Global Transportation Finance Newsletter

September 2020

In This Issue

Sudan Economic Sanctions and Export Controls: A Primer for Aircraft Lessors

The status of Sudan often arises for aircraft and jet engine lessors that require their lessees to comply with U.S. economic sanctions and export control programs. As the Office of Foreign Assets Control ("OFAC") of the U.S. Department of the Treasury has recently issued guidance on the Sudan program,[1] this is an opportune time to review the current status of Sudan insofar as the existing programs are concerned.

Many civil aircraft and jet engine leases contain provisions that prohibit the lessee and its allowed sublessees from operating the aircraft or engine to, from or within "prohibited" or "restricted" countries and regions, i.e., those countries and regions that are subject to comprehensive trade embargoes. From the standpoint of U.S. law, such countries and regions currently include Cuba, Iran, Syria, North Korea and the Crimea region of the Ukraine.

Prior to October 2017, Sudan and the Government of Sudan were also subject to comprehensive U.S. trade embargoes and, in accordance with their own compliance policies, U.S. lessors typically included lease restrictions prohibiting their lessees from conducting flights to, from or within Sudan or conducting business with Sudan Airways, which appeared on OFAC's list of Specially Designated Nationals ("SDN") at the time. U.S. Lessors that ignored or failed to enforce such restrictions learned from OFAC's 2019 settlement in *Apollo Aviation*[2] that their own nonfeasance could result in the imposition of civil penalties for violations of Sudanese sanctions.[3]

In October 2017, as a result of improving conditions, the United States began taking down existing trade sanctions against Sudan. Under Executive Orders signed by Presidents Obama and Trump,[4] prior Executive Orders were revoked, in whole and in part,[5] and dozens of Sudanese individuals and companies were removed from OFAC's SDN list.[6] In June 2018, the then-existing Sudanese Sanctions Regulations were removed, thereby opening the door for U.S. persons to re-engage in previously prohibited transactions with Sudan and the Government of Sudan.[7] As a result of these actions, new aircraft and jet engine leases that were entered into after June 2018 often blue penciled Sudan from the list of restricted or prohibited countries.

The Guidance recently published by OFAC reminds us, however, that the sanctions book on Sudan did not end there.

For starters, the "national emergency" with respect to Sudan, first declared by President Clinton in 1997 pursuant to the International Emergency Economic Powers Act ("IEEPA"),[8] has never been terminated and, in fact, has been expanded over the years. The declaration of a national emergency was last continued by President Trump on October 31, 2019[9] on grounds that, despite "positive developments" in Sudan, "the crisis constituted by the actions and policies of the Government of Sudan that led to the declaration of a national emergency" was then unresolved.[10]

Although seemingly odd that a national emergency still exists with respect to Sudan after 23 years,[11] the fact that it does makes the return of sanctions against Sudan by executive fiat that much easier. Under IEEPA, the President may exercise broad sanctions powers "to deal with any unusual and extraordinary threat, which has its source in whole or substantial part outside the United States, to the national security, foreign policy, or economy of the United States, *if the President declares a national emergency with respect to such threat.*"[12] Thus, the continuing existence of a national emergency involving Sudan under IEEPA allows the President to reimpose sanctions authorities against Sudan without Congressional direction or authorization.

Team News

Mark J. Ditto and Michael E. Draz Named to *Airline Economics* "40 under 40" list in 2020

***Mark J. Ditto** and **Michael E. Draz**, Vedder Price Shareholders and members of the Global Transportation Finance team, were recently named to Airline Economics "40 under 40" list which recognizes the most talented individuals in the commercial aviation industry.*

Mark J. Ditto Discusses Force Majeure and the Evolving Legal Landscape in Times of Turmoil on Aerospace Executive Podcast

Global Transportation Finance Shareholder **Mark J. Ditto** recently joined Craig Picken on the Aerospace Executive Podcast and discussed the evolving legal landscape in the commercial aviation industry.

In addition to the continuation of the national emergency against Sudan under IEEPA, Sudan also remains on the list of State Sponsors of Terrorism published by the U.S. Department of State, having first appeared on that list on August 12, 1993.[13] Sudan was viewed by the U.S. State Department at the time as harboring international terrorist groups and providing "a convenient transit point, meeting site and safe haven [sic] for Iranian-backed extremist groups."[14] Sudan's involvement with terrorist groups culminated in 1998 when al-Qaeda operatives simultaneously detonated truck bombs outside the United States Embassies in Kenya and Tanzania, killing 224 people, including 12 Americans.

Factual findings by a U.S. District Court later confirmed what many at the time believed: that Sudan "had knowingly served as a safe haven near the two United States Embassies and allowed al-Qaeda to plan and train for the attacks."[15] The court also found that Sudan "had provided hundreds of Sudanese passports to al-Qaeda, allowed al-Qaeda operatives to travel over the Sudan-Kenya border without restriction, and permitted the passage of weapons and money to supply al-Qaeda's cell in Kenya."[16]

In retaliation for the embassy bombings, the United States "conducted cruise missile strikes against [a] … pharmaceutical plant outside of Khartoum – which was believed at the time to be manufacturing chemical weapons for use by al-Qaeda and other international terrorist groups."[17] Bilateral relations between Sudan and the United States had reached their "low point." However, in the months following the September 11, 2001, attacks against the United States by al-Qaeda, Sudan "began a campaign of expelling foreign jihadists from its soil and cooperating with U.S. [counter-terrorism] officials in the fight against … al-Qaeda."[18]

In 2005, Sudan made peace with South Sudan and seemed to be on the road to removal from the U.S. terror list. However, those positive efforts became stalled as a result of subsequent fighting and human rights violations which occurred in the Darfur region of Sudan. Although Sudan was cooperating with the United States in the fight against international terrorism, its human rights record in Darfur created a split within the Obama administration on the de-listing issue.

Under the Trump administration, cooperation and relations between the two countries appear to be on a more positive trajectory. In April 2019, Sudan's long ruling President Omar al Bashir was ousted and his regime replaced by a transitional government led by Prime Minister Abdalla Hamdok, who is pressing for a peaceful transition to democracy. The transitional government is also attempting to conclude an agreement with the United States to settle damages claims resulting from the 1998 embassy bombings. Prime Minister Hamdok's goal is the eventual removal of Sudan from the list of State Sponsors of Terrorism and the establishment of normalized political, economic and trade relations with the United States. Although there are significant political and legal hurdles in the United States before that goal becomes reality, Secretary of State Michael Pompeo is on record as supporting immediate rapprochement.[19]

In the meantime, Sudan remains a State Sponsor of Terrorism, a designation that continues to have important implications for the export and re-export[20] of items subject to the EAR, including civil aircraft of U.S. origin and foreign-built aircraft incorporating more than a *de minimis* amount of U.S. controlled content. These implications flow from Section 1754(c) of the recently enacted Export Control Act of 2018, which states that a license is required for the "export, re-export, or in-country transfer" of controlled items to any country whose government has been found to repeatedly provide "support for acts of international terrorism."[21]

Because Sudan remains on the list of State Sponsors of Terrorism, exports and re-exports to Sudan are controlled for anti-terrorism ("AT") purposes and those controls will likely remain in place until a deal is reached to remove the country from the list. AT controls affect the export and re-export of civil aviation aircraft and related gas engines, parts and components under ECCN 9A991, which means that Sudan will be subject to AT controls under 15 C.F.R. §742.10 and a general licensing policy of denial if an appropriate license exception is not otherwise available under 15 C.F.R. §740. The most common license exception used in connection with civil aircraft is the one that applies to aircraft, vessels and spacecraft (AVS) – commonly referred to as the temporary sojourn license exception.[22] The application of AVS is subject to detailed requirements that must be strictly followed.

The OFAC Guidance provides a valuable reminder to U.S. aircraft lessors that Sudan remains a special case. Although no longer subject to a comprehensive trade embargo administered by OFAC, Sudan is still subject to a national emergency declaration under IEEPA and is still listed as a State Sponsor of Terrorism, a designation which triggers AT export controls. Aircraft and jet engine lessors whose lessees fly to Sudan should be mindful of that country's status and should ensure that their leases require compliance with sanctions and export controls otherwise applicable to the leased aircraft and engines.

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Thought Leadership

Shareholder and Head of New York Capital Markets group **Kevin A. MacLeod** recently published "How do Aircraft ABS structures perform if cash flows are reduced due to Covid-19" in *Ishka Insights*. The article includes a recap of the events of default and structural features that minimize the probability that an interest payment event of default will occur, as well as outlines structural credit protections.

Shareholders **Francis X. Nolan, III** and **John F. Imhof Jr.** were recently published in *Lexology Getting the Deal Through* for their latest Q&A, Marshall Islands. In the latest volume of their series of annual reports that provide international analysis in key areas of law and policy, Mr. Nolan and Mr. Imhof discussed legal ownership and registration of vessels, repayment options, ship mortgages and other liens over vessels, insolvency and restructuring administration under Marshall Islands law and much more.

Shareholder **Edward K. Gross** and Associates **Erich P. Dylus** and **Jonathan M. Rauch** of the firm's Global Transportation Finance team published "Under Scrutiny: The New GAO Recommendations for FAA Aircraft Registration" in the current issue of the ABA's *The Air & Space Lawyer* (vol. 33, no. 2, 2020).

UK ETS – Aviation Emissions Post-Brexit

In June 2020, the United Kingdom's Department for Business, Energy & Industrial Strategy (**BEIS**) published its preferred approach to carbon pricing. The government's aim is to implement a UK emissions trading system (**UK ETS**) in January 2021 following Brexit that is linked to both the European Union Emissions Trading Scheme (**EU ETS**) and the Swiss Emissions Trading Scheme (**Swiss ETS**) and is at least as ambitious in terms of scope and subject to the same cap as the EU ETS, proportional to the UK's current share of the EU ETS cap (as if the UK had remained in EU ETS following Brexit).

This article outlines aviation-specific considerations of the proposed UK ETS and the interaction of the proposed scheme with the Carbon Offsetting and Reduction Scheme for International Aviation (**CORSIA**), the International Civil Aviation Organisation's (**ICAO**) market-based mechanism for offsetting emissions from aviation.

A Scheme Linked to EU ETS, as the UK Leaves the EU ETS

The government's preference is for a scheme linked to the EU ETS. A linked scheme would ensure allowances in each system are recognised by the other and is particularly relevant to the aviation sector as many aircraft operators that would participate in UK ETS are likely to participate in the EU ETS as well. The UK's intention is for the aviation monitoring, reporting and verification process (**MRV**), free allocation methodology and exemption rules to mirror those outlined in EU ETS Phase IV (2021–2030).

Pursuant to the UK's agreement to withdraw from the EU, UK aircraft operators that currently participate in EU ETS are required to comply with their EU ETS obligations for the transition period (ending 31 December 2020). From January 2021, the UK will be obliged to enforce obligations arising under the EU ETS from 2020 and surrender applicable allowances by 30 April 2021. Access to UK-administered EU ETS accounts in the EU ETS's registry (the **Registry**) will remain to facilitate this.

Following this date, operators, owners and financiers with access to an account in the UK section of the Registry should plan for this access to be lost and information on an operator's compliance with the EU ETS in the UK section of the Registry will likely not be available.

The Simplified UK ETS

In the UK ETS, aircraft operators will have to open accounts in a new UK registry. In order to simplify compliance, the government would prefer a reporting arrangement where aircraft operators would be administered by only one state – either the UK or another state in the EEA – to ensure an airline would only have to deal with one authority for compliance and one account for allowances.

The UK ETS aims to cover domestic UK flights, flights from the UK to the EEA and flights from the UK to Switzerland. The aviation component of the emissions cap would be calculated to ensure it is at least as ambitious as the proportional share of the EU ETS cap for the UK with respect to aviation emissions. Similar to the EU ETS, the UK ETS aims to apply to aircraft operators regardless of their home country or the state of registration of the application.

UK ETS and CORSIA

As the UK will also participate in CORSIA, aircraft operators potentially face obligations under multiple emissions reductions schemes from 2021. UK aircraft operators are currently reporting emissions for CORSIA to the Environment Agency and complying with MRV requirements for CORSIA in relation to international flights. The only additional requirement for the UK ETS would be to report emissions on domestic flights. Non-UK aircraft operators would need to report their UK ETS emissions, in addition to their national reporting. Sharing of data between states is the preferred policy option of the UK to ensure this process is simplified.

CORSIA requires qualifying aircraft operators to offset the increase in international aviation emissions above 2019 levels, at least during the first three years of CORSIA (this can be changed by ICAO's assembly). In effect, this means if aviation emissions do not rise in 2021 compared with 2019 levels, airlines will have no offset obligations under CORSIA.

CORSIA only covers international flights whereas the UK ETS will cover domestic flights and those to the EEA and Switzerland. The government is considering postponing the annual compliance deadline for aircraft operators by at least one year (and possibly up to 2025 to align with CORSIA and account for amendments to MRV requirements in the interim), allowing aircraft operators to use CORSIA offset units to meet the UK ETS obligations and share data between states to reduce the burden airlines face in order to comply with both CORSIA and the UK ETS.

Aligning MRV Requirements with the EU ETS and CORSIA

Given the risk that MRV requirements will differ between the multiple emissions offsetting schemes applicable to aircraft operators, the EU has consulted on amending the EU ETS MRV regulations to take into account the CORSIA Standards and Recommended Practices (**SARPs**) in time for the 2019–2020 monitoring phase. The UK's proposal is to align the UK ETS MRV rules with the EU ETS (as amended in light of CORSIA) to ensure aircraft operators only face one set of MRV regulations going forward.

Honors & Awards

AIRFINANCE JOURNAL AWARDS2019

Global Transportation Finance Team Recognized for Latin American Deal of the Year at Airfinance Journal Global Awards 2019

Vedder Price was recently recognized for its role in the **Latin American Deal of the Year** at the *Airfinance Journal* Global Awards. Global Transportation Finance Shareholders Jeffrey T. Veber and Christopher A. Setteducati and Bankruptcy Shareholder Michael J. Edelman represented several commercial banks and financial institutions associated with Avianca Holdings SA (Avianca) $4.5 billion debt re-profiling program, making it the largest lease and debt re-profiling program for a Latin American carrier.

RANKED IN
Chambers
High Net Worth
2020

Vedder Price recognized in ***Chambers High Net Worth 2020***

The Vedder Price Business Aviation Practice was ranked **Band 1** for the fifth consecutive year by *Chambers High Net Worth 2020.*

Chambers High Net Worth Global-Wide Private Aircraft recognized Global Transportation Finance Shareholders Edward K. Gross and Derek Watson as **Band 1** and David M. Hernandez as **Band 2**.

The first phase of the UK ETS will run from January 2021 to December 2030. Given the EU's forthcoming review of CORSIA SARPs, the UK has proposed to split aviation into two sub-phases, phase 1(a) from 2021 to 2023 (to mirror CORSIA's pilot phase which the UK will participate in) and phase 1(b) from 2024 to 2030. The aim of this split is to ensure the UK ETS has flexibility to incorporate the amended MRV rules. Measures will also be taken to ensure aircraft operators will not have to submit two sets of allowances or offset credits for the same emissions (e.g. the international flights from the UK to the EEA and Switzerland and vice versa, which will fall within each of CORSIA, the EU ETS and the UK ETS).

Differing Compliance Periods

While the EU ETS and proposed UK ETS will consist of one-year compliance cycles, under CORSIA operators will not need to offset emissions until 2025. The UK is therefore considering postponing the deadline of surrendering credits under the UK ETS to 2025 to ensure operators will not be paying twice for the same emissions. Also under consideration is whether an aircraft operator would be able to use CORSIA-eligible credits to meet its UK ETS obligations. Given the UK's commitment to be at least as ambitious as the EU ETS, it will be interesting to see whether this ambition extends to matching the EU's requirements for surrendering credits.

Next Steps

As the BEIS report only outlined the government's preferred policy option following consultation, legislation will now need to be presented and passed in the UK and agreement must also be reached with the EU and Switzerland for any inter-linking agreement with the EU ETS and the Swiss ETS.

As COVID-19 has already significantly impacted the aviation industry and will likely continue to do so into 2021 and beyond, emissions targets and scope under each of the EU ETS, the UK ETS and CORSIA are likely to be further questioned by the industry given the financial consequences on a sector that has been particularly impacted by the pandemic.

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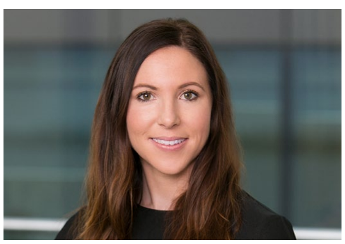

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The LEGAL 500 UNITED STATES

Vedder Price recognized in *Legal 500 United States 2020*.

Transport: Aviation Air Travel – Finance and Transport: Rail and Road – Finance both ranked as a **Top-Tier Firm**. Transport: Shipping – Finance ranked as **Recommended**.

Geoffrey R. Kass ranked as a **Hall of Fame** attorney. John T. Bycraft, Michael E. Draz, Francis X. Nolan, III and Jeffrey T. Veber all ranked as **Leading Individuals**. Clay C. Thomas ranked as a **Next Generation Lawyer**. In addition, Adam R. Beringer, John E. Bradley, John T. Bycraft, Michael E. Draz, Cameron A. Gee, John F. Imhof, Geoffrey R. Kass, Francis X. Nolan, III, Raviv Surpin, Clay C. Thomas and Jeffrey T. Veber all ranked as **Recommended** attorneys.

RECOGNIZED BY Best Lawyers

Vedder Price is pleased to announce that 45 attorneys have been recognized by Best Lawyers® in the 2021 edition of *The Best Lawyers in America*. In addition, Shareholder Francis X. Nolan, III has been named the **2021 Lawyer of the Year** in Admiralty and Maritime Law.

Daniel J. Connors and Jillian S. Greenwald were recognized as **Ones to Watch** in the fields of Transportation and Banking and Finance Law. In addition, John E. Bradley, Francis X. Nolan, III, Ronald Scheinberg, Jeffrey T. Veber and Edward K. Gross were all recognized.

Shipping and the Marshall Islands: Economic Substance Regulations and New Reporting Requirements

Following its recent promulgation of the Marshall Islands Economic Substance Regulations, the Marshall Islands Registrar of Corporations now requires all non-resident domestic entities and foreign maritime entities to report annually on their compliance with or exemption from these Regulations. This article summarizes the Regulations as they are likely to apply to non-resident domestic shipping companies and foreign maritime entities and the newly applicable reporting requirements.

What Are the Marshall Islands Economic Substance Regulations?

To comply with requirements recently imposed by the European Union (the "**EU**")[1] and the Organisation for Economic Co-operation and Development (the "**OECD**")[2] intended to restrict the use of preferential tax regimes, the Marshall Islands Registrar of Corporations (the "**Registrar**") responsible for non-resident domestic entities promulgated the Marshall Islands Economic Substance Regulations, 2018, which were last amended on August 29, 2019 (the "**ESR**").[3] The ESR require that all "relevant entities" that derive income from "relevant activities" demonstrate that they have economic substance in the Republic of the Marshall Islands (the "**RMI**") in relation to those relevant activities. The ESR are enforced by the Registrar.

For the past 20 years, the EU, the OECD and other international organizations have intensified their efforts to identify and address harmful tax practices that cause base erosion and profit shifting. These efforts target companies that adopt tax planning strategies to shift profits to jurisdictions where the companies have little to no real activity but where taxes are low, resulting in lower taxes being paid. The objective of addressing and eradicating these harmful tax regimes is to prevent "no or only nominal tax" jurisdictions from attracting profits from certain mobile activities without corresponding economic activity. The rationale behind these efforts is threefold: First, the existence of such harmful preferential tax regimes distort competition. Companies that operate across borders and profit from such tax regimes have a competitive advantage over companies that operate only at the domestic level. Second, these regimes have an impact on the location of financial and other service activities and may distort investment decisions and erode the tax bases of other jurisdictions. Such distortion will ultimately lead to inefficient allocation of resources. Third, harmful preferential tax regimes undermine the fairness and broad social acceptance of tax systems that may erode voluntary compliance by all taxpayers.[4]

The EU and OECD recognize that the issue does not lie with the companies that benefit from such tax regimes but with the tax rules themselves. They consider that the onus should be on governments to address these issues by amending or introducing new legislation, which should incorporate a mechanism for establishing the "economic substance" of corporations undertaking income generating activities. The absence of "economic substance" suggests that a jurisdiction may be attempting to attract investment and transactions that are purely tax driven. It may also indicate that a jurisdiction does not have an appropriate legal or commercial environment or that it does not offer any economic advantages to attract substantive business activities without offering tax minimizing opportunities. Following established economic research, economic substance regulations are supported by various mechanisms to identify the relevant entities carrying out income generating activities, as well as introducing a reporting mechanism and incentives for compliance, which should effectively address the harmful impact of preferential tax regimes.

The core requirement of the ESR is the economic substance test in Section 4(1) thereof, which requires that every "relevant entity" must, for each financial period in which it derives income from a "relevant activity," have economic substance in the RMI in relation to that relevant activity.

Do the ESR Apply to Your Company?

Is Your Company a Relevant Entity?

The Marshall Islands flag is often described as a "flag of convenience" because its shipping regulations are more flexible than those applicable to vessels flagged in most other jurisdictions, and as a result, a large percentage of the owners of vessels engaged in international trade choose to flag their vessels in the Marshall Islands. The owner of a Marshall Islands flagged vessel engaged in international trade is almost always a non-resident domestic corporation, partnership or limited liability company incorporated, organized or formed in the Marshall Islands (a "**non-resident domestic entity**" or "**NRDE**") or a company organized outside of the Marshall Islands and registered with the Registrar as a foreign maritime entity in the Marshall Islands (an "**FME**").

Recent Speaking Engagements

June 24, 2020

Ishka Dublin Digital Series

Kevin A. MacLeod, a Vedder Price Shareholder and Head of the New York Capital Markets group, was a featured speaker at the 2020 Ishka Dublin Digital Series. Mr. MacLeod participated in a panel discussion titled "Aircraft ABS Update."

July 8, 2020

Corporate Jet Investor Conference

Vedder Price Shareholder **Edward K. Gross** presented at the Corporate Jet Investor (CJI) conference. CJI Global combined over 125 speakers and leaders in business aviation with 12 hours of live sessions, networking, audience polling and more. Mr. Gross participated in the session "The future of US registrations."

July 21, 2020

Safe Air Charter Live Event

David M. Hernandez, a Shareholder on Vedder Price's Global Transportation Finance team, presented at the Safe Air Charter Live Event. The event discussed how to safely engage in air taxi and ride sharing services as it pertains to both the general public as well as stakeholders and pilots. Mr. Hernandez discussed concerns associated with unauthorized charter operations, which have serious regulatory and safety consequences.

The ESR provide that every NRDE is a "relevant entity" unless its business is centrally managed and controlled outside the RMI and the NRDE is tax resident outside the RMI.[5] The ESR also provide that every FME is a "relevant entity" if its business is centrally managed and controlled in the RMI, unless the FME is tax resident outside the RMI.[6]

The Registrar may regard an entity as tax resident outside the RMI if the entity is subject to the tax regime of another jurisdiction by reason of its domicile, residence, or any other criteria of a similar nature.[7] The Registrar will require any NRDE or FME claiming to be tax resident outside the RMI to produce satisfactory evidence to substantiate the same, such as a tax identification number, tax residence certificate, assessment or payment of a tax liability, or other proof the entity is subject to the tax regime of another jurisdiction.[8]

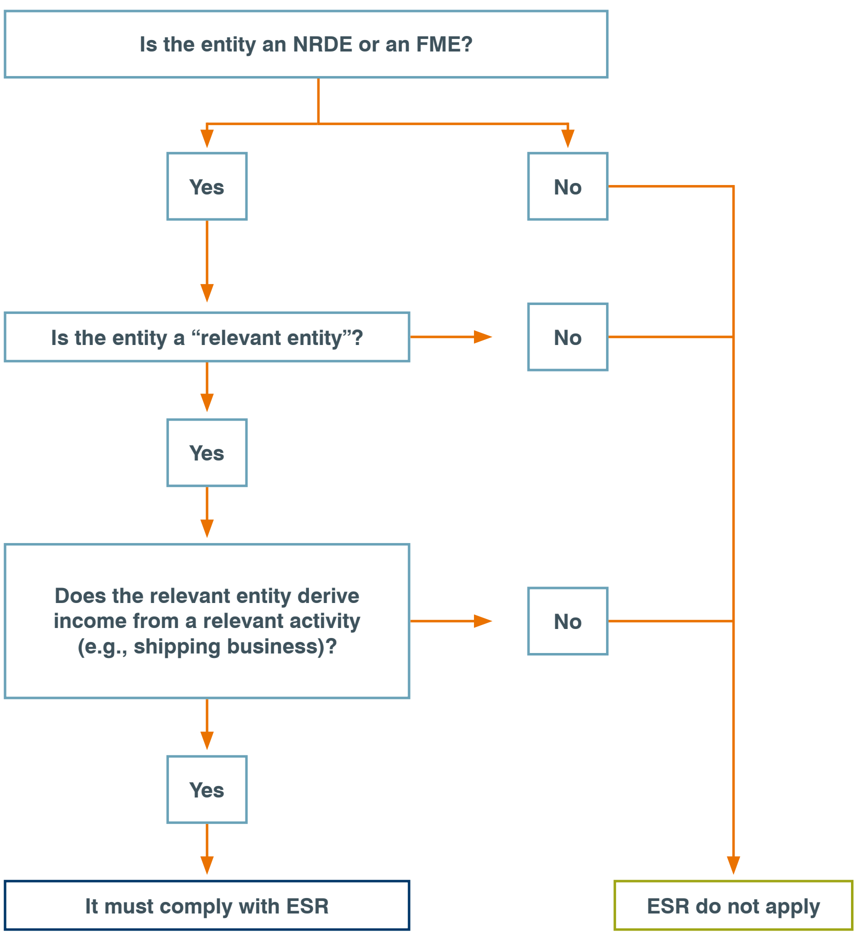
Does Your Company Derive Income from a Relevant Activity?

Section 3 of the ESR defines "relevant activities" to include a wide assortment of activities, including many of the activities performed by ship owners, charterers and their parent companies.

Among the activities that constitute "relevant activities" is the "shipping business," which is defined as the operation of ships in international traffic for income from the transport of passengers or cargo and includes any of the following activities where the relevant activity is directly connected with, or ancillary to, such operation: (i) the rental on a charter basis of a ship; (ii) the sale of tickets or similar documents and the provision of services connected with the sale of tickets or similar documents, either for the enterprise itself or any other enterprise; (iii) the use, maintenance or rental of containers (including trailers and related equipment for the transport of containers) used for the transport of goods or merchandise; (iv) the management of the crew of a ship; (v) the registration of a ship; (vi) the recording of a financial instrument or lien in relation to a ship; (vii) the ownership of a ship; (viii) the financing of a ship; (ix) the obtaining of statutory certificates for a ship; (x) the surveying of a ship; or (xi) the provision of services related to the foregoing.[9]

Relevant activities are also defined to include the "holding company business," which means the business of a "pure equity holding company," which is defined as a company that only holds equity participations in other entities, only earns dividends and capital gains, and performs no commercial activity.[10]

The requirements for determining whether the ESR apply to an entity are summarized by the following diagram:



August 5, 2020

Airport Coorperative Research Program Insight Event

Global Transportation Finance Associate **Erich P. Dylus** spoke at the Airport Cooperative Research Program (ACRP) Insight Event, "Introduction to Blockchain and Airport Operations in a COVID-19 Environment." Mr. Dylus moderated the panel entitled "Privacy Concerns in Airport Blockchain Usecases." He and his panelists discussed how blockchain helps increase information sharing while recognizing passenger, airline, airport and public health information needs and rights.

August 19, 2020

Strafford Live Webinar

Edward K. Gross, a Shareholder on Vedder Price's Global Transportation Finance team, presented at the Strafford Live webinar. The webinar, titled "Structuring Equipment Financing: Lease Accounting Rules, Bundling Services and Software, UCC and Bankruptcy Treatment," examined important new developments in equipment financing, including the implementation of lease accounting standards and bundled lease structures that include service components.

September 15, 2020

5th Annual Capital Link International Shipping Forum – China Digital Conference

Vedder Price Global Transportation Finance Shareholder **Ji Woon Kim** presented at the 5th Annual Capital Link International Shipping Forum – China Digital Conference. Mr. Kim moderated the panel titled, "Chinese Finance Solutions for the Shipping Industry: Growth Innovation & Adaptation to the New Shipping Industry Landscape."

If Your Company Is a Relevant Entity Deriving Income from a Relevant Activity, Does It Satisfy the Economic Substance Test?

As noted above, the ESR require that every relevant entity must, for each financial period in which it derives income from a relevant activity, have economic substance in the RMI in relation to that relevant activity.[11]

To demonstrate that a relevant entity has economic substance in the RMI in relation to a relevant activity, the relevant entity in most cases must show that:

- it is directed and managed (as defined in the ESR) in the RMI in relation to the relevant activity;
- having regard to the level of relevant activity carried out in the RMI, it has (i) an adequate number of qualified employees in the RMI, (ii) an adequate physical presence in the RMI and (iii) an adequate amount of expenditure incurred in the RMI; and
- it carries out core income-generating activity ("**CIGA**") in relation to the relevant activity in the RMI.[12]

What Is Considered CIGA in a Shipping Business?

CIGA must be an activity of central importance to a relevant entity in terms of generating income and that is being carried out in the RMI.[13]

The following are considered CIGA in relation to a shipping business:

- managing crew (including hiring, paying and overseeing crew members);
- overhauling and maintaining ships;
- overseeing and tracking deliveries;
- determining what goods to order and when to deliver them; and
- organizing and overseeing voyages.[14]

The ESR note that the determination of economic substance in the context of a shipping business recognizes that significant CIGA within shipping is often performed in transit outside the RMI and that the value creation attributable to CIGA that occurs from a fixed location is more limited than for other types of regimes for mobile business income.[15] The determination further considers whether the relevant entity complies with all obligations under the RMI Associations Law and RMI Maritime Act 1990, and with International Maritime Organization regulations, customs and manning requirements.[16]

What is Considered CIGA in a Holding Company Business?

CIGA for a holding company business includes all activities related to that business,[17] but the economic substance test is different from the test applicable to applicable to relevant entities deriving income from other relevant activities. To satisfy the economic substance test applicable to relevant entities engaged in a holding company business, the relevant entity must confirm that it:

- complies with its statutory obligations under the RMI Business Corporations Act, Revised Partnership Act, Limited Partnership Act, or Limited Liability Companies Act, as appropriate; and
- has adequate human resources and premises in the RMI for holding and managing equity participations in other entities.[18]

What Are the Consequences If a Relevant Entity Deriving Income from a Relevant Activity Fails to Comply with the ESR?

If the Registrar determines that a relevant entity does not meet the economic substance test, it will issue a notice stating the reasons for that determination[19] and the relevant entity will be liable to a fine of up to $50,000 for the relevant financial period, revocation of its formation documents and dissolution, or both.[20] If a relevant entity fails to meet the test for two consecutive financial periods, it will be liable for a fine not exceeding $100,000, revocation of its formation documents and dissolution, or both.[21]

September 23, 2020

AlterDomus Webinar

Vedder Price Shareholder **Adam R. Beringer** presented at the AlterDomus Webinar titled "Aircraft Leasing in the New World." Mr. Beringer and his co-presenters discussed the decline in air traffic due to the COVID-19 pandemic and how COVID-19 has impacted the aviation industry as a whole.

Deal Corner

Vedder Price Advises Aviation Capital Group on Offering of $1 Billion of Unsecured Notes

Vedder Price advised Aviation Capital Group LLC (ACG), one of the world's premier full service aircraft asset managers, in connection with its Rule 144A/Regulation S offering of $1 billion of 5.500% senior unsecured notes due 2024. The team was led by Head of the New York Capital Markets group Kevin A. MacLeod. In addition to Mr. MacLeod, the Vedder Price team included Capital Markets Shareholder John T. Blatchford, Tax Shareholder Andrew Falevich and Associate Amir Heyat.

What Are a Company's Reporting Obligations in Relation to the ESR?

All NRDEs and FMEs are now required to report their exemption from or compliance with the ESR annually. Starting in July 1, 2020, all NRDEs and FMEs are required to submit an annual report through the Registrar's secure web portal to report, among other information:

- information relevant to whether the NRDE or FME is a relevant entity;
- information relevant to whether the NRDE or FME derives income from a relevant activity; and
- if the NRDE or FME is a relevant entity deriving income from a relevant activity, (i) the amount and type of its gross income, (ii) the amount and type of its expenses and assets, (iii) the number of its employees, and (iv) whether it has conducted CIGA in the RMI.[22]

The first reporting period for each NRDE and FME opens on the first anniversary of its incorporation, organization or formation to occur after July 1, 2020. The first reporting period for each newly formed NRDE and FME will open on the first anniversary of its incorporation, organization or formation. Each NRDE and FME is required to file its annual report no later than 12 months after each such anniversary and each anniversary of its incorporation, organization or formation occurring thereafter.

Must the Registrar Keep Reported ESR Information Confidential?

Except insofar as may be necessary under the ESR, the Registrar and any person acting on its behalf must preserve and aid in preserving confidentiality in relation to all information provided by an entity pursuant to the ESR.[23]

However, if (a) a relevant entity fails to meet the economic substance test for any financial period, the Registrar is required to forward information provided in respect of such financial period to (i) the competent authority of the European Union Member State in which the parent company, ultimate parent company and ultimate beneficial owner of the relevant entity resides and (ii) if the relevant entity is organized outside the RMI, to the competent authority of the jurisdiction in which the relevant entity is organized;[24] and (b) an entity is not deemed to be a relevant entity because its business is centrally managed and controlled outside the RMI and is tax resident outside the RMI and has provided evidence to the Registrar to that effect, the Registrar is required to provide any relevant information or evidence that relates to such entity to (i) the competent authority of the European Union Member State in which the parent company, ultimate parent company and ultimate beneficial owner of the entity resides; and (ii) the competent authority of the European Union Member State in which the entity claims to be tax resident.[25]

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Endnotes

Sudan Economic Sanctions and Export Controls: A Primer For Aircraft Lessors

1. *See* Office of Foreign Assets Control, *Sudan Program and Darfur Sanctions Guidance as of August 11, 2020 (hereinafter "Guidance")*.

2. *See* Office of Foreign Assets Control, *Enforcement Information for November 7, 2019, re: Apollo Aviation Group, LLC*.

3. *See* John E. Bradley, *Apollo Settles Alleged Sanctions Violations: Aircraft Lessors Pay Attention* (Dec. 19, 2019), https://www.vedderprice.com/apollo-settles-alleged-sanctions-violations-aircraft-lessors-pay-attention?overview.

4. *See* Exec. Order No. 13761, *Recognizing Positive Actions by the Government of Sudan and Providing for the Revocation of Certain Sudan-Related Sanctions* (Jan. 13, 2017), as amended by, Exec. Order No. 13804, *Allowing Additional Time for Recognizing Positive Actions by the Government of Sudan and Amending Executive Order 13761* (July 11, 2017).

5. Effective October 12, 2017, sections 1 and 2 of Exec. Order No. 13067, 62 Fed. Reg. 59,989 §§1, 2 (Nov. 3, 1997) and all of Exec. Order No. 13412, 71 Fed. Reg. 61,369 (Oct. 13, 2006), were revoked.

6. Office of Foreign Assets Control, *Notice of Sanctions Action Pursuant to Executive Order 13067 and Executive Order 13412*, 82 Fed. Reg. 49,698 (Oct. 26, 2017).

7. Office of Foreign Assets Control, *Removal of the Sudanese Sanctions Regulations and Amendment of the Terrorist List of Government Sanctions Regulations*, Final Rule, 83 Fed. Reg. 30,539 (June 29, 2018). The revocation of the then-existing Sudanese Sanctions Regulations did not affect OFAC sanctions related to the conflict in Darfur or OFAC designations of any Sudanese persons pursuant to other sanctions programs. *Id.*

8. 50 U.S.C. §§ 1701-1708.

9. 84 Fed. Reg. 59,287 (Nov. 1, 2019).

10. *Id.*

11. The House Report accompanying IEEPA stated that national "emergencies are by their nature rare and brief, and are not to be equated with normal, ongoing problems." Christopher A. Casey et al., Cong. Research Serv., R45618, The International Emergency Economic Powers Act: Origins, Evolution, and Use 17 (2020) [hereinafter CRS Report] (citing H.R. Rep. No. 95-459, at 11 (1977)).

12. 50 U.S.C. § 1701(a) (emphasis added). In addition, Congress "has used IEEPA outside of the context of national emergencies. When Congress legislates sanctions, it often authorizes or directs the President to use IEEPA authorities to impose those sanctions." CRS Report, supra note 12, at 23.

13. *See* U.S. Dep't of State, Bureau of Counterterrorism, State Sponsors of Terrorism https://www.state.gov/state-sponsors-of-terrorism/ (last visited Sept. 25, 2020).

14. Cameron Hudson, *Removing Sudan's terrorism designation: Proceeding with caution*, The Atlantic Council (Mar. 16, 2020) (https://www.atlanticcouncil.org/blogs/africasource/removing-sudans-terrorism-designation-proceeding-with-caution/) [hereinafter "Hudson"] (citing U.S. Dep't of State, Patterns of Global Terrorism 1994 23 (1995).

15. *Owens v. Republic of Sudan*, 826 F. Supp.2d 128, 139-146 (D.D.C. 2011).

16. *Id.*

17. Hudson, *supra*, note 14.

18. *Id.*

19. *See* Letter dated September 16, 2020, from Secretary of State Michael R. Pompeo to the Hon. Mitchell McConnell (https://www.documentcloud.org/documents/7213125-Pompeo-Letter-McConnell-Sudan-2020-09-18-073433.html).

20. The term "re-export" is defined to include an "actual shipment or transmission of an item subject to the [Export Administration Regulations] from one foreign country to another foreign country, including the send or taking of an item to or from such countries in any manner." 15 C.F.R. § 734.14(a)(1).

21. A similar provision, 50 U.S.C. § 4506(j) (repealed 2018), appeared in the now repealed Export Administration Act of 1979, Pub. L. No. 96-72 (repealed 2018).

22. 15 C.F.R. § 740.15.

Shipping and the Marshall Islands Economic Substance Regulations and New Reporting Requirements

1. *See* Council of the European Union Code of Conduct Group (Business Taxation), *Conclusions of 5 December 2017 on the EU list of non-cooperative jurisdictions to tax purposes.*

2. *See* OECD (2018), *Resumption of Application of Substantial Activities for No or Only Nominal Tax Jurisdictions – BEPS Action 5*, OECD, Paris.

3. The Republic of the Marshall Islands Economic Substance Regulations, 2018, as amended through August 29, 2019.

4. *See* OECD, *Bitesize BEPS – Frequently Asked Questions*.

5. *See* ESR § 2(s)(i).

6. *See id.* § 2(s)(ii).

7. *See id*. § 8(4) n.4.

8. *See id*.

9. *See id*. § 2(u).

10. *See id*. §§ 2(j), 2(p).

11. *Id.* § 4(1).

12. *See id*.. § 4(2).

13. *Id*. § 5.

14. *Id*. § 5(g).

15. *See id*. § 5(g) n.3.

16. *See id*.

17. *Id.* § 5(e).

18. *See id*. § 4(5).

19. *See id*. § 7(1).

20. *See id*. § 7(2)(a).

21. *See id*. § 7(2)(b).

22. *See* Update, The Marshall Islands Corporate Registry, *Republic of the Marshall Islands Economic Substance Reporting Portal to Open 1 July 2020* (June 29, 2020), *see also* Republic of the Marshall Islands, *Guidance and Frequently and Questions on Economic Substance* (October 17, 2019, revised January 8, 2020); *see also* Republic of the Marshall Islands, *Economic Substance Reporting Portal User Guide*.

23. *See* ESR § 11.

24. *See id*. § 8(1).

25. *See id*. § 8(4).

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