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Global Transportation Finance Newsletter

In This Issue...

Another Hurdle Cleared on the Path to Ratification – The UK and the Cape Town Convention and Aircraft Protocol 1

Ship Financing Charter Loses Key to Texas Court 3

Get the FATCA Outta Here? Not Likely. 6

Firm Expands to Los Angeles

Following the opening of our San Francisco office in 2013, we are pleased to announce our recent move into Los Angeles, adding enhanced corporate experience in mergers and acquisitions and complex corporate transactions.

Another Hurdle Cleared on the Path to Ratification – The UK and the Cape Town Convention and Aircraft Protocol

"*The Government has carefully considered the views of the respondents to the call for evidence and has decided to proceed with ratification of the treaty*" – para. 1.4 - Convention on International Interests in Mobile Equipment (the Convention) and the Protocol thereto on Matters Specific to Aircraft Equipment (the Protocol), Government Response to the Call for Evidence (the Government Response).

As part of the UK Government's ongoing consultation on the ratification of the Convention and the Protocol, the Government Response was published on 6 December 2013 – it followed a call for evidence issued on 30 July 2010 and a summary of responses published in February 2011. The Government Response is cautiously optimistic about any benefits that may accompany ratification, noting that it:

- *may* reduce financing costs for airlines in relation to their purchase and leasing needs, particularly through the capital markets;
- would bring *a benefit* in terms of the ability to register interests against engines (currently interests may only be registered against airframes in the UK – common with many other jurisdictions);
- *could remove pressure* from the closing of aircraft finance transactions because the International Registry is available online throughout the year (currently the registration section of the Civil Aviation Authority in the UK is only available between 10 a.m. and 4 p.m. London time);

Neil Poland & David Brookes Join Vedder Price London as Partners

Neil Poland has a significant practice that spans Europe, Asia, the Middle East and the United States. He acts for clients in the aviation, rail and banking industries on asset and structured finance deals, including restructurings and operating lease structures, export credit financings, public debt issues and aircraft delivery.

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- *could reduce* problems arising out of conflict of laws on cross-border finance and leasing transactions; and
- *may resolve* some of the concerns that arise on the application of the rules on *lex situs* in relation to English law aircraft mortgages and title transfers.

Points of Interest

The ASU Discount

The Government Response also suggests that, following ratification, UK airlines may be eligible for the OECD Aircraft Sector Understanding (the ASU) discount, which may be granted by an Export Credit Agency (an ECA) in relation to its support for the financing of aircraft. The discount for UK airlines is normally restricted due to the so-called "Home Country Rule" – an unwritten rule, which has traditionally prevented airlines in "producer nations" (i.e., the UK, France, Germany, Spain and the United States) from receiving export credit support from the ECAs for aircraft manufactured in those countries – predominantly Airbus and Boeing aircraft.

British Airways (BA) was, however, able to obtain Euler Hermes (the German ECA) support for its JOLCO transaction for an Airbus A380 in September 2013. It should also be noted that the Home Country Rule does not apply for, amongst others, Embraer or Bombardier aircraft.

Capital Markets Ratings

One advantage of ratifying the Convention and the Protocol by adopting the qualifying declarations set out in the ASU – the so-called "gold standard" – is the positive weighting attached to this standard by the ratings agencies when considering the ratings for capital markets transactions. If the UK adopts these "gold standard" qualifying declarations, even if no export credit-supported aircraft financing transaction is ever entered into by a UK airline, full implementation of the qualifying declarations may well result in the ratings agencies providing more favourable ratings for capital markets transactions than are available now.

One of the principal qualifying declarations is the adoption of "Alternative A", the insolvency regime set out in Article XI (*Remedies on insolvency*) that provides, arguably, the best legal protection for creditors in aircraft financing transactions. The Government has not yet determined whether to implement Alternative A, and the Government Response indicates this will be consulted upon. The UK's ability to adopt Alternative A is restricted by the declarations made by the EU (see "*Next Steps*", following), which require that implementation may only be made through amendment to national insolvency laws. In capital markets transactions utilising an Enhanced Equipment Trust Certificates vehicle (EETC) involving airlines located in countries that have ratified the Convention and the Protocol other than the United States[1] (e.g. Canada and the UAE), the adoption of Alternative A has been a focus of the ratings agencies.

Repossession in the UK

In the UK, BA's "British Airways 2013-1" EETC launched in June 2013 (covering 6 Airbus A320s, 2 Boeing B777-300ERs and 6 Boeing B787-8s) without the benefit of the Convention and the Protocol's Alternative A.

When giving a rating for the EETC, Fitch noted "… *[its] legal analysis for this transaction relied on the general insolvency regime in the UK, which [it] considers to be strong for creditors in general, but notes that there are no special carve-outs for aviation assets similar to 1110 or the CTC. However, the creditor-friendly nature and reliability of the UK legal regime, precedent under UK law, and several structural elements of the transaction provide significant credit protection, making possible the application of [its] EETC criteria to this transaction.*[2]"

On the one hand, it might be argued that the repossession regime in the UK is sufficiently robust so as not to need Alternative A to be adopted. However, previously favourable statements by ratings agencies are no guarantee that the UK's repossession regime will continue to be regarded this way. Adoption of Alternative A should ensure that the UK's airlines are at least on a par, in this respect, with the airlines of other countries that have adopted Alternative A.

Lex Situs

Ratification of the Convention and the Protocol has, as some contributors to the Call for Evidence highlighted to the Government, raised the possibility of ridding English law of fundamental issues with respect to the creation of valid mortgage interests in aircraft and valid title transfer (if the aircraft is located outside the UK at the relevant time). The rule under English law is that the creation of a mortgage interest or title transfer under an agreement governed by English law must be valid in the jurisdiction in which the aircraft is located at the relevant time – the application of the rules on *lex situs* as confirmed in *Blue Sky*.[3] Some commentators have (perhaps hopefully) suggested that, because the Convention and the Protocol do not look to *lex situs* for the purposes of considering when an international interest has been created, *lex situs* would have no relevance for the creation of valid mortgage interests (or for valid title transfers) under English law following ratification of the Convention and the Protocol.

The UK Government correctly confirms, in the Government Response, that ratification of the Convention and the Protocol will not solve the *Blue Sky* issue. Ratification allows registration of interests against UK "debtors" (as defined in the Convention and the Protocol) and in relation to UK-registered aircraft, but this does not resolve general issues of *lex situs* – creditors must still look to English law (which applies *lex situs* rules) to determine whether an interest has been validly created or transferred.

Ratification of the Convention and the Protocol may represent an opportunity to make an additional amendment to English law to address the *lex situs* issues but the Government Response does not indicate that this is a matter the Government is considering.

Next Steps

The Government Response does not set out a timetable for the ratification of the Convention and the Protocol, but notes that there will now be a consultation on the declarations to be made in relation to the treaty.

The UK's choices in relation to the declarations are limited, in certain circumstances, by its membership in the European Union. The EU acceded to the Convention as a "regional economic integration organization" (pursuant to Article 48 of the Convention) and made certain declarations that bind the Member States and have the effect that:

- no Member State may make a declaration in relation to Article XXI of the Protocol, which relates to the jurisdiction that has competency in relation to an aircraft object – Member States' rules governing jurisdiction are determined pursuant to Council Regulation (EC) No. 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgment in civil and commercial matters – nor will Member States be able to amend their national law so that the same substantive outcomes are produced as if a declaration had been made;
- no Member State may make a declaration in relation to Article VIII of the Protocol, which relates to the "choice of law" provisions for agreements – Member States' rules governing choice of law are determined pursuant to the Rome I Regulation[4] – nor will Member States be able to amend their national law so as to achieve the same result; and
- no Member State may make a declaration in relation to Articles XI or XII of the Protocol, which relate to (a) in the case of Article XI, the insolvency remedies that will apply (i.e., selection of Alternative A or Alternative B) and (b) in the case of Article XII, the required co-operation by national courts in the jurisdiction where the aircraft is located with the applicable foreign courts and foreign insolvency administrators. Member States' rules governing insolvency are subject to Council Regulation (EC) No. 1346/2000 of 20 May 2000 on insolvency proceedings – Member States will, however, be able to amend their national law so as to produce the same substantive result.

Conclusion

Whilst no timetable for implementation was set out in the Government Response, the outlook for implementation in the UK appears to be good. The Government Response clearly and precisely sets out reasons why implementation makes sense for the UK, even if the benefits are not guaranteed, and dismisses the notion that implementation will solve the *Blue Sky* issue.

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1 While the United States did not adopt Alternative A in its ratification of the Convention, Section 1110 of the United States Bankruptcy Code is widely viewed as providing substantially equivalent protections to Alternative A, and was the model that Alternative A was based on.

2 Fitch Ratings, British Airways 2013-1.

3 *Blue Sky & Others v. Mahan Air* [2009] EWHC (Comm), [2010] EWHC 631 (Comm).

4 Regulation (EC) No. 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations.

Cape Town: New Contracting States

Mozambique – effective November 1, 2013

Kuwait – effective February 1, 2014

Malawi – effective May 1, 2014

Ship Financing Charter Loses Key to Texas Court

The federal district courts of the United States provide an efficient and stable dispute resolution forum for marine lenders with distressed shipping debt on their hands. However, because the federal district courts are courts of limited jurisdiction, an aggrieved marine lender must have a metaphorical key to the court – known as

subject matter jurisdiction – in order to gain entry. Diversity jurisdiction[1] and federal question jurisdiction[2] are popular forms of subject matter jurisdiction, but they are not always available to maritime litigants.

In the absence of diversity or federal question jurisdiction, most marine lenders will invoke the admiralty and maritime jurisdiction of the court in order to gain entry. Such jurisdiction is proscribed by the United States Constitution[3] and federal statute[4] and is typically founded upon the existence of a maritime claim, which is usually based upon a maritime contract or a maritime tort. For most marine lenders seeking to enforce their shipping loans this means having an enforceable maritime contract in the jurisdictional sense.

What Is a Maritime Contract?

The answer is not always intuitive or obvious. The U.S. Supreme Court has stated that courts cannot look to "whether a ship or other vessel was involved in the dispute" or "to the place of the contract's formation or performance" in deciding whether a contract is a maritime one.[5] Rather, courts must examine "the nature and character of the contract" with a focus on whether the contract has "reference to maritime service or maritime transactions."[6] Although "maritime commerce" must be the principal focus of a contract, the Supreme Court has rejected the notion that "only contracts embodying commercial obligations between the 'tackles' … have maritime objectives."[7] As maritime commerce has evolved over time, the Supreme Court has made it clear that the shore line no longer provides a bright-line test between maritime and non-maritime contracts.

For purposes of marine finance in the United States, several long-established jurisdictional principles remain true. Shipbuilding contracts are thus far not viewed as maritime contracts[8] and neither are contracts for the purchase and sale of ships.[9] And although agreements to borrow money are typically viewed as non-maritime in nature, preferred ship mortgages are maritime contracts and can be enforced by statute in federal court along with the underlying loan agreement that is secured by the mortgage.[10] In addition, contracts for the carriage of cargo – including voyage charters, time charters and bareboat charters – have been long recognized as maritime contracts for jurisdictional purposes.[11]

Are Ship Financing Charters Maritime Contracts?

Ship financing charters are debt structures employed by a lender and borrower – typically in lieu of a traditional mortgage – to finance the use and acquisition of a vessel by the borrower. However, unlike a preferred ship mortgage, there is no federal statute that allows the enforcement of a financing charter in the federal district courts. So the question is whether a ship financing charter is a maritime contract for jurisdictional purposes. That was the issue in *Icon Amazing L.L.C. v. Amazing Shipping, Ltd.*, 951 F. Supp. 2d 909 (S.D. Tex. 2013) (*Icon Amazing*), a case decided by a federal district court in Texas in 2013, and one that is of considerable importance to marine lenders who offer charter financing products.

Facts of Icon Amazing

The *Icon Amazing* case involved a sale and leaseback financing of the supramax bulk carrier AMAZING (the Vessel) – constructed in 2010 for the Turkish shipping company Geden Holdings Limited (Geden) at a cost of US$33,500,000. The 100% financing provided by ICON Capital (ICON) replaced construction financing previously provided. The financing structure required the sale of the Vessel from Geden to a special purpose entity[12] owned by one or more investment funds managed by ICON (the Owner), with a simultaneous charter back to a special purpose entity owned by Geden (the Charterer) on a demise basis. The principal structuring agreements were heavily amended versions of the standard Norwegian Saleform 1993 and the BIMCO Standard Bareboat Charter "BARECON 2001" (the Charter).

The Charter was for a seven-year term with intermediate purchase options in favor of the Charterer and an end-of-charter purchase obligation requiring the Charterer to purchase the Vessel. Charter hire was to be paid on a "hell or high water" basis. Credit support was provided in the form of an on-demand corporate guarantee provided by the Charterer's parent (the Guarantor). The Charter also contained numerous financial covenants to be observed by the Guarantor, as well as top-off provisions requiring the Charterer to provide additional security or pay additional charter hire in the event that the Vessel's fair market value fell below certain agreed thresholds.

Due to market conditions prevalent at the time, the transaction failed. As the Vessel's market value declined, the Owner required additional charter hire and security under the Charter's top-off provisions. Freight rates that the Vessel was able to secure in a soft market were insufficient to pay basic charter hire (principal and interest) under the Charter. The Charterer defaulted under the Charter and, after a period of unsuccessful negotiations, the Owner commenced an action against the Charterer and Guarantor in a federal district court in Texas.

Federal Court Jurisdictional Analysis

The Owner sought access to the court on grounds that the court possessed admiralty and maritime jurisdiction because the Charter was a maritime contract. Once inside the court, the Owner sought and obtained a writ of maritime attachment under Rule B of the Supplemental Rules to secure its claims against the Charterer and Guarantor. The property that formed the object of the maritime attachment was another vessel (the M.V. HERO) allegedly owned by Geden or one of its subsidiaries. On a successful motion by the defendants to vacate the attachment, the court determined that it lacked admiralty jurisdiction because the Charter was not a maritime contract.

The court found that the Charter required the Charterer to purchase the Vessel at the end of the term.[13] The court also found that charter hire payments were not market-based but rather installments of the full purchase price for the Vessel.[14] Finally, the court found that the Owner's claim was not only for unpaid charter hire, but also for additional security under the top-off clause.[15] On the basis of these findings, the *Icon Amazing* court determined that the Charter was not a "conventional maritime charter party" but, instead, an "inseparable component of a larger non-maritime vessel sale/financing transaction."[16] In short, the court ruled that the Charter was nothing more than a sale and purchase contract in charter party clothing and, as such, could not be recognized or enforced as a maritime contract.

Although the Charter clearly had non-maritime aspects, such as the purchase option and obligation, it also had distinct maritime provisions that could be found in many "conventional" charter parties. Other courts have had no trouble separating the non-maritime from the maritime aspects of a charter party, and enforcing the latter.[17] Moreover, it is clear from its complaint that the Owner was seeking to recover unpaid charter hire, and was not suing to enforce any of the Charterer's purchase options or obligations. Regardless of how it was determined and agreed between the parties, the payment of charter hire formed the basis of the distinctly maritime bargain by which the Owner agreed to demise the Vessel to the Charterer.

Conclusion

The *Icon Amazing* decision serves as an important reminder to marine lenders that the enforcement of financing charters in U.S. federal district courts may be an uncertain proposition unless the lender possesses some other jurisdictional key to the court. In this regard, lenders should be mindful that, in 2013, the financing charter initiative developed by the Marine Financing Committee of the Maritime Law Association of the United States became law in the Republic of the Marshall Islands.[18] Under this law, vessel financing charters that are recorded as such against ships registered in the Marshall Islands will be treated as preferred ship mortgages as a matter of law. Although principally designed to mitigate re-characterization risk associated with finance charters generally,[19] the law also creates a wholly independent basis of admiralty jurisdiction for the enforcement of finance charters in the United States. Thus, any financing charter recorded against a vessel registered in the Marshall Islands will have the status of a preferred mortgage under Marshall Islands law, thereby allowing enforcement as such in a U.S. district court,[20] regardless of the maritime characteristics of the charter itself.

If you have questions about this update, please contact John E. Bradley at jbradley@vedderprice.com or +1 (212) 407 6940.

1 28 U.S.C. §1332. Diversity jurisdiction exists when the amount in dispute exceeds a certain threshold, (currently US$75,000) and the lawsuit is between citizens of different states or citizens of a state and a foreign country.

2 28 U.S.C. §1331. Federal question jurisdiction extends to all civil actions arising under the Constitution, laws or treaties of the United States.

3 Article III, Section 2 of the Constitution provides that "The judicial power shall extend … to all cases of admiralty and maritime jurisdiction."

4 28 U.S.C. §1333.

5 *Norfolk Southern Railway Co. v. Kirby*, 543 U.S. 14 (2004).

6 *Id., citing North Pacific S.S. Co. v. Hall Bros. Marine Railway & Shipbuilding Co.*, 249 U.S. 119, 123 (1919).

7 *Id.*

8 *Kossick v. United Fruit Co.*, 365 U.S. 731 (1960).

9 *The Ada*, 250 F. 194 (2d Cir. 1918); but see *Kalafrana Shipping Ltd. v. Sea Gull Shipping Co.*, 591 F. Supp. 2d 505 (S.D.N.Y. 2008) (holding post-*Norfolk Southern Railway* that a ship sale and purchase agreement is a maritime contract for jurisdictional purposes).

10 See 46 U.S.C. §31325; *see also Detroit Trust Co. v. The Thomas Barlum*, 293 U.S. 21 (1934).

11 *Marine Logistics, Inc. v. England*, 265 F.3d 1322 (Fed. Cir. 2001).

12 Special purpose entity.

13 951 F. Supp. 2d at 917.

14 *Id.*

15 *Id.*

16 *Id.*

17 *Jack Neilson, Inc. v. TUG PEGGY*, 428 F.2d 54 (5th Cir. 1970).

18 *See* P.L. 2013-5 Nitijela Bill No. 25, March 6, 2013, "to amend Sections 112 and 317 of the Republic of the Marshall Islands Maritime Act (the Act), and to add a new Section 302A to the Act."

19 *See e.g., American President Lines v. Lykes Bros. S.S. Co.*, 196 B.R. 574 (Bankr. M.D. Fla. 1996).

20 Under U.S. law, a mortgage, hypothecation or similar charge against a foreign flag vessel will be recognized as a preferred ship mortgage in the United States if it "was executed under the laws of the foreign country under whose laws the ownership of the vessel is documented and has been registered under those laws in a public register at the port of registry of the vessel or at a central office." 46 U.S.C. §31301(6)(B).

Get the FATCA Outta Here? Not Likely.

Despite several delays, it seems almost certain that the "Foreign Account Tax Compliance Act"[1] (FATCA) will finally go into effect on July 1, 2014. FATCA is a withholding tax regime designed to prevent U.S. taxpayers from hiding income offshore and avoiding U.S. taxes. FATCA's impact will need to be considered in most cross-border transportation finance transactions. While the FATCA rules are complex and a thorough treatment of them is beyond the scope of this article, below are some key issues relating to the impending effectiveness of FATCA that are important to keep in mind.

When Do the FATCA Rules Go Into Effect?

After several delays and extensions, the FATCA rules are currently scheduled to become effective with respect to payments of interest, dividends and rentals and other similar payments made on or after July 1, 2014. While this deadline has been extended several times, the Internal Revenue Service (IRS) has repeatedly stated that no further delays are anticipated.[2] Obligations outstanding on July 1, 2014 will be "grandfathered," and the FATCA rules will not apply to payments made under these pre-existing obligations,[3] unless such obligations are substantially modified after that date.[4] Withholding on payments of "gross proceeds" is not set to begin until after December 31, 2016. Although FATCA withholding will not apply until July 1, 2014, parties who are currently negotiating transportation finance transactions are typically taking into account the possible application of FATCA withholding in the future and are documenting such transactions accordingly.

Overview of the Rules

In general, FATCA imposes a 30% withholding tax on "withholdable payments" to certain non-U.S. persons (foreigners). Withholdable payments broadly include any payment of: (a) U.S. source interest (including OID), dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments and other fixed and determinable annual or periodical gains, profits or income, or (b) U.S. source gross proceeds from the sale or other disposition of any property of a type that can produce U.S. source interest or dividends.[5]

Since it is the payor that is obligated to withhold from payments if withholding is required under FATCA, any payor making a payment to a foreigner should confirm that such payment is either (a) related to an obligation to which FATCA does not apply (such as a grandfathered obligation or a non-U.S. source obligation), or (b) made to a foreigner who can provide proof of exemption from FATCA withholding.

Determining U.S. Source

Determining the source of interest payments is usually straight forward, as the jurisdiction of the borrower generally determines the source.[6] However, in the complex financing structures often utilized for transportation finance transactions, a deeper analysis may be required. For instance, in certain cross-border structured finance transactions a nominal U.S. borrower is used to "own" and "lease" the aircraft to a foreign airline lessee. However, for U.S. tax purposes this borrower is merely an agent, or conduit, for the lessee and the lessee would be treated as the owner of the aircraft. In these circumstances, notwithstanding the nominal U.S. borrower, the parties take the position that, since the true borrower is the foreign airline, the interest is not U.S. source and thus not subject to the FATCA rules.

While sourcing rental payments may seem straightforward at first glance, as you generally look to the jurisdiction where the asset is used, the analysis become trickier for transportation equipment like aircraft.[7] As aircraft may be used in many jurisdictions, the Internal Revenue Code provides special rules treating as U.S. source: (a) 100% of the income attributable to flights that begin AND end in the U.S., and (b) 50% of the income attributable to flights not described in (a) which begin OR end in the U.S.[8] Thus, even aircraft leased to a foreign carrier could generate U.S. source rental income if, for example such foreign carrier operates flights to the U.S. or has the ability to sublease the aircraft to a U.S. carrier. For these reasons, it is prudent to include FATCA provisions in aircraft leases with foreign carriers, even where such leases do not initially seem as though they will generate U.S. source income.[9]

Avoiding Withholding Under FATCA

A payor of U.S. source income will need to ensure that its payee is exempt from FATCA withholding. Payments to U.S. entities are generally exempt from FATCA withholding and a payor should collect a Form W-9 or other appropriate evidence of U.S. status when making a payment of U.S. source income to a U.S. entity in order to confirm FATCA withholding is not required.

FATCA is directed primarily at "foreign financial institutions" (FFIs), but also covers "non-financial foreign entities" (NFFEs). While there are various methods for FFIs and NFFEs to be exempt, several of the most common ones are discussed below.

An FFI may be exempt either by reason of the government of its home jurisdictions having entered into an intergovernmental agreement (IGA) with the U.S. or by entering into an agreement with the IRS to report U.S. account holders. There are two types of IGAs: (a) Model 1 IGAs, whereby the FFIs report to their local government, which shares the relevant information with the IRS, and (b) Model 2 IGAs, whereby the FFIs report directly to the IRS. The U.S. and numerous foreign jurisdictions have concluded IGAs[10] and FFIs in a country with an IGA can obtain a "global intermediary identification number" (GIIN), which can be supplied to payees to evidence exemption.

NFFEs can obtain exemption from FATCA by confirming they are the beneficial owner of the payment and reporting their substantial (10% or more) U.S. owners, if any. Reporting information includes name, address and U.S. taxpayer identification number (TIN) of U.S. owners. Under certain circumstances the NFFE can report its ownership information to the IRS rather than the payee. In addition, certain classes of NFFEs are exempt, such as publicly traded companies or companies predominantly engaged in an active business. It remains to be seen whether a leasing company will be considered to be engaged in an active trade or business (and what tests will be applicable to qualify for this status).

When making a payment of U.S. source income to a foreigner, a payor should collect a Form W-8BEN-E to confirm the payee's FATCA exemption status.[11]

Negotiating and Documenting FATCA Provisions

Bad news – you will probably need to get tax lawyers involved. Many, if not most, parties seem to be taking a cautious approach and are inserting FATCA provisions where there is any possibility that the payments could be U.S. source currently or in the future. The Loan Market Association has drafted a variety of "standard" provisions but cautions that there are no simple drafting solutions.

Approaches to the allocation of risk vary from a shared approach to an allocation of all of the risk to either the borrower or the lender, in the case of a secured financing, or the lessee or the lessor, in the case of a lease. Borrowers and lessees often make the argument their lender or lessor, as the case may be, should "come to the table" as FATCA compliant and be able to demonstrate such compliance or suffer withholding if they cannot. Lessors and lenders, on the other hand, often make the argument that they should not be at risk for changes in U.S. law. However, these perspectives should not be over emphasized as each transaction needs to be examined in the light of the particular parties and circumstances. In the short run, the negotiation and documentation of these provisions will continue to require time and effort. In the long run, the terms and allocations of risk will likely standardize in a manner similar to how U.S. withholding tax provisions have standardized over the years.

* * *

The above is intended as a practical summary relating to certain key aspects of FATCA as it affects transportation finance transactions. A complete explanation of the FATCA rules is far beyond the scope of this article. The key takeaway is that you need to prepare now to deal with the FATCA rules to avoid 30% withholding on payments relating to U.S. source obligations.

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1 I.R.C. §§ 1471-1474.

2 "Final" FATCA regulations were published in the Federal Register on March 6, 2014 (Fed Reg Vol 79 No 44 p. 12812).

3 Technically the obligation needs to be issued before July 1, 2014 and outstanding on July 1, 2014 in order to be grandfathered, and an obligation issued on July 1, 2014 does not qualify for the exception.

4 A substantial modification may be triggered by, among other things, a change in interest rate, maturity or obligor.

5 Unlike traditional withholding rules, the FATCA regime will eventually apply to proceeds from the sale or other disposition of instruments producing U.S. source interest or dividends. The rules are broad enough to include principal payments on debt instruments.

6 I.R.C. § 861(a)(1).

7 I.R.C. § 861(a)(4) covering rentals generally.

8 I.R.C. § 863(c) covering transportation income which includes aircraft rentals (I.R.C. § 863(c)(3)(A)).

9 Where there is a foreign lessee with no other U.S. payor connection, it remains to be seen how the IRS will enforce the FATCA withholding obligation against the foreign lessee with minimal U.S. contacts (e.g., such as merely flying back and forth to and from the U.S.).

10 The U.S. has concluded Model 1 IGAs with: Canada (2-5-2014), Cayman Islands (11-29-2013), Costa Rica (11-26-2013), Denmark (11-19-2012), Finland (3-5-2014), France (11-14-2013), Germany (5-31-2013), Guernsey (12-13-2013), Hungary (2-4-2014), Ireland (1-23-2013), Isle of Man (12-13-2013), Italy (1-10-2014), Jersey (12-13-2013), Malta (12-16-2013), Mauritius (12-27-2013), Mexico (11-19-2012), Netherlands (12-18-2013), Norway (4-15-2013), Spain (5-14-2013) and the United Kingdom (9-12-2012); and Model 2 IGAs with: Bermuda (12-19-2013), Chile (3-5-2014), Japan (6-11-2013) and Switzerland (2-14-2013).

11 A new W-8BEN-E form will be used for foreign entities and will include the appropriate information to demonstrate FATCA compliance or an exemption from FATCA withholding. Note that a proper exemption from "regular" U.S. withholding will also need to be documented. It is possible that a payee may be exempt from FATCA withholding but not regular withholding.

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