

# Global Transportation Finance Newsletter

December 2016

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## Commitment Letters Not To Be Taken Lightly— How Committed Are We?

At the outset of a transaction, parties often use a commitment letter, letter of intent or memorandum of understanding to set out the principal terms on which the parties wish to establish their commercial relationship. The terms of these documents are often non-binding in nature and usually explicitly state that this is the case, carving out certain exceptions such as the confidentiality provisions and any terms governing the payment of any fees or deposits due prior to signing the final transaction documentation. Naturally with a commitment letter, certain elements of the commitment itself are more likely to be binding, and in the case of *Novus Aviation Ltd v Alubaf Arab International Bank BSC(c)*,<sup>1</sup> the position was explored in light of the absence of any statement that any of its terms were non-binding.

### Facts of the Case

In May 2013, the Bahraini bank Alubaf Arab International Bank BSC(c) (**Alubaf**) signed a commitment letter addressed to aircraft lessor and finance arranger Novus Aviation Ltd (**Novus**) to provide approximately US\$40m equity financing to assist with the purchase of an Airbus A330-300 aircraft to be leased to Malaysian Airlines (**MAS**).

In June 2013, before the principal documents were executed, Alubaf informed Novus that it did not wish to proceed with the equity financing, as it had been advised that the special purpose companies being incorporated as part of the ownership structure for the aircraft would need to be consolidated into Alubaf's financial statements. With delivery of the aircraft to MAS scheduled to occur in July 2013, Novus was unable to arrange alternative equity funding, and MAS purchased the aircraft itself using debt financing.

If Alubaf had not withdrawn from the transaction, Novus (through a special purpose company) would, as the court found, most likely have purchased the aircraft and Novus would have received management fees from Alubaf through a management agreement (which had already been signed by Alubaf at the time of its withdrawal but awaited

**VedderPrice**



Happy Holidays from all of us at Vedder Price, including our newest office in Singapore, established by Shareholder Ji Woon Kim and Solicitor Lev Gantly.



JI WOON KIM



LEV GANTLY



Vedder Price hosted the Fall California Aviation Professionals Carol Chase Speaker Series on November 9th at the Bentley Reserve in San Francisco. Over 50 guests attended an **Operating Lessor Roundtable** and a panel discussion on **Rating Overview of Aircraft ABSs and EETCs**.

Novus' signature). These fees were the damages claimed by Novus as a result of Alubaf's anticipatory repudiatory breach of the terms of the commitment letter and the management agreement.

### The Claim and the Defences

Before the High Court in England, Novus claimed the following:

1. the management agreement and the commitment letter were binding contracts;
2. these were both repudiated by Alubaf; and
3. as a result, Novus lost the opportunity to earn fees under the management agreement (damages claimed were over US\$8m).<sup>2</sup>

Alubaf denied the claims on the following grounds:

1. the commitment letter was not intended to be legally binding and/or is void for uncertainty;
2. the signatory to the commitment letter and management agreement did not have authority to bind Alubaf to provide funding for the transaction; and
3. in any event, there was no binding contract, as neither document was countersigned by Novus and returned to Alubaf before Alubaf decided not to proceed with the transaction.<sup>3</sup>

### Analysis of the High Court

#### Intention of the Parties

The judgment focused on the inclusion of a governing law clause in the commitment letter and discussed other language in the letter which sought to impose legal obligations on the parties with the inclusion of words such as "shall" and "covenants." The judge found that the wording of the governing law clause in particular was a clear objective measure of the parties' intention to create legal relations. This was a result of applying the objective test established by the Supreme Court where Lord Clarke stated the applicable principle:

*"Whether there is a binding contract between the parties and, if so, upon what terms depends upon what they have agreed. It depends not upon their subjective state of mind, but upon a consideration of what was communicated between them by words or conduct, and whether that leads objectively to a conclusion that they intended to create legal relations and had agreed upon all the terms which they regarded or the law requires as essential for the formation of legally binding relations."*<sup>4</sup>

Alubaf argued that there is a practice in the aviation finance industry that parties are not bound to participate until "definitive documentation is executed at the closing of the transaction"<sup>5</sup>. However, the judge believed that there was no ambiguity in the wording of the commitment letter and that if Alubaf had intended the commitment

### Recent Accolades



*Chambers UK 2017* Asset Finance: Aviation ranks Vedder Price Band 2. Gavin Hill and Neil Poland are also ranked Band 2 as individual lawyers, with Derek Watson achieving a debut ranking in Band 4.



*U.S. News – Best Lawyers*, a publication of *U.S. News & World Report*, names Vedder Price "Law Firm of the Year" for Equipment Finance in its annual "Best Law Firms" rankings. This is the third time in four years that Vedder Price has received this honor, which is awarded to only one firm per legal practice area. Vedder Price also achieved national top-tier status in two additional practice areas: Admiralty & Maritime Law and Banking & Finance Law.

letter to be non-binding or only certain provisions to be binding, then that should have been expressed explicitly in the document. Furthermore, the court found that there was no objective evidence in the conduct of the parties that suggested the letter was non-binding and/or to be treated as a letter of intent. In fact, Novus took action to proceed with the transaction with MAS as a result of the commitment letter being signed by Alubaf as, from Novus' perspective, Alubaf was "locked in" as an equity investor. Expert evidence presented in the case showed that while an equity investor may elect not to commit itself unconditionally until the documentation has been finalised, the terms of the commitment letter did not do this.

The commitment letter contained two conditions:

- satisfactory review and completion of documentation for the purchase, lease and financing; and
- the transaction realising a minimum net expected average cash on cash return of around 9.5% per annum.

Alubaf's counsel argued that the first condition should be read as two conditions: (i) satisfactory review and (ii) completion of documentation for the purchase, lease and financing. Further, counsel submitted that there is little difference between a review of the documentation for the transaction and a review of the transaction as represented by the documentation, and that therefore a commitment which is conditional upon such review is too uncertain to be enforceable.

The judge did not agree with these submissions and found the first condition to be sufficiently certain (and that it ought not to be construed as two separate conditions) and that Alubaf's right to reject documentation as unsatisfactory should not be unqualified—in the absence of other language, the contractual discretion should be "exercised in good faith for the purpose for which it was conferred, and must not be exercised arbitrarily, capriciously or unreasonably (in the sense of irrationally)".<sup>6</sup>

#### **Authority: Actual vs. Apparent**

The court held that Novus had no reason to believe that the Head of Treasury and Investments (who signed both the commitment letter and the management agreement on behalf of Alubaf) did not have the authority to bind Alubaf, based principally on the communication between the parties, and that, accordingly, the commitment letter bound Alubaf.

As with many large institutions, Alubaf had an authorised signatory list, but the judge found that any constraints set out in the list were not relevant in this circumstance given that this transaction had been formally approved by the bank's investment committee, which had authorised the individual "to proceed with executing the necessary documentation to fund and close the [MAS] transaction".<sup>7</sup>

The court found that whether the Head of Treasury and Investments had actual authority to bind Alubaf or not was not relevant, as it was plain that he had apparent authority, which is sufficient in law to bind Alubaf. Apparent authority arises where a

## Thought Leadership

Vedder Price was one of five leading U.S. law firms that collaborated on a recently published White Paper, [Applicability of U.S. Risk Retention Rules to Structured Aircraft Portfolio Transactions](#), examining application of the new U.S. credit risk reporting rules to a typical issuance of securities by a newly formed special purpose vehicle that owns (or will own) a portfolio of aircraft and related leases. The White Paper was prepared by attorneys from Vedder Price and four other law firms, Clifford Chance LLP, Hughes Hubbard & Reed LLP, Milbank, Tweed, Hadley & McCloy, LLP and Pillsbury Winthrop Shaw Pittman LLP.

Kevin MacLeod was quoted in an *Airfinance Journal* article [Dodd-Frank reform: How will aircraft ABS deals be affected?](#) discussing the Dodd-Frank Wall Street Reform and Consumer Protection Act, and specifically the new credit risk retention rules for asset-backed securities (ABS) that will come into effect on December 24.

*Getting the Deal Through* has published its annual report, [Q&A, Marshall Islands](#), written by Shareholder **Francis X. Nolan, III**, providing international analysis in key areas of law and policy including vessel due diligence under Marshall Islands law, repayment, registration of vessels, ship mortgages and other liens over vessels, tax considerations for vessel owners and much more.

Shareholder **Francis X. Nolan, III** was recently published in *Benedict's Maritime Bulletin* for his article, [What is a "Vessel" and When? – Fleeting Concepts](#). In the article, Mr. Nolan discusses the recent Comite Maritime International (CMI) joint conference, where a panel presented the "extensive inconsistencies and anomalies created by the continuing differing definitions in national laws and international conventions of the terms 'vessel' and 'ship,'" and also discussed the potential adverse impact of unstable definitions in the financing of vessels.

principal represents to a third party that it is authorised to act on that party's behalf and the third party relies on such representation. In these circumstances, the principal is bound by the agent's act whether or not the agent was actually authorised to act.

The evidence showed that Novus had been told that Alubaf had "formally fully approved" the transaction, and accordingly the judge held that Novus was able to rely on the Head of Treasury and Investments' authority to bind Alubaf unless it was specifically informed otherwise.

### **Acceptance and Agreement**

Both the commitment letter and the management agreement anticipated a countersignature by Novus. In relation to the commitment letter, the delivery of a countersignature by Novus to Alubaf (which would only indicate acceptance of the terms) was deemed unnecessary, as Novus' conduct clearly demonstrated that it accepted the terms of the commitment by Alubaf and was proceeding with the transaction on that basis.

The management agreement was distinguished by a provision which stipulated that the obligations of the parties were to take effect when the agreement had been executed by both parties. Thus, countersignature was the required mode of acceptance, unless waived by the other party.<sup>9</sup> The facts did not indicate there having been any waiver, and the document was only partially executed (i.e., by Alubaf only). However, the court concluded that the management agreement formed part of the documents which would be signed prior to closing, and evidence indicated that it was in agreed form and that (as a matter of course, as a closing formality) Novus would ultimately provide its signature. Accordingly, the court found that the arrangements under the management agreement would have formed part of the transaction had it proceeded to close; and the fees thereunder would have been due from Alubaf to Novus.

### **Brexit Impact**

As detailed in a follow-on case before the court relating to the quantum of damages,<sup>9</sup> Novus had made a Part 36 offer<sup>10</sup> which was more advantageous for Alubaf than the value of the judgment in Novus' favour when calculated at the time the judgment was issued. However, this advantage arose solely as a result of exchange rate fluctuation—Novus' Part 36 offer was provided in pounds, while the amounts being claimed were in dollars. Following a broad weakening in the pound against the dollar since the result of the referendum on leaving the European Union, the dollar value of the Part 36 offer was inflated as against its value in dollars both at the time the Part 36 offer was made and at the start of the trial.

Given the inflated dollar value of the Part 36 offer which followed the referendum result, the judge found that the fluctuation, and resulting discrepancy, was just "happenstance" and, accordingly, the judge determined it "unjust" to apply the usual rule, which would allow the court to apply interest on the original damages amount at a rate of up to 10% above base rate and to grant costs on an indemnity basis<sup>11</sup> along with interest on those costs at a rate of up to 10% above base rate.

## **Recent Speaking Engagements**

### **November 30 – December 1: Corporate Jet Investor Miami 2016, Coral Gables.**

- Shareholder Edward Gross moderated the "Credit Control" panel and discussed how banks choose which deals to take part in, how the process works and how to balance risk with growth, among other topics.
- Shareholder David Hernandez presented on sanctions in Cuba, Iran and other markets.
- Shareholder Marc Klyman discussed business jet capital markets.

### **November 9: Marine Money's 17th Annual Ship Finance Forum, New York.**

Shareholder Francis X. Nolan, III moderated a session "Fresh Capital: Credit Alternatives from Insurance Companies to Family Offices to FinTech," that explored alternative capital and how it has become a staple for shipowners looking to take advantage of today's maritime market opportunities.

### **October 26 – 28: Tulane Admiralty Law Institute and Maritime Law Association's 50-Year Reunion, New Orleans.**

Shareholder Francis X. Nolan, III, participated in a panel discussion entitled "Marine Finance and Liens."

### **October 23 – 25: 55th Annual ELFA Convention, Palm Desert.**

- Shareholder Marc Klyman presented on "A New Perspective on the Securitization of Equipment Leases."
- Shareholder Edward Gross presented on "Recent Legal Decisions: What You Don't Know Can Negatively Impact Your Business."

## Conclusion

Parties entering into a transaction should always seek to ensure that their intentions are accurately reflected in the documentation, and an objective view of conduct and communications between the parties may be used to assess the true purpose and intent of the parties.

In this case, the commitment letter was a binding commitment which should be distinguished from a non-binding letter of intent. Parties should be clear on the purpose of the initial documentation even though commitment letters, letters of intent and memoranda of understanding are often very short form agreements setting out only the high-level agreed points. Transaction parties should take particular care to clearly draft any conditions to each party's obligation to proceed with the transaction, as well as to clearly identify provisions that are intended to be non-binding understandings as opposed to binding agreements. In addition, institutions should also be clear on the authority granted to employees and the manner in which this authority is communicated to counterparties.

It should be noted that the judge did not give leave to appeal in this case, but it appears that Alubaf has applied to the Court of Appeal for permission to appeal.



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## Update: Commercial Drone Operations in the US

On August 29, 2016, the United States Federal Aviation Administration (**FAA**) adopted long-awaited regulations governing commercial operations of small unmanned aircraft systems (**UASs**) as Part 107 of the Federal Aviation Regulations (**Part 107**). FAA Administrator Michael Huerto estimates that there will be 600,000 registered commercial UASs operating in U.S. airspace within a year after the enactment of Part 107. This will be an impressive leap from the 20,000 or so UASs currently registered for commercial use in the U.S. The Association for Unmanned Vehicle Systems International (**AUVSI**) believes that the UAS industry will create more than 100,000 jobs and generate more than \$82 billion for the U.S. economy over the next decade. It is worth a brief look at these new regulations, which will impact not only the aviation sector, but also the public at large.

Any commercial aircraft operation in the United States National Airspace System (**NAS**) requires a certificated and registered aircraft, a licensed pilot and operational approvals or an exemption from such requirements. UASs, commonly called drones, along with all other devices that are used for flight in the air, constitute aircraft for this purpose. (The broad reach of the term "aircraft" is illustrated by the FAA's grant of authorization to operate a smartphone-controlled paper airplane for aerial photography.) The vast majority of lawful commercial operations of small UASs weighing less than 55 pounds (**Small UASs**) in the United States will be operated pursuant to Part 107.

Prior to the adoption of Part 107, there were three permitted ways to operate UASs for work, business or other commercial purposes: (i) apply for and obtain an exemption from the supervision and registration requirements of the Federal Aviation Act pursuant to Section 333 of the FAA Modernization and Reform Act of 2012 (**Section 333 Exemption**) and operate the UASs pursuant to the express terms of the Section 333 Exemption, (ii) obtain an airworthiness certificate for the UASs and operate the aircraft by a pilot pursuant to an operating certificate or (iii) obtain a Certificate of Waiver

or Authorization from the FAA and operate the UASs pursuant to the terms of such Certificate of Waiver or Authorization. Each of these options required that the UASs be operated by a pilot holding an Airman Certificate. Before Part 107, legal operations of UASs in the United States for commercial purposes were primarily based on Section 333 Exemptions, except for operations by public entities, which were primarily based on Certificates of Waiver or Authorization. Section 333 authorizes the U.S. Secretary of Transportation to determine whether an airworthiness certificate is necessary in order for a UAS to operate safely in the NAS on a case-by-case basis. During the period from September 25, 2014 through September 28, 2016, 5,552 Section 333 Exemptions for commercial operation of UASs were granted by the FAA.

The Section 333 Exemption process was a stopgap measure used by the FAA to approve commercial operations of UASs on a case-by-case basis while it developed more general regulations. Part 107 contains regulations of general applicability authorizing the commercial operation of Small UASs subject to specific operational restrictions and requirements. With some changes, the restrictions and requirements imposed in many of the Section 333 Exemptions that were granted prior to the adoption of Part 107 formed a framework for the restrictions and requirements for the commercial operation of Small UASs contained in Part 107.

Part 107 creates the operational rules for the commercial use of Small UASs. The basic rules and requirements to operate under Part 107 are as follows:

- obtain Remote Pilot Certificate, which requires the Small UASs operator to (i) be at least 16 years of age, (ii) pass an FAA aeronautical test and (iii) submit to and pass a Transportation Security Administration background check;
- operate the Small UASs within visual line of sight (**VLOS**) of the Remote Pilot;
- operate the Small UASs during daylight hours;
- operate the Small UASs at a height of not more than 400 feet above the ground;

- operate the Small UASs at or below 100 mph;
- not fly the Small UASs over people except for those participating in the operation or those under a covered structure;
- not operate the Small UASs from a moving vehicle unless the operation is over a sparsely populated area;
- yield the Small UASs to manned aircraft; and
- only operate the Small UASs in non-FAA controlled airspace, such as those areas farther than five nautical miles from airports.

In addition to these basic rules and requirements, the Small UASs must also be registered with the FAA, and reregistered every three years. Failure to register (or reregister) a Small UAS or failure to have the correct pilot certification (or exemption from the Part 107 Rules) can result in fines of up to \$27,500 per violation. Under Part 107, Small UAS operators are expected to comply with general safety and privacy guidelines as implemented by local and state authorities. Operating under Part 107 bypasses the usual stringent FAA airworthiness standards and requirements, so all Small UAS operators are expected to perform their own safety and communication checks to ensure the Small UAS is safe to fly.

Part 107 provides that an application may be submitted for the issuance of a Certificate of Waiver (CoW) waiving some but not all of the operational restrictions imposed by Part 107 if the FAA concludes that the proposed operations can be safely conducted. Following are some of the waivable requirements: restrictions on operation from a moving vehicle or aircraft, daylight operation, VLOS operations, operation of multiple small unmanned aircraft systems, yielding the right of way and operations over people. With respect to each of the waivable requirements in Part 107, the FAA issued specific performance-based standards that must be satisfied in order to obtain a waiver. Some examples of these performance-based standards are requirements that the applicant provide a method for resolving failure of the Small UASs or its systems, a method to ensure that risks presented to non-participating persons and property are controlled or eliminated and a

method to ensure that all persons involved in the operation of the Small UASs are free of any distractions that may prevent them from fulfilling their duties. These guidelines, which are grouped into categories relating to the specific provision of Part 107 for which the waiver is sought, are intended to make it more likely that applications are approved on first submission. The FAA has stated that most of the applications for waivers that have been denied have failed to comply with the FAA's published guidelines for the requested waiver.

Certain requirements in Part 107 are not subject to waiver including the weight limitation of 55 pounds. While the VLOS requirement is waivable, no waivers will be issued to allow the carriage of property for compensation. This restriction means that the use of Small UASs to deliver merchandise for compensation under Part 107 will be limited to VLOS operations. Approval for the use of UASs for the delivery of merchandise without VLOS will need to be pursuant to an authority other than Part 107, such as a Section 333 Exemption.

The procedure for applying for a waiver from the waivable requirements under Part 107 can be accomplished online and is quite streamlined. During the period from August 29, 2016 through November 25, 2016, 1,185 waivers for Part 107 operations were granted, 173 of which were for a single waiver allowing nighttime operations. Only one waiver under Part 107 has been granted for flights over people, only three waivers have been granted for flights beyond VLOS and only six waivers have been granted for operation of multiple unmanned Small UASs. Over 80 authorizations have been granted for flights in FAA-controlled airspace.

While many of the operations of UASs that were authorized pursuant to Section 333 Exemptions will be permissible under Part 107, the Section 333 Exemption process still will be available for operations that are outside Part 107 and not eligible for a CoW. Operations under a Section 333 Exemption will still require an Airman Certificate rather than a Remote Pilot Certificate under Part 107.

The FAA continues to address issues relating to the commercial operation of UASs. Among the key issues remaining to be addressed are conditions relating to

operations of UASs over people, operations of UASs beyond VLOS for the delivery of merchandise for compensation, and other purposes and autonomous operations of UASs. The FAA anticipates adopting regulations this winter under which operation of Small UASs over people will be authorized. These regulations will likely focus on safety concerns related to participants and bystanders. The FAA and other federal agencies in conjunction with private entities continue to research and test the operation of UASs beyond VLOS operations. The next several years are likely to see major developments in the scope of permissible commercial operations of UASs which will have considerable commercial benefits for a range of industries (construction, agriculture, surveying and mapping to name a few) that already take advantage of UASs technology and will benefit even further from these developments.



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# ICAO Strikes Deal at 2016 Assembly to Create the First Global Market-Based Mechanism for International Aviation Emissions

On October 6, 2016, after years of protracted negotiations, the General Assembly of the International Civil Aviation Organization (ICAO) passed Resolution 22/2,<sup>1</sup> creating the first global market-based measure (GMBM) to attempt to contain aviation emissions. The GMBM, known as the Carbon Offsetting and Reduction Scheme for International Aviation (CORSA), will take effect in 2021, be reviewed every three (3) years and run until 2035. CORSA is among a basket of measures—along with improved air traffic management and more energy-efficient aircraft, engine and fuel technology—aimed at reducing aviation emissions. Despite this unprecedented and groundbreaking progress by ICAO, CORSA has significant limitations, leaves questions unanswered and mechanics undetermined, and in the view of many nongovernmental organizations (NGOs) does not sufficiently address the ongoing dangers posed by aviation greenhouse gas (GHG) emissions.

## What Was Agreed

Unlike the cap-and-trade system of the European Union's Emissions Trading Scheme (EU ETS), whereby aircraft operators are required to purchase and surrender permits to pollute, and the allotment of free permits decreases over time, CORSA requires operators situated in countries party to the scheme to offset their excess emissions above 2020 baseline levels by purchasing qualifying carbon offset credits from GHG reduction and limitation projects in other industries. The first two phases of CORSA, from 2021 through 2026, will be voluntary, and countries may join or opt out of the scheme at any time. From 2027 through 2035, it will be mandatory except for those countries, flights or operators specifically exempted from (and not voluntarily participating in) the scheme.<sup>2</sup>

Under the ICAO resolution, aviation carbon emissions will continue to increase through 2020, after which nonexempted emissions above the 2020 international

aviation industry baseline must be offset. As of October 12, 2016, 66 countries<sup>3</sup> collectively comprising more than 86.5% of international aviation activity indicated their intention to voluntarily participate in CORSA from its outset. Many of the remaining ICAO member countries are either exempted or have yet to commit to the scheme. Russia, India, Brazil, Saudi Arabia, Chile, Argentina and Venezuela are on record with objections that CORSA either fails to further the goal of carbon neutral growth from 2020 as codified in the Paris Agreement under the UN Framework Convention on Climate Change,<sup>4</sup> or its implementation disproportionately burdens developing countries. During CORSA's voluntary phase, sectoral baselines will be set from 2020,<sup>5</sup> whereas during the mandatory phase, each operator will increasingly set its own emissions baseline using emissions data from either 2021, 2022 or 2023.<sup>6</sup>

## Limitations and Uncertainties

The term "Reduction" in the CORSA acronym is a misnomer, as the scheme makes no attempt to reduce aviation emissions but only to offset surplus emissions above baseline levels. Most of the technical and mechanical details of CORSA have yet to be agreed, including: the identity and types of GHG abatement projects that will qualify as eligible offsets for aircraft operators; the measurement, reporting and verification of aviation emissions; and the electronic registries through which offset credits will be held and transferred. Current timelines call for these criteria, procedures and logistics to be ready for implementation by 2018. Of particular significance, CORSA only applies to international flights—meaning, for example, that 60% of all flights departing and arriving in the United States are not covered by CORSA. Domestic flights are left to be regulated by individual national authorities under the Paris Agreement (a process the U.S. Environmental Protection Agency has recently initiated with its endangerment finding on aviation GHGs<sup>7</sup>). Also undetermined at this time are the penalties for noncompliance and the enforcement criteria to be utilized by member states, leaving uncertainty over uniformity, efficacy and consistency of enforcement.



There is also the potential for uncertainty and debate as to which flights after 2020 should be covered under CORSIA and which flights may continue to be regulated under EU ETS. Currently, EU ETS remains in effect for nonexempted flights that originate and terminate in the European Economic Area (EEA) by all operators, regardless of domicile, until 2020; but this period may soon be extended beyond 2020. International aviation emissions are regulated by ICAO and not by sovereign states or regional alliances such as the EU. For example, under ICAO's definition,<sup>9</sup> a flight from Paris to Frankfurt would be considered an "international flight" and thus by definition regulated under CORSIA.

While many observers and NGOs have indicated that CORSIA falls far short of what they consider to be ambitious and a regulatory system equivalent to EU ETS,<sup>9</sup> the EU and its member states appear to have reluctantly conceded that the deal reached in October by ICAO is better than no deal at all, and that CORSIA can be improved upon through its mandated triennial review process. There is concern among some members of the EU Parliament (MEPs) that, should global aviation emissions peak by 2020 and decline thereafter, there will be no requirement for international operators or their governments to offset any aviation emissions whatsoever.

## What Lies Ahead

In early 2017, the EU Parliament will debate CORSIA and its impact on EU ETS compliance beyond both January 1, 2017 and 2020.<sup>10</sup> It is widely expected that aviation will continue under EU ETS until at least 2020, with application continuing in its current form to intra-EEA flights and the current "stop the clock" derogation remaining in place for intercontinental flight activities.<sup>11</sup> There is talk among some MEPs of reintroducing "full scope" EU ETS compliance for international flights between the EEA and those countries that have declined to join the voluntary phase of CORSIA. Due to the lack of ambition under the ICAO scheme perceived by many EU MEPs, a strong faction is building for EU ETS to continue in conjunction with CORSIA to cover EEA domestic and regional flight activities. For now, EU ETS remains in full force and effect for intra-EEA flights; operators are not

currently permitted to offset emissions from these flights; and allowances must still be purchased and surrendered annually (as opposed to the three-year compliance cycle contemplated by CORSIA).

Some MEPs are looking to tighten EU ETS even further by reducing the aviation cap and eliminating free aviation allowances. They argue that under current EU ETS rules, for example, a flight from Paris to Brussels is subject to a 95% cap and distribution of mostly free aviation emissions allowances, whereas a train trip on the same route is subject to a reduced 45% cap and no free EU emissions allowances. In addition, aviation fuel is exempt from purchase tax, and some politicians believe that aviation is unfairly subsidized.

Many observers believe that the ICAO's resolution creating CORSIA was the lowest common denominator to enable all parties to show a tangible result for their efforts, particularly since prior proposed GMBMs envisioned a mandatory rather than voluntary scheme. With international aviation being effectively given the green light to continue increasing carbon emissions faster than technology can reduce them, non-aviation industries will have to redouble their efforts to compensate in order to have any chance of achieving the goals of the Paris Agreement by 2020 (or beyond).



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## Commitment Letters Not To Be Taken Lightly—How Committed Are We?

- <sup>1</sup> [2016] EWHC 1575 (Comm).
- <sup>2</sup> Para. 32, *ibid.*
- <sup>3</sup> Para. 33, *ibid.*
- <sup>4</sup> Paragraph 47, *ibid.*; *RTS Flexible Systems Ltd v Molkerei Alois Muller GmbH & Co KG* [2010] UKSC 14, [2010] 1 WLR 753.
- <sup>5</sup> Para. 47, *Novus Aviation Ltd v Alubaf Arab International Bank BSC(c)* [2016] EWHC 1575 (Comm).
- <sup>6</sup> Para. 58, *ibid.*
- <sup>7</sup> Para. 76, *ibid.*
- <sup>8</sup> *Reveille Independent LLC v Anotech International (UK) Ltd* [2016] EWCA Civ 443, para. 41.
- <sup>9</sup> *Novus Aviation Ltd v Alubaf Arab International Bank BSC(c)* [2016] EWHC 1937 (Comm).
- <sup>10</sup> A Part 36 offer is an offer to settle under the UK's Civil Procedure Rules which may result in severe costs consequences if a party loses, having failed to accept a "better" offer ahead of the applicable hearing; it is designed to encourage parties to settle cases prior to going to trial.
- <sup>11</sup> Being a dollar-for-dollar recovery of all costs with no limitation that these are only those costs reasonably incurred.

## ICAO Strikes Deal at 2016 Assembly to Create the First Global Market-Based Mechanism for International Aviation Emissions

- <sup>1</sup> [http://www.icao.int/Meetings/a39/Documents/WP/wp\\_530\\_en.pdf](http://www.icao.int/Meetings/a39/Documents/WP/wp_530_en.pdf).
- <sup>2</sup> Exempted countries mainly consist of least developed countries, small island developing states and land-locked developing countries whose share of global revenue ton kilometer activity falls below a minimal threshold. Exempted operations mainly consist of flights by aircraft with a maximum takeoff weight of 5,700 kg or less, flights for humanitarian, medical or firefighting purposes, or operators with annual carbon dioxide emissions of 10,000 metric tons or less.
- <sup>3</sup> A current list of voluntarily participating CORSIA member states may be found at <http://www.icao.int/environmental-protection/Pages/market-based-measures.aspx>.
- <sup>4</sup> See [http://unfccc.int/paris\\_agreement/items/9485.php](http://unfccc.int/paris_agreement/items/9485.php).
- <sup>5</sup> Referred to as "100% Sectoral Share."
- <sup>6</sup> Referred to as "Dynamic Share" comprising a mix of sectoral and individual share, with at least 20% individual share during the period 2030–2032 and at least 70% individual share during the period 2033–2035.
- <sup>7</sup> "EPA Determines that Aircraft Emissions Contribute to Climate Change Endangering Public Health and the Environment 27 July 2016," <https://www.epa.gov/newsreleases/epa-determines-aircraft-emissions-contribute-climate-change-endangering-public-health-0>.
- <sup>8</sup> ICAO defines an "international flight" as a flight containing one or more international stages. See <http://www.aviationglossary.com/icao>.
- <sup>9</sup> See, e.g., "Opinion: Why ICAO's Emissions Deal Will Not Make a Difference," *Aviation Week*, October 22, 2016 (<http://aviationweek.com/commercial-aviation/opinion-why-icao-s-emissions-deal-will-not-make-a-difference>); "ICAO GMBM Agreement a Hard-Fought Compromise and a First Step, Say NGOs, But Falls Short of Temperature Goals," *GreenAir Online*, October 25, 2016. (<http://www.greenaironline.com/news.php?viewStory=2297>); "ICAO: What is Going On?," *Transport & Environment Briefing*, September 2016.
- <sup>10</sup> "EU Airline Pollution Curbs Stay in the Air Until Next Year," <http://www.reuters.com/article/europe-carbon-aviation-idUSL8N1CH4CT>.
- <sup>11</sup> This is to be debated by the European Parliament under Articles 14 and 15 of Regulation (EU) No. 421/2014.
- <sup>12</sup> Barry Moss, CEO of Avocet Risk Management Ltd. in Brussels, Belgium, co-wrote this article with Shareholder Jordan Labkon.

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