will be of interest to see whether future administrators choose to take a similar approach of essentially kicking the can down the road.

CEFC Shanghai International Group Ltd. ("**CEFC**"):

In 2017, CEFC granted a keepwell deed in support of notes issued by its BVI subsidiary. The keepwell deed was governed by English law with submission to Hong Kong courts. Following a default by the BVI subsidiary on the notes, the noteholders filed an action in the Hong Kong courts for breach by CEFC of the keepwell deed, and in the absence of defence by CEFC, were awarded a default judgment in their favour. In May 2019, the noteholders applied to the Shanghai Financial Court for recognition and enforcement of the Hong Kong judgment, and in November 2019 following the bankruptcy of CEFC, with the administrators in respect of the keepwell deed. In November 2020, the Shanghai Financial Court issued a decision granting recognition and enforcement of the Hong Kong judgment in the PRC. This decision was made on a purely procedural basis, i.e., the validity, nature and effect of the keepwell deed as a matter of PRC law was not within scope. This could provide a useful avenue of enforcement for creditors going forward and highlights the importance of the selection of dispute resolution forum and governing law.

Conclusion

In the absence of any better alternative given continuing regulatory restrictions on PRC Parents granting guarantees, we expect the use of put option agreements (in lieu of a guarantee) to continue to be the accepted market practice and standard involving PRC leasing companies. Given recent case law, governing law and jurisdiction clauses may, however, be subject to added scrutiny and creditors may want to be quicker to act in a pre-insolvency enforcement scenario.

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Biden Administration Economic Sanctions Developments Delineate Allies and Enemies

Although the Biden Administration has declined to preview the results of its ongoing comprehensive reviews of U.S. sanctions programs, the characteristics of sanctions programs under the Biden Administration are already taking shape. Administration officials consistently underscore the goals of supporting human rights and democratic institutions, as well as providing sanctions relief to alleviate adverse impacts on local populations where that can be done without supporting anti-democratic government actors. And at the same time, the Administration is adding to the list of sanctioned parties associated with key adversaries and deploying a whole-of-government approach to supplement sanctions in support of U.S. foreign policy goals. Across sanctions programs, the United States is closely coordinating with its allies.

Will the door to some closed markets crack open?

The Administration is looking for ways to provide sanctions relief, particularly in the context of broad embargos, to alleviate the impact of sanctions on local populations. In light of recent protests and crackdowns on protestors, there have been persistent calls on the Administration to ease the Trump-era Cuba sanctions that are the broadest of the active sanctions programs. President Biden stated on July 16, "Cuba is a — unfortunately, a failed state and repressing their citizens. There are a number of things that we would consider doing to help the people of Cuba, but it would require a different circumstance or a guarantee that they would not be taken advantage of by the government — for example, the ability to send remittances to — back to Cuba. I would not do that now because the fact is it's highly likely that the regime would confiscate those remittances or big chunks of it."[1] While the Administration contemplates adjustments to the sanctions program to aid the people of Cuba, it also continues to designate parties that are known to participate in human rights abuse or anti-democratic efforts on the island. On July 22, 2021, OFAC added the Cuban Minister of Defense and the Special Forces Brigade to the SDN List for their role in alleged abuses against protestors, and it reiterated that under current regulations, all Cuban nationals are blocked parties, and that all U.S. persons are prohibited from providing funds, goods, or services to or for the benefit of such persons, or receiving of funds, goods, or services from any such person.[2] OFAC further expanded those sanctions on July 30, when it added to the SDN List the Revolutionary National Police ("Policia Nacional Revolucionaria"), an arm of the Cuban Ministry of the Interior, as well as its Director and Deputy Director, after reviewing photographs and video recordings of the PNR arresting and using violence against peaceful demonstrators.[3] Easing sanctions on Cuban nationals would bring U.S. policy into closer alignment with its allies.

Although the Cuba sanctions program has recently received the most public discussion, the same principles also may apply to the sanctions program Venezuela, suggesting that the narrowing of sanctions programs is a possibility, but it can only be done with appropriate safeguards to ensure that resources flowing into the country would not be pilfered by government officials engaged in human rights or anti-democratic abuses. U.S. officials also continue to leave the door open for Iran to come back to the negotiating table and, along with the United States, come back into compliance with JCPOA undertakings. U.S. and European allies consistently press for this, which could lead to partial market re-openings in Iran.[4]

Will future sanctions on adversaries be limited to designations, or take the form of broader sectoral sanctions?

The Biden Administration is continuing to increase pressure on adversaries not only with sharp rhetoric and by designating individuals and companies on sanctions lists, but also by implementing broader sector-focused sanctions programs to thwart identified threats to national security such as the Chinese military industrial complex and Russian hackers, as well as issuing business advisories highlighting legal risks beyond sanctions. A whole-of-government approach is being deployed to supplement sanctions and achieve foreign policy goals. Across sanctions programs, the Commerce Department's Bureau of Industry and Security (BIS) has designated a series of actors on the Entity List, which means that an export license is required before U.S.-origin items can be exported, reexported, or transferred to them. [5] The Commerce Department noted that the Entity List is an additional tool to monitor and control exports to bad actors and parties that are perceived to be a risk of diverting sensitive items to bad actors, stating, "We will continue to aggressively use export controls to hold governments, companies, and individuals accountable for attempting to access U.S.-origin items for subversive activities in countries like China, Iran, and Russia that threaten U.S. national security interests and are inconsistent with our values."[6]

Where it identifies ongoing human rights abuses and threats to democracy, such as in Xinjiang and Hong Kong, the Biden Administration is coordinating inter-agency initiatives to spotlight abuses, legal risks, and business risks. In July, the Biden Administration released two business advisories back-to-back on China. First, on July 13, the State Department, in coordination with Treasury, Commerce, Homeland Security, the Office of the U.S. Trade Representative, and the Department of Labor, issued an updated Xinjiang Supply Chain Business Advisory highlighting the legal, business, and reputational risks associated with business activities connected to the Xinjiang region of China.[7] State Department officials explained, "The advisory notes that – the Department of State's determination that the PRC government is perpetrating genocide and crimes against humanity in Xinjiang. It cautions that given the severity and extent of these and other abuses, businesses and individuals that do not exit supply chains, ventures, and investments connected to Xinjiang could run a high risk of violating U.S. law."[8] The European Union issued a coordinated advisory regarding Xinjiang. Due to concerns regarding human rights abuses, including forced labor, against minority Muslim groups there, Commerce has also added government and commercial companies to the Entity List.

Then, on July 16, the Administration reacted to legal developments impacting Hong Kong. President Biden stated, "The situation in Hong Kong is deteriorating. And the Chinese government is not keeping its commitment that it made how it would deal with — with Hong Kong." [9] That same day, the Departments of State, Treasury, Commerce, and Homeland Security issued a joint advisory entitled "Risks and Considerations for Businesses Operating in Hong Kong," and added seven individuals to the SDN list for their alleged role in undermining Hong Kong's independence and China's commitments under the Hong Kong Autonomy Act.[10] The Administration stated, "On the accountability front, the State Department announced earlier today seven officials who were sanctioned for their actions — threatening the peace, stability, security, and autonomy of Hong Kong. [. . .] On the transparency front, today, the U.S. government issued a business advisory [. . .] for Hong Kong, which is intended to inform businesses and highlight the growing risk for those operating in Hong Kong. The bottom line is that businesses should be aware that the risks faced in mainland China are now increasingly present in Hong Kong."[11] The Biden Administration also continues to enforce sanctions regarding non-SDN Chinese Military Industrial Complex companies.

Four Key Takeaways

Although we cannot say exactly what shape revisions to sanctions programs will take, we expect to see potential opportunities alongside novel compliance challenges.

1. The easing of embargoes may open up business opportunities in countries that have been largely shut off from parties subject to U.S. sanctions regulations, which may create opportunities. However, even if broad sanctions are lifted, targeted sanctions will remain in place, leaving behind a patchwork of sanctioned parties and restrictions to navigate.

2. As the list of bad actors subject to restrictions continues to grow and enforcement activity remains vigilant, screening and monitoring procedures for lessees and sub-lessees remain key best practices for sanctions compliance. Periodic screening during the pendency of a lease, as well as periodic checking on locations of aircraft for deviations from recorded locations and paths, will help detect potential sanctions red flags as quickly as possible.

3. To prioritize compliance resources, lessors will benefit from introducing tiered risk levels based on the country where the lessee or sub-lessee is located, and conducting more frequent screening and monitoring on the highest risk jurisdictions. Enhanced due diligence for transactions that touch higher risk jurisdictions may be advisable.

4. Global coordination may lead to greater standardization, fewer conflicts, and fewer instances of competitive disadvantages for those subject to U.S. sanctions.

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Endnotes

Biden Administration Economic Sanctions Developments Delineate Allies and Enemies

1. *See* The White House, “Remarks by President Biden and Chancellor Merkel of the Federal Republic of Germany in Press Conference” (Jul. 15, 2021).

2. *See* U.S. Treasury Dep’t, Office of Foreign Assets Control, Press Release, “Treasury Sanctions Cuban Minister of Defense and Special Forces Brigade for Abuses Against Protestors” (Jul. 22, 2021).

3. *See* U.S. Treasury Dep’t Office of Foreign Assets Control, Press Release, “Treasury Sanctions Cuban Police Force and Its Leaders in Response to Violence Against Peaceful Demonstrators” (Jul. 30, 2021).

4. *See* Ned Price, U.S. Dep’t of State, Office of the Spokesperson, “Department Press Briefing - July 13, 2021” (Jul. 13, 2021).

5. *See* U.S. Dep’t of Commerce, Bureau of Industry and Security, Press Release, “Commerce Department Adds 34 Entities to the Entity List to Target Enablers of China’s Human Rights Abuses and Military Modernization, and Unauthorized Iranian and Russian Procurement” (Jul. 9, 2021).

6. *See* U.S. Dep’t of Commerce, Bureau of Industry and Security, Press Release, “Commerce Department Adds 34 Entities to the Entity List to Target Enablers of China’s Human Rights Abuses and Military Modernization, and Unauthorized Iranian and Russian Procurement” (Jul. 9, 2021).

7. *See* U.S. Dep’t of State, Bureau of Economic and Business Affairs, Xinjiang Supply Chain Business Advisory (Jul. 13, 2021).

8. *See* Ned Price, U.S. Dep’t of State, Office of the Spokesperson, “Department Press Briefing - July 13, 2021” (Jul. 13, 2021).

9. *See* The White House, “Remarks by President Biden and Chancellor Merkel of the Federal Republic of Germany in Press Conference” (Jul. 15, 2021).

10. *See* U.S. Treasury Dep’t, Office of Foreign Assets Control, Hong Kong Business Advisory (Jul. 16, 2021).

11. *See* The White House, “Press Briefing by Press Secretary Jen Psaki” (Jul. 16, 2021).

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