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October 2011

Global Transportation Finance Newsletter

From the Chair of the Vedder Price Global Transportation Finance Team

Dear Friends:

Vedder Price is pleased to announce the opening of our new office in London. Our presence in London marks the next step in our goal to serve you better and more efficiently. By expanding our capabilities through our UK office, Vedder Price's Global Transportation Finance team is now even better equipped to handle your deals that involve both U.S. and English law.

Partners Gavin Hill and Derek Watson lead our experienced team in London and focus on our transportation finance clients. We've created a website with comprehensive information about the London office, team members and contact information at www.vedderprice.com/globaltransportationfinance. We look forward to offering enhanced English law capabilities through our new London office, while providing the same service and expertise you've come to expect from Vedder Price.

Sincerely,

Dean N. Gerber
Chair, Vedder Price Global Transportation Finance Team

* * *

How Lessors and Lenders Can Audit the Eurocontrol Accounts of Lessees

Eurocontrol has implemented a change to the way lessors, lenders and security trustees can audit the Eurocontrol accounts of lessees. Effective September 1, 2011, lessors will no longer receive an aircraft operator's statement of account from Eurocontrol via e-mail. In an attempt to provide better security, Eurocontrol will now provide such statements only upon the lessor's request via a secured extranet system called CEFA (Central Route Charges Office Extranet for Airspace Users). We have been advised by Eurocontrol that lenders and security trustees also will be granted access to CEFA under the same protocol. In order to gain access, the requesting party needs to complete an Agreement (available on Eurocontrol's website). Once the Agreement is completed and received by Eurocontrol, the requesting party can view an operator's statement of account online 24/7. Access is free. However, requesting parties must obtain approval from each operator whose statement of account they wish to view by having the operator sign an Authorization Letter in the prescribed form.

Because lenders and lessors must execute the Agreement, they should take note that the Agreement contains various noteworthy provisions including the following: Article 4 provides that to the extent permitted by national law, in the event of a dispute, Eurocontrol's data, including metadata, shall be admissible in court and shall constitute evidence of the facts contained therein unless contrary evidence is adduced. Section 9.2 provides

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that once a statement of account becomes available on CEFA, it shall be deemed received by the "Leasing Company," which agrees to proactively and regularly check the CEFA site. Article 13 contains various provisions concerning confidentiality and protection of data. Section 14.2 requires the Leasing Company to indemnify Eurocontrol against any claims for damages made by third parties where the claims or damages are due to a fault of the Leasing Company. Article 15 provides that without prejudice to any mandatory national law, the transmission of electronic data under the Agreement shall be governed by Belgian law. Article 16 provides that any dispute arising out of or in connection with the Agreement shall be referred to the Brussels Court of First Instance (Belgium), which shall have sole jurisdiction.

Also, Section 17.3 provides that the Agreement is for an indefinite period, but either party may terminate it on not less than three months' written notice, and that Eurocontrol is entitled to terminate or suspend the Agreement in a case foreseen under the confidentiality and protection of data provisions (Section 13.1) or if all authorizations to release Statements of Account to the lessor have been withdrawn. Section 17.4 provides that access to the Statements of Account of an Aircraft Operator will be terminated without notice in case of the withdrawal of the authorization to release such Statements of Account. However, the prescribed form of Authorization Letter provides that it may only be revoked or amended by written instructions from the operator and lessor.

The foregoing is merely a summary of a few of the provisions of the Agreement. All provisions should carefully be reviewed before signing. However, it appears the only way lessors, lenders and security trustees can obtain the statement of an operator's account is by means of the Authorization Letter and signed Agreement.

If you have any questions about this article, please contact **John I. Karesh** at +1 (212) 407 6990. ■

Reregistering Vessels After Foreclosure Sale

Foreclosure against a vessel differs from foreclosure against other personal property for good reason. The U.S. Constitution confers admiralty jurisdiction on U.S. district courts, which have the power to order that vessels be arrested within their territorial jurisdiction and be sold free and clear of any liens or encumbrances whatsoever. A sale accomplished in this manner by federal court order generally is recognized by other nations as conveying title to the purchaser free and clear of liens while necessarily extinguishing all claims against the vessel. The U.S. recognizes this same power in equivalent courts in foreign countries. No other remedy available to the mortgagee, self-help or otherwise, can achieve the same result.[1] Jurisdiction of the U.S. district court over a vessel arrested within its territorial bounds is *in rem* over the vessel itself as a separate person and does not depend on the presence of its owner or any basis of jurisdiction over its owner. Based on this *in rem* jurisdiction, U.S. courts often order sales of foreign-flag vessels arrested in U.S. waters, which vessels then are purchased at auction by new owners who reflag them in other foreign registries.

Most commercial vessels and larger pleasure vessels are registered under the laws and flag of a nation. The common effects of registration are that the vessel falls under the protection of, and regulation by, the flag state, and the flag state assumes a responsibility to regulate the vessel's conduct and condition. These are long-standing concepts of customary international law and are reflected in the 1986 United Nations Convention on Conditions for Registration of Ships.

In the United States, vessel registration is defined in terms of "documentation" and is accomplished by complying with requirements set forth in 46 U.S.C. Chapter 121 and its implementing U.S. Coast Guard Regulations found in 46 C.F.R. Part 67. A vessel may be documented as a U.S.-flag vessel only if it is

[1] Self-help remedies are, however, useful to preferred mortgagees as preliminary steps to the exercise of the foreclosure remedy. For example, mortgagees can use self-help to take physical control or direct the vessel to a location where she can be arrested.

"wholly owned" by a United States citizen. Generally, an owner must establish title to the vessel by proving chain of title from the prior owner or manufacturer to itself. Nonetheless, U.S. law specifically states that a certificate of documentation is "conclusive proof of nationality for international purposes" but is not conclusive evidence of ownership in any title dispute.[2]

In the case of a foreclosure sale, U.S. law requires certified copies of the relevant court orders, whether domestic or foreign, authorizing the sale.[3] If the auctioned vessel was registered in a foreign country, U.S. law requires evidence of the vessel's removal from that registry before the vessel may be registered in the United States.[4] This is normally satisfied by an official certificate of deletion issued by the registry of the foreclosed vessel. This is consistent with customary international law that a vessel may only be registered under, and fly the flag of, one nation at a time.

In some countries, the registration statutes permit a new owner to provisionally register a vessel, pending later delivery of a deletion certificate, at which point the permanent registry can be effected. Most often, a buyer provisionally registers its vessel by obtaining a "permission to sell" from the seller's registry. The permission to sell is a comfort letter for the buyer, as well as a stated requirement of the new flag register, ensuring that the deletion certificate will be forthcoming upon return and cancellation of the seller's registry document for the vessel. In a typical commercial sale of a vessel, a buyer requires such a permission, if not a full deletion, and also requires an abstract or similar official document confirming that, at the moment of sale, there are no liens or encumbrances (such as a mortgage) on the vessel, other than an encumbrance which will be directly paid out of sale proceeds.

Involuntary or "forced" sales are another matter, as the soon-to-be-divested owner generally is not motivated to cooperate in the title transfer. U.S. law provides a full palette of remedies to mortgagees and other maritime lien holders against vessels registered both in and outside the U.S., as long as the vessels are arrested in U.S. waters. U.S. law grants the U.S. district courts jurisdiction to order the sale of a vessel to satisfy unpaid claims on the application of the mortgagee or lienor. Such a sale is conducted by the U.S. Marshal under federal court order and conveys title to the vessel, free and clear of any liens, claims or encumbrances existing as of the date of sale.[5] The case of *Goldfish Shipping, S.A. v. HSH Nordbank AG* demonstrates that, while U.S. law provides that a court-ordered sale of the vessel transfers title free of any encumbrances in certain circumstances this may not be sufficient to put the vessel's past behind it.[6]

In *Goldfish*, a major international shipping bank foreclosed on a Turkish-flag vessel in the Port of Philadelphia.[7] The defaulting Turkish vessel owner was not before the court. At auction, an unrelated buyer purchased the vessel and received a bill of sale from the U.S. Marshal, by order of the U.S. district court.[8] The new owner provisionally re-registered the vessel in Panama and sailed with a cargo to the Mediterranean.[9] The prior Turkish owner arrested the vessel upon arrival in Spain.[10] After delays, the Spanish courts lifted the arrest, and the vessel sailed to Italy, where the prior owner re-arrested the vessel.[11] More delays, and the vessel was released.[12]

The Turkish owner claimed that the vessel was still his, as it had not been deleted from the Turkish registry, which could not happen under Turkish law unless and until the mortgagee first released the mortgage.[13] The mortgagee refused to file papers to release the mortgage on the Turkish register, claiming that this would also release the mortgagee's claim to a deficiency under Turkish law.[14] The buyer

[2] 46 U.S.C. Section 12134.
[3] 46 C.F.R. Section 67.77.
[4] 46 C.F.R. Section 67.55.
[5] 46 U.S.C. Section 31326(a).
[6] *See* Goldfish Shipping, S.A. v. HSH Nordbank AG, No. 07-3518, 2008 U.S. Dist. LEXIS 93135 (E.D. Pa. Nov. 3, 2008), *motion to amend judgment denied* by 623 F. Supp. 2d 635 (E.D. Pa. 2009), *aff'd*, 150 Fed. App'x (3d Cir. Apr. 21, 2010).
[7] *Id.* at 1.
[8] *Id.* at 2.
[9] *Id.* at 5.
[10] *Id.*
[11] *Id.* at 7.
[12] *Id.*
[13] *Id.*
[14] *Id.* at 3.

sued the mortgagee claiming that the mortgagee had an obligation, as any other seller would in a sale "free and clear," to do whatever was necessary to permit the buyer to receive its bargained-for enjoyment of the vessel.[15] The mortgagee claimed that it had done all it could without surrendering its deficiency claim and that a buyer's claim can exist only against the prior owner, noting that a foreclosure sale in admiralty divested any claim of the prior owner in the vessel.[16] The mortgagee also pointed out that the U.S. Marshal, and not the mortgagee, was the "seller" of the vessel.[17]

Ultimately, the Third Circuit Court of Appeals agreed with the mortgagee.[18] The court held that the judicial sale did, in fact, result in the buyer receiving title free and clear of encumbrances.[19] The actions by the prior owner, while certainly harmful to the buyer, were not caused by any failure in title (and, in fact, were unlawful and thus no different from any other wrongful arrest of the vessel); thus, the foreclosing lender was not liable for the actions of the former owner, nor was the foreclosing lender obligated to deregister its Turkish mortgage to prevent the former owner from continuing to attempt to arrest the vessel.[20] In essence, the buyer was left to seek its own remedies against the former owner.[21]

There are a number of legal fixes for this problem under discussion in international legal circles, including a proposed international convention to strengthen foreign recognition of judicial sales of vessels and to establish more clearly the prior registry's obligation to cancel the registration and issue the appropriate certificate. No silver bullet is on the horizon as of yet. In the meantime, a buyer in a foreclosure sale needs to take additional steps to make sure that it is not acquiring a vessel with unresolvable issues on reregistration.

The devil is very much in the details. Few nations accept decisions by administrators or courts in other countries requiring the country of registration to delete vessels from its national registry. This may be due in part to a lack of confidence in the integrity of the foreclosing nation's courts or government. It also may be due to registry-state restrictions on the sale of vessels out of registry, particularly without registry-state prior approval. Moreover, the admiralty court sale orders and bills of sale do not address any requirement as to the treatment of the prior registration, as court orders and bills of sale merely establish good title on a going-forward basis.

So what can the responsible bidder do to avoid or mitigate the risk evidenced in the *Goldfish* case? First and foremost, the bidder should take into consideration the registry of the vessel at auction and consult with counsel on the mechanics of deleting the vessel from the prior registry, a necessary step in registering the vessel in a new jurisdiction after foreclosure.[22]

While foreclosure itself is not called into question by the *Goldfish* case, the perceived value of the collateral sold at auction may well be affected in the future, particularly for vessels under flags that are deemed troublesome or unreliable in releasing vessels from their registries. Lenders, as well as bidders, should consider the mechanics not only of entering a registry, but also of departing one.

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Frank currently chairs The Maritime Law Association of the United States' standing committee on Marine Finance and also serves as the United

[15] *Id*. at 8–9.
[16] *Id*. at 10–1 and 18.
[17] *Id*. at 24.
[18] *See supra* note 19 at 155.
[19] *Id*. at 153.
[20] *Id*.
[21] Although no decision, published or otherwise, is yet available, there is apparently a similar scenario playing out in the High Court of Ireland, where a South Korean-flag vessel was sold at auction following arrest by a GECC affiliate, as mortgagee. *See* Geoff Garfield London, *Geneva Player Pursues GE Arm, TradeWinds*, March 31, 2011, also available at http://www.tradewinds.no/weekly/w2011-04-01/article579165.ece, published April 1, 2011 (last visited June 15, 2011). According to reports published in *TradeWinds*, the mortgagee refuses to discharge its mortgage of record in South Korea on grounds that such an action would defeat the priority of its claim in a related bankruptcy proceeding of the shipowner. The buyer claims that the mortgagee has a duty to do what it can to assure that the buyer has acquired title free of encumbrances. No resolution in the Irish courts has been reported thus far.

[22] Unofficially, certain open registries encourage those planning to bid on foreclosed vessels to discuss these issues with the intended new registry in advance to determine if there are ways to provide assurances that the residual mortgage filings will not hamper successful registration following foreclosure.

States member on the Comité Maritime International's Sub-Committee drafting a convention on recognition of foreign judicial sales of vessels.

Should a Dispute Under a Letter of Intent Be Arbitrated?

Introduction

This article will explore some issues concerning arbitration of disputes arising under a letter of intent (an "LOI"). Arbitration clauses are often included in the final transaction documents but are rarely found in an LOI. Although [the party (the "Offeror") offering a deal summarized in an LOI to the counterparty (the "Offeree")] the parties may be reluctant to burden the LOI with a dispute resolution provision, it may nevertheless be a good idea to consider whether arbitrating such disputes is appropriate.

Although one can debate the advantages of arbitration, final transaction documents, especially in cross-border transactions, often provide for arbitration as a means to avoid the inhospitable courts of a foreign jurisdiction, to better ensure confidentiality, and because an arbitration award may more easily be enforceable in some countries than a foreign judgment. The same considerations apply to a dispute arising out of an LOI. Such disputes include whether the LOI is binding, if a deposit is refundable when the deal collapses or whether a party failed to negotiate in good faith or deliberately failed to fulfill a condition to the transaction as a means of aborting the transaction.

The answer to the question whether such disputes should be arbitrated may depend on whether the question is asked of the Offeror or the Offeree. The Offeror may not need arbitration to pursue a claim against the Offeree if retention of a deposit is the Offeror's sole remedy or if the Offeror is less likely to assert a claim than the Offeree. Absent arbitration, the Offeree would have to assert its claim against the Offeror in a court having personal jurisdiction over the Offeror. If the Offeror is comfortable that a court in the Offeree's home country will not have jurisdiction over the Offeror, the risk of litigating in the Offeree's jurisdiction is reduced.

If Arbitration Is Not Desired

Avoiding arbitration is simple: a party can only be compelled to arbitrate pursuant to a binding, written (not necessarily signed) agreement to do so. If the LOI contains no arbitration clause and none can be inferred, there will be no basis for arbitration.

If Arbitration Is Desired

To provide for arbitration, the LOI must include an arbitration clause or effectively incorporate one by reference from another document binding on the parties. The first draft LOI can simply provide that "All disputes arising out of or related to this LOI shall be resolved in New York City, New York by arbitration in accordance with the rules in effect on the date of this LOI of the [specify the arbitration tribunal – e.g. the International Centre for Dispute Resolution]." Although such an abbreviated clause will leave issues unresolved about the arbitration, brevity may nevertheless be appropriate in an LOI because it is less obtrusive than a "full blown" arbitration clause and if not objected to, it should be sufficient to get the dispute and resolution of the omitted matters determined by the arbitrator in accordance with tribunal rules.

When signed by both parties, an LOI containing an arbitration clause will ordinarily create a binding agreement to arbitrate. Even LOIs providing that the parties will only be bound by final transaction documents often specify that some LOI terms are binding, such as the provisions concerning payment and refund of deposits and fees, confidentiality and perhaps a "no-shop" provision. An arbitration clause can easily be included in this list.

The Risk of the Unintentional Arbitration Clause

One can have a binding arbitration agreement embedded in a non-binding LOI because in determining whether there is a binding agreement

to arbitrate, the arbitration clause will generally be treated as a separate contract.[1] Suppose the Offeror sends a non-binding LOI that includes an arbitration clause and the Offeree does not strike or object to it, but instead provides comments to other provisions in the LOI, pays the deposit to the Offeror and proceeds with negotiations for the definitive documents before the deal collapses with each side blaming the other.[2] Although these facts, without more, should not give rise to an enforceable arbitration agreement, the result may not be certain and there could be a question of whether the existence of a binding arbitration agreement will be decided by an arbitrator. The party receiving a draft containing an arbitration clause should strike or otherwise indicate its rejection of the clause if it does not want to arbitrate LOI disputes. At least by so doing, the issue of arbitration can be discussed along with the other business terms at the LOI stage.

Under New York and U.S. federal law, absent a contrary agreement, the question whether a binding arbitration contract exists is a question of law to be decided by the court, not by an arbitrator.[3] However, absent a contrary agreement, the specification in the arbitration clause of the tribunal selected to act as arbitrator invokes the rules of that tribunal and may result in the arbitrator deciding the question whether a binding arbitration agreement exists.[4] Article 15 of the International Dispute Resolution Procedures of the ICDR provides that "[t]he Tribunal shall have the power to rule on its own jurisdiction, including any objections with respect to the existence, scope or validity of the arbitration agreement." To the same effect are Rule 8(a) of the AAA Commercial Arbitration Rules, Article 23 of the Rules of the London Court of International Arbitration, and Article 6.2 of the Rules of Arbitration of the International Chamber of Commerce.

Conclusion

Arbitration clauses are not often included in an LOI, but arbitration might make sense in some situations. Parties should be clear in expressing their intent regarding the existence of an arbitration agreement to avoid the need for a court or an arbitrator to decide whether a binding arbitration agreement exists concerning disputes arising out of the LOI.

If you have any questions about this article, please contact **John Karesh** at +1 (212) 407 6990, who gratefully acknowledges the contributions to this article by **Marcus Williams**, a summer associate at Vedder Price. ■

1 Rent-A-Center, West, Inc. v. Antonio Jackson, ___ U.S. ___, 130 S. Ct. 2772 (2010) (U.S. federal law); 5 N.Y. Jur. 2d., § 89 (New York law).

2 The same question arises if the Offeror sends an LOI without an arbitration clause and the Offeree sends a marked-up draft of the LOI back to the Offeror that adds an arbitration clause. A discussion of the extent, if any, to which Section 2-207 of the Uniform Commercial Code (the so-called battle of the forms section relating to sales of goods) applies to a determination under these facts of whether there is a binding arbitration agreement is beyond the scope of this article.

3 *See* Three Valleys Municipal Water District v. E.F. Hutton & Company, Inc., 925 F.2d 1136 (9th Cir. 1991) (U.S. federal law); 5 N.Y. Jur. 2d., §§ 69–70 (New York law). The Federal Arbitration Act of the United States (9 U.S.C. § 1 *et seq.*) governs arbitration of disputes arising *inter alia* under contracts affecting interstate commerce and preempts more restrictive state law. *See*, *e.g.*, 5 N.Y. Jur. 2d., § 69. Almost any finance, lease or sale transaction relating to an aircraft will be deemed to "affect interstate commerce." But since there is no inconsistency between New York State and federal law on this issue, there should be no federal preemption.

4 Apollo Computer, Inc. v. Helge Berg, et al., 886 F.2d 469 (1st Cir. 1989); In re Application of RD Mgmt. Corp., 196 Misc. 2d 579, 766 N.Y.S. 2d 304 (Sup. 2003) (relating to the scope, not existence, of an arbitration agreement). The party opposing arbitration will probably not want to have the dispute resolved by an arbitrator who gets paid only when there is a controversy to arbitrate, and who is not necessarily bound to follow governing law. But even court decisions are often based on a policy that strongly favors arbitration.

FAA Scrutinizes Non-Citizen Trusts

For more than 30 years, individuals and business entities which desired to "N" register an aircraft in the United States but could not certify that they met the U.S. citizenship requirements under the Federal Transportation Code[1] have relied on non-citizen trusts (NCTs) to effect U.S. registration. Aircraft owners, operators and financing parties have employed NCTs and relied on the Federal Aviation Administration's (FAA) pertinent regulations and course of conduct for legal compliance.[2]

1 Generally, (i) a corporation only qualifies as a U.S. citizen if its president and 2/3 of its other managing officers and directors are U.S. citizens, and 75% its voting shares are held by U.S. citizens, and (ii) a partnership qualifies as a U.S. citizen only if it is owned solely by natural persons who are U.S. citizens.

2 NCTs are discretionary trusts established by one or more beneficiaries that are not U.S. citizens for purposes of registering an aircraft with the FAA registry. NCT trust agreements must contain provisions complying with the pertinent regulations, including ceding certain "control rights" to the trustee.

NCTs have many legitimate business purposes. A non-citizen purchaser might temporarily register an aircraft pursuant to an NCT while it is being modified in the U.S. before being exported and delivered to another country. Non-U.S. citizen operating or finance lessors often use NCTs when registering aircraft leased to U.S. airlines. Many financing parties require U.S. registration to take advantage of benefits attributable to the aircraft being maintained under the FARs and more favorable commercial remedies, particularly remedies under the Cape Town Convention, if available. Moreover, non-U.S. citizen lenders that repossess an aircraft may use an NCT to register the aircraft. NCTs are essential for "N" registration of corporate aircraft being operated by many U.S. companies that do not satisfy U.S. citizenship requirements. In certain circumstances, without NCTs, non-U.S. citizen aircraft owners might not have any registry available.

During the spring of 2010, the FAA raised doubts about NCT registrations. The aviation industry warned the FAA that any change in the FAA's approach would effectively serve as a moratorium on NCT-registered aircraft, with a variety of unintended consequences. The FAA ultimately agreed to resume its long-standing procedures regarding NCT registration. However, the FAA did note that it would continue to scrutinize the use of NCTs. After deliberating for almost one year, the FAA issued a public notice to the industry, scheduling an open hearing on June 1, 2011 in Oklahoma City. The notice included a series of questions on the use of NCTs to be addressed at the hearing. Aviation industry participants submitted comments responding to the notice and engaged in formal and informal exchanges with the FAA at the June 1 meeting.[3]

The takeaways from the June 1 meeting were comforting to industry participants who attended. First, it is unlikely that the FAA will issue regulations or opinions rendering all NCT arrangements invalid. Second, many of the FAA's NCT-related concerns appear resolvable by revising the standard form NCT trust agreements, including strengthening the trustee's control of essential aircraft-related matters. Third, changes to the NCT process might be made so that trustees can better serve as a resource to the FAA for information about trustors/beneficiaries, operators and operations of NCT-registered aircraft, including by establishing further NCT-related information reporting mechanisms. At the June 1 meeting, and by follow-up submissions to the FAA, aviation industry advocates offered additional comments and proposed resolutions addressing the FAA's NCT-related concerns and urged the FAA to further collaborate with industry participants regarding any actions that may be taken to address these concerns, all while maintaining a "status quo" treatment of NCTs while the FAA's evaluation continues.

As of the writing of this summary, the FAA has not responded to the industry's comments and proposed resolutions to the FAA's concerns. The least intrusive change resulting from the FAA's recent NCT-related activities might be its imposing additional reporting requirements on operators to the extent not already covered by existing regulatory requirements, but consistent with (i.e., not modifying) existing U.S. aviation law. However, as always, it is difficult to predict how the FAA ultimately will address NCTs, and financing parties and lessors should continue to monitor the FAA's position on NCTs and be particularly wary of efforts to extend any compliance requirements to passive parties having an interest in an aircraft.

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[3] Representatives of the FAA attributed the recent NCT scrutiny to concerns involving its responsibilities to monitor, enforce and ensure compliance with the airworthiness and maintenance standards required of FAA-registered aircraft; failure to satisfy these responsibilities could lead to a potential dereliction by the U.S. of its duties as a Chicago Convention contracting state. It also is likely that NCT-related concerns have been raised by homeland security and drug enforcement officials.

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The attorneys in the firm's Global Transportation Finance team represent lessees, lessors, financiers, equity investors and related parties in a broad range of equipment finance transactions, including those involving aircraft, railcars, locomotives, vessels, computers, medical equipment, industrial production equipment, satellites, cars and trucks.

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