Vedder Price

Global Transportation Finance Newsletter

April 2022

Inside

Buying Aircraft – PDPs, Financial Assistance and Liquidated Damages

DHC v SpiceJet

Before the Commercial Court in *De Havilland Aircraft of Canada Limited v SpiceJet Limited* [2021] EWHC 362 (Comm), each of De Havilland Aircraft of Canada Limited (**DHC**) and SpiceJet Limited (**SpiceJet**) sought summary judgment against the other in relation to non-performance by the other under a purchase agreement dated 8 September 2017 (the **Purchase Agreement**) for the delivery of 25 Q400 aircraft (the **Aircraft**) by DHC to SpiceJet. The decision of the Court provides a useful reminder of the English courts' approach to interpreting contracts and when disputes may be settled on a summary basis.

Background

In addition to setting out the scheduled delivery months for delivery of the Aircraft (the **SDMs**), the Purchase Agreement set out the arrangements for payments to be made by SpiceJet for the Aircraft, including pre-delivery payments (**PDPs**) that SpiceJet was required to pay to secure delivery of the Aircraft, and provided that if SpiceJet defaulted on its obligations to make the PDPs then DHC could terminate the Purchase Agreement in respect of the affected Aircraft and claim liquidated damages. Further, if four or more Aircraft were affected, DHC could terminate the Purchase Agreement in its entirety.

The first five Aircraft were paid for and delivered in accordance with the terms of the Purchase Agreement, but after delivery of the fifth Aircraft, SpiceJet ceased paying PDPs that fell due in relation to the next fifteen Aircraft and failed to take delivery of the sixth, seventh and eighth Aircraft that were scheduled for delivery prior to the commencement of the contractual dispute proceedings between DHC and SpiceJet.

As a result of SpiceJet's failure to pay the PDPs and failure to accept delivery of the Aircraft, DHC served notice on SpiceJet, terminating DHC's obligation to deliver the undelivered Aircraft pursuant to the Purchase Agreement and seeking liquidated damages of $42.95 million in accordance with the terms of the Purchase Agreement or, alternatively, damages for breach of contract.

Before the Commercial Court, DHC sought summary judgment in relation to its claim for liquidated damages whilst SpiceJet sought summary judgment that:

- it was not obliged to pay the PDPs in accordance with the terms of a Change Order 6 relating to the Purchase Agreement dated 15 April 2019 (**CO6**);
- DHC had failed to provide sufficient assistance relating to the financing of the Aircraft in accordance with the terms of Letter Agreement 13 relating to the Purchase Agreement (**LA13**); and
- the claimed amount of liquidated damages is an unenforceable penalty.

Issues

(1) CO6

Pursuant to the terms of CO6, the SDMs for certain of the Aircraft were amended to extend the periods for delivery that had originally been agreed in the Purchase Agreement in respect of the first eight Aircraft. For the remaining seventeen Aircraft, CO6 stated that the SDMs were "*suspended and that [the parties] shall make good faith efforts to find an amicable solution to revised terms and conditions for such Aircraft*."

SpiceJet argued that this suspension of the SDMs for those seventeen Aircraft relieved them of their obligation to pay the PDPs for those Aircraft and, accordingly, it had not defaulted on four or more Aircraft (having only failed to take delivery of the sixth, seventh and eighth Aircraft).

The Court found that whilst the SDMs may have been suspended, there was no agreement to suspend or terminate the payment of the PDPs where the invoices had been rendered and the debts incurred at the time of CO6. In particular, the Court noted that it was persuaded particularly by the argument that DHC remained obliged to manufacture and deliver the remaining Aircraft, as there was a long stop date for delivery of the Aircraft by August 2023, and there was no evidence that the parties intended to change the PDP obligations, and it was perfectly commercial for them to leave them as they were.

(2) LA13

As a counterclaim to DHC's claim, SpiceJet argued that DHC breached its obligations pursuant to LA13 to provide assistance in arranging finance for the Aircraft and that this failure prevented SpiceJet from making its PDP payments.

Team News

The Vedder Price Global Transportation Finance team is pleased to announce that we have elevated two of our attorneys to Shareholder. Please join us in congratulating Justine L. Chilvers and James Kilner!

Justine L. Chilvers

Justine concentrates her practice in transportation finance, with a special focus on aviation and rail finance. She regularly advises commercial and investment banks, operating lessors, finance companies, hedge funds and other investors on a wide range of cross-border and domestic aircraft and rail finance transactions. In 2021, she was recognized by *The Legal 500 United States* as a Rising Star in the Transport: Aviation & Air Travel Finance category. Justine earned her J.D. from Fordham University School of Law and her B.A. from the University of Pennsylvania, *magna cum laude*.

James Kilner

James has experience in a wide range of banking and finance transactions, focusing in particular on cross-border asset financing, secured lending structures and general and structured financings. James also represents clients in aviation sales and lease backs and operating leases, as well as ECA guaranteed loan financings. In 2021, he was recognized by *The Legal 500 United States* in the category of Transport: Aviation & Air Travel – Finance. James received his law degree from BPP Law School, London, and his LL.B. from the University of Birmingham, with honors.

LA13 provided that Bombardier "*shall provide the following Financing Assistance. Bombardier would be pleased to assist Buyer in developing, in consultation with Buyer and its aircraft finance specialists, third party financing structures for the financing of Buyer's acquisition of the Aircraft…*"

SpiceJet argued that DHC failed to assist in the arrangement of financing for the Aircraft in accordance with the terms of LA13 and, in particular, breached its obligations in relation to the proposed financing of certain of the Aircraft by Chorus Aviation Capital and TrueNoord.

The Court found that whilst LA13 did impose obligations on DHC to assist with the financing of the Aircraft, the obligation did not amount to a requirement for DHC to "work with SpiceJet and its financiers and/or other guarantors to procure finance." Accordingly, the Court found that SpiceJet did not have an arguable case and summarily dismissed the counterclaim.

(3) Damages

In the event of a default on its obligations under the Purchase Agreement in respect of an Aircraft, SpiceJet was required to pay DHC US$2.5 million. As the Purchase Agreement was terminated in relation to twenty Aircraft, DHC claimed US$42.95 million (accounting for certain payments that SpiceJet had already made). SpiceJet claimed that this amounted to an unenforceable penalty, and that this issue could not be determined as part of a summary judgment.

The Court rejected SpiceJet's arguments noting that each of DHC and SpiceJet were substantial commercial operators, with comparable bargaining power and were advised by experienced and sophisticated lawyers and that SpiceJet had agreed, in the Purchase Agreement, that "such liquidated damages do not constitute a penalty."

Further, SpiceJet couldn't require a full trial to establish DHC's actual loss precisely because it had agreed to pay liquidated damages to "avoid the expense and time incurred in calculating the actual extent of loss."

The Court continued that the amount of liquidated damages, which represented 12.5% of the stated purchase price of each Aircraft, appeared to be a genuine pre-estimate of loss and that SpiceJet had "neither in evidence nor through counsel made any attempt to cast doubt on the realistic nature of this estimate."

Conclusion

The case is interesting in that several substantial issues were decided on a summary basis – the Court was clear that this was permitted where "there is a short point of law or construction, […] it has before it all the evidence necessary for the proper determination of the question and […] the parties have had an adequate opportunity to address [the Court] in argument."

It is clear that the Court was minded that it would interpret each contract on the basis of what was written in the contract – this was true of CO6, which the Court found related only to the SDMs and not the PDPs, true of LA13, which didn't impose an obligation on DHC other than to assist SpiceJet with financing opportunities for the Aircraft, and true of the Purchase Agreement itself, which clearly set out the requirement for the payment of liquidated damages.

The judge was clear that when interpreting the contracts: "I must look at the whole agreement; I must apply an objective test; I must take into account that the agreement was handled, negotiated and prepared by skilled professionals; particularly in the event of any ambiguity I should apply a commercial approach to it, but always subject to bearing in mind the possibility that one side may have agreed to something which with hindsight did not serve its interest."

SpiceJet sought to appeal the judgment but failed to pay amounts to the Courts Fund Office to sustain its appeal and as a result its notice of appeal was struck out, and a subsequent application for extension of time by SpiceJet was also refused[1].

John Pearson

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Team News Continued

We are proud to announce that highly-respected attorney Joshua Alexander has re-joined the firm's London office as a member of the Global Transportation Finance team. Prior to re-joining Vedder Price, Mr. Alexander spent just over two years at Qatar Airways. He supported the airline in the roles of Senior Manager Contracts and Acting Vice President Contracts.

Last month members of our Global Transportation Finance team and our client Aero Capital Solutions had a blast watching the top 64 golf players in the world at the World Golf Championships-Dell Technologies Match Play in Austin. Thank you, ACS; it was great to spend time with you in Austin!

Russia Sanctions

The **Global Transportation Finance** team of Vedder Price has been at the forefront of updating our clients with the events affecting our industry as a result of the Ukraine-Russia war. We have included six updates we recently shared with our friends and clients. If you have any questions on how the Russia Sanctions may be affecting your company, do not hesitate to contact our Global Transportation Finance attorneys.

BIS Revokes AVS License Exception for Belarusian Air Carriers; Updates List of Aircraft Reexported to Russia and Belarus in Violation of Licensing Requirements

EU Releases Fifth Round of Russian Sanctions: Impacts for Aviation and Maritime

BIS Issues Administrative Orders Temporarily Denying Export Privileges of Three Russian Air Carriers

BIS Identification of Aircraft Reexported to Russia in Violation of Russia-Belarus Licensing Policy

Memorandum of Russia Sanctions for the Aviation and Maritime Industries

International Sanctions Widen as Ukraine Crisis Deepens

Senate Passes Ocean Shipping Reform Act of 2022: Overhaul of the Shipping Act Expected

On March 31, 2022, the United States Senate passed the Ocean Shipping Reform Act of 2022 (S. 3580) ("OSRA 2022"), which had been sponsored by Senator Amy Klobuchar (D-MN) on February 3, 2022,[1] and reported from the Committee on Commerce, Science, and Transportation on March 24, 2022. OSRA 2022, which was heavily supported by numerous U.S.-based shippers' associations, follows passage by the United States House of Representatives of the Ocean Shipping Reform Act of 2021 (H.R. 4996) ("OSRA 2021") on December 8, 2021.[2] Our previous report on OSRA 2021 can be found here.

OSRA 2022 comes during a period of heightened scrutiny and concerns concerning the practices of supply chain participants and the effect of such practices on supply chain efficiencies, delays and costs. Like its OSRA 2021 predecessor, OSRA 2022 attempts to meet the current challenges by strengthening the regulatory authorities of the Federal Maritime Commission (the "FMC" or the "Commission") under the Shipping Act of 1984, as amended (the "Shipping Act"),[3] while simultaneously increasing the statutory compliance requirements for various regulated entities, including common carriers,[4] ocean common carriers ("VOCCs"),[5] ocean transportation intermediaries ("OTIs")[6] and marine terminal operators ("MTOs").

As a follow up to our analysis of OSRA 2021, this article reviews the headline changes which would be brought about by OSRA 2022.

A. Anti-Retaliation Amendments[7]

OSRA 2022 would expand the anti-retaliation provisions of the Shipping Act in two key respects. First, in its current iteration, the Shipping Act's anti-retaliation provisions apply solely to the retaliatory practices of common carriers.[8] Under section 5 of OSRA 2022, a new general prohibition would be added to section 41102 that would apply the Shipping Act's anti-retaliation provisions to MTOs and OTIs, in addition to common carriers. Second, OSRA 2022 would expand the universe of persons against whom retaliation is prohibited to include, in addition to shippers, OTIs, shippers' agents and motor carriers.

While the idea of expanding the scope of the Shipping Act's anti-retaliation provisions may be laudable, OSRA 2022 contains some of the same legislative illogic as OSRA 2021 insofar as MTOs are concerned. As previously discussed (here), the position occupied by MTOs in the supply chain makes it impossible for them to "retaliate" against shippers or others by refusing or threatening to refuse "cargo space accommodations." Unlike ocean common carriers, MTOs do not offer or sell cargo space accommodations so it is difficult to fathom how they could refuse such accommodations as a retaliatory tool.

In its current iteration, the Shipping Act also states that a common carrier may not "resort to other unfair or unjustly discriminatory methods because the shipper has patronized another carrier, or has filed a complaint, or for any other reason."[9] Section 5 of OSRA 2022 would expand the scope of regulated entities covered by the "resort to" clause to include OTIs and MTOs, in addition to common carriers, and would expand the scope of protected parties to include shippers' agents, OTIs and motor carriers, in addition to shippers.

Under the provisions of section 5, common carriers **and** OTIs and MTOs would be prohibited from "[resorting] to any other unfair or unjustly discriminatory action" for (a) the reason that a shipper **or** a shippers' agent, OTI or motor carrier has (i) patronized another carrier; or (ii) filed a complaint against the common carrier, MTO or OTI, or (b) any other reason. Section 5 broadens the companion provisions contained in section 8 of OSRA 2021, and generally improves their logic by including shippers' agents, OTIs and motor carriers within the class of persons protected under the "resort to" prohibitions. That said, it seems improbable that any MTO could stifle liner competition by resorting to any unfair or unjustly discriminatory actions because a shipper, shippers' agent or OTI has "patronized another carrier."

B. Unreasonable Refusals to Deal and Discrimination Amendments

OSRA 2022 would tighten the Shipping Act's grip regarding unreasonable refusals to deal as they apply to common carriers. First, section 7 of OSRA 2022 would substitute a new provision to section 41104(a)(3) of the Shipping Act stating that common carriers shall not "unreasonably refuse cargo space accommodations when available," or broadly "resort to other unfair or unjustly discriminatory methods." Section 7 would also make clear that proscribed unreasonable refusals to deal or negotiate under section 41104(a)(10) of the Shipping Act specifically apply "with respect to vessel space accommodations provided by an ocean common carrier." With respect to service contracts, section

Honors & Awards

RANKED IN Chambers Global 2022

Vedder Price Recognized in *Chambers Global* 2022

Chambers Global ranked the Vedder Price Global Transportation Finance team **Band 2** in the category of Asset Finance – Global Market Leader.

Chambers Global recognized Gavin Hill as **Band 2**, Jeffrey T. Veber as **Band 3** and Geoffrey R. Kass as **Band 4** in the category of Asset Finance – Global.

Recent Speaking Engagements

March 31, 2022

Kevin A. MacLeod presented at Ishka+Investing in Aviation Finance: Europe. Kevin participated in a panel entitled "Aircraft ABS health check: What's happening below the B tranches?" The panel analyzed the aircraft ABS market and its incredible revival in 2021 and its implications for aircraft ABS investors.

To view the webinar click here.

March 31, 2022

John Pearson presented at the first ESG-dedicated conference Ishka+ESG: Committing to a Cleaner Aviation Future. John's session entitled "Regulation to ensure sustainable aviation – carrot or stick?" focused on the development of a new regulatory landscape governing how aviation must evolve to meet its responsibilities to climate change and how the industry is collaborating to meet these demands. John is the lead associate on Vedder Price's Global Transportation Finance ESG Task Force.

To view the webinar click here.

7 would add new language to section 41104(a)(5) of the Shipping Act which specifically prevents common carriers from engaging in unfair or unjustly discriminatory practices "against any commodity group or type of shipment." OSRA 2021 did not address these specific concerns.

C. Demurrage and Detention Amendments

Section 7 of OSRA 2022 would prohibit any common carrier from assessing "any party for a charge that is inconsistent or does not comply with all applicable provisions and regulations," including the provisions set forth in section 41102(c) of the Shipping Act, which require the establishment, observance and enforcement of "just and reasonable regulations and practices" related to the receiving, handling, storing or delivering of property. Section 7 would also prohibit any common carrier from invoicing "any party for demurrage or detention charges" unless the invoice includes certain specified information, discussed below, showing that the charges comply with the interpretive provisions and statements of policy contained in part 545 of the Commission's rules,[10] including the rules implementing the Commission's incentive principles.[11]

The information that OSRA 2022 would require on detention and demurrage invoices issued by common carriers tracks the information proposed by the Commission in its recent Advance Notice of Proposed Rulemaking (the "ANPRM").[12] Unless otherwise determined by the Commission as part of the ANPRM, the information contents of an invoice required by section 7 of OSRA 2022 would include 13 specific items. Most of this billing information is already provided by common carriers (and MTOs with respect to demurrage), with two notable exceptions. First, under section 7, invoices issued by common carriers would be required to include a statement that the invoiced charges are "consistent with any of . . . [the Commission's] rules with respect to detention and demurrage." Second, such invoices would be required to contain a further statement that "the common carrier's performance did not cause or contribute to the underlying invoiced charges."

The legal compliance statement required by section 7 of OSRA 2022 tracks similar provisions in OSRA 2021, and is a bit puzzling for the same reasons.[13] As previously explained (here), whether a particular detention or demurrage charge is "consistent" with the Commission's corresponding regulations may be a function of one's interpretation of the incentive principles as they pertain to the circumstances of the charge. Common carriers and shippers often have divergent views on whether charges are supported (or not) by the incentive principle, which is why the Commission has administrative law judges who are trained to resolve such contested matters.

The second required statement – that the common carrier's performance did not "cause or contribute to the underlying invoiced charges" – seems equally puzzling and particularly ham-handed. Determinations of cause and effect and contributing factors often require the investigation of facts that may not be obvious or immediately apparent at the moment when a loaded import container exits a marine terminal, which is when most demurrage calculations and billings are settled. What is the point in having a VOCC make final, legally relevant certifications as to direct and contributory causes when the information necessary to make such certifications may be unavailable?

These statements as to legal compliance and cause and effect would not be overly problematic but for the administrative hammer that OSRA 2022 would use to enforce them. First, section 7 of OSRA 2022 states that any failure to include required information on an invoice having detention or demurrage charges, including required statements with respect to compliance and cause and effect, will "eliminate any obligation of the charged party to pay the applicable charge" – regardless of the legitimacy of the charge. Moreover, if the Commission later determines following an investigation that an invoice is "inaccurate or false," the common carrier would become subject to potential refund orders and the assessment of civil penalties under section 41107 of the Shipping Act.

D. Complaints Concerning Common Carrier Charges

Section 10 of OSRA 2022 would provide the Commission with a new, streamlined tool to address disputed or contested charges assessed by common carriers. Under section 10, any person would be authorized to submit to the Commission, and the Commission would be required to accept, "information concerning complaints about charges assessed by a common carrier," including bill of lading numbers, invoices or "any other relevant information." Upon receipt of a submission, the Commission would be obligated to investigate the charge to determine compliance by the common carrier with the prohibitions contained in sections 41104(a) and 41102 of the Shipping Act.

In response to such an investigation, the common carrier would be provided an opportunity "to submit additional information related to the charge" and would bear the burden of "establishing the reasonableness of any demurrage or detention charges" in light of the incentive principles contained in the Commission's Interpretive Rule.[14] As previously discussed in connection with OSRA 2021, the imposition of such evidentiary burdens on common carriers would seemingly turn established burdens of persuasion and production on their head. In the event that the Commission determines that the

March 28, 2022

John F. Imhof Jr. moderated a panel entitled "Ship Finance – The Financiers' Perspective" at Capital Link's 16th Annual International Shipping Forum. The panel was comprised of senior maritime and shipping finance executives from Citi, CIT, DNB and Neptune Maritime Leasing, and it explored how various ship finance options address the capital needs of shipping companies and fit into their institutions' overall strategies.

To view the webinar click here.

March 9, 2022

David M. Hernandez and **Edward K. Gross** spoke at the Corporate Jet Investor (CJI) London 2022 conference. Eddie moderated the session "U.S. Transactions," for which David served as panelist. The panel focused on aircraft guarantees and whether or not U.S. export issues affect aircraft outside the United States.

February 24, 2022

John F. Imhof Jr. moderated a panel entitled "Regulation & Policy Panel – Developments & Outlook" at Capital Link's inaugural Jones Act & U.S. Flag Shipping Forum. The Forum examined the regulations, programs and policies surrounding the Jones Act and the U.S. Flag and the role that each plays in furthering U.S. national defense and U.S. presence in global trade and commerce.

To view the webinar click here.

Deal Corner

Vedder Price Advised Lynx Air on Sale and Leaseback of Three New Boeing 737-8 MAX Aircraft

Vedder Price represented Lynx Air, Canada's newest ultra-affordable carrier, in the sale and leaseback of the first of three B737-8 MAX Aircraft to be leased from Aergo Capital Limited. The three aircraft will be the first to be delivered to Lynx Air from its Boeing purchase agreement and will form the initial fleet for the airline's launch in the coming months. The Vedder Price team included Neil Poland and Jack Goold in London, working with Lynx Air's Canadian counsel Joe Brennan and Gloria Kang at Lindsey MacCarthy LLP.

charge does not comply with sections 41104(a) or 41102 of the Shipping Act, section 7 would compel the Commission to order a refund and assess a civil penalty against the common carrier under section 41107.

E. Investigations, Reports and Public Disclosures

Under the Shipping Act, the Commission is currently authorized to investigate, either on its own or on the basis of a filed complaint any conduct or agreement that it believes to be in violation of the Act.[15] Section 11 of OSRA 2022 would expand the scope of this investigatory authority to include "fees and charges" that the Commission believes to be in violation of the Shipping Act. The results of such investigations will be made publicly available on the Commission's website under the heading: "Fact Finding No. 29, International Ocean Transportation Supply Chain Engagement."

Section 6 of OSRA 2022 would add a new provision to section 46106 of the Shipping Act which would require the Commission to publish, and annually update, on its website its findings of "false detention and demurrage invoice information by common carriers" and corresponding "penalties imposed or assessed against common carriers." Such scarlet letter postings by the Commission on its website are presumably meant to alert shippers to recidivist common carriers and to incentivize compliance by such carriers.

F. Additional Rulemaking Proceedings

OSRA 2022 would require the Commission to initiate three separate rulemaking proceedings.

The first rulemaking would further define prohibited practices by VOCCs, MTOs and OTIs "regarding the assessment of demurrage or detention charges," in relation to section 41102(c) of the Shipping Act, which requires the establishment, observance and enforcement of "just and reasonable regulations and practices" related to the receiving, handling, storing or delivering of property. The rule would seek to clarify "reasonable rules and practices" related to the assessment of detention and demurrage charges to address matters relating to the incentive principles.

The second rulemaking would define "unfair or unjustly discriminatory methods" of common carriers under newly amended section 41104(a)(3) of the Shipping Act.

The third rulemaking would define, in consultation with the Commandant of the U.S. Coast Guard, "unreasonable refusals to deal or negotiate with respect to vessel space" under newly amended section 41104(a)(10) of the Shipping Act.

Conclusion

The Senate returned S. 3580 to the House of Representatives on April 4, 2022, seeking its concurrence.[16] Passage of the measure by the House, in substantially the form in which it was received from the Senate, and signing into law by President Biden, are widely expected.

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Deal Corner Continued

Vedder Price Represented GBX Leasing in $323.2 Million Railcar Securitization

Vedder Price represented GBX Leasing, LLC in connection with its inaugural railcar securitization offering. GBX Leasing 2022-1 LLC, as special purpose entity and wholly-owned subsidiary of GBX Leasing, issued $323.2 million of secured notes backed by a portfolio of over 4,400 railcars. The Vedder Price team included Michael E. Draz, Global Transportation Finance Shareholder, Jeffrey T. Veber, Global Transportation Finance Shareholder and member of the Vedder Price Board of Directors, Kevin A. MacLeod, Shareholder and Head of the New York Capital Markets Group, and Tax Shareholder Matthew P. Larvick, with support from Global Transportation Finance Associates Joel R. Thielen, Daniel L. Spivey, Nathan M. Telep and Ananya Hindupur and Capital Markets Associate Samuel Esclavon.

The UCC Catches up to Emerging Technology

A special committee is in the process of amending the model commercial code which serves as the basis for state laws that govern most commercial transactions originated in the United States. These amendments, which are intended to update the model commercial code to reflect emerged and emerging technologies like blockchain, virtual currencies, nonfungible tokens (**NFTs**) and other digital assets, are expected to be finalized and offered for enactment by the states as early as the fall of 2022. When enacted, the amendments will have a transitional impact on the spectrum of commercial transactions, especially secured financing and personal property leasing, capital markets transactions and other matters of interest to participants in asset financing transactions. Informed financiers, investors, lessors and others will be able to achieve market advantages if they can successfully employ the systems and practices supported by these amendments. Provided below is a summary explanation of the purposes and transactional implications of these amendments.

The role of state law and the Uniform Commercial Code.

The law governing commercial transactions in the United States is largely state law. Although bankruptcy laws are federal, the other essential commercial laws applied by courts to determine the rights of parties to a commercial dispute include the common law, statutory law or creditor's rights laws of a particular state. Common law is essentially the legal precedent based on published opinions by courts that previously considered the pertinent legal principles and facts. A state's creditor's rights laws include both procedural rules that must be followed when enforcing claims or judgments in the courts of that state, and statutes intended to protect creditors from fraud by a debtor.

The state law that is applicable to commercial disputes among parties to sales or leases of goods (e.g., equipment or inventory), payment instruments, secured financings and many other commercial matters, is statutory. That statutory law is referred to as the Uniform Commercial Code (the "**UCC**") and is a set of commercial laws based on a model "uniform" code, a version of which has been enacted by the governing law state. For example, the "New York law" governing a sale of an aircraft, the lease of a locomotive or a loan financing of high-tech equipment would be, respectively, Articles 2, 2A and 9 of the UCC, as enacted by the New York legislature.

The UCC Amendments.

Background. The UCC has been enacted in all 50 states, the District of Columbia, Puerto Rico and the U.S. Virgin Islands. Since its widespread enactment in the 1960s, the UCC has been periodically revised to address changes in commercial practices. In 2019, the Uniform Law Commission (**ULC**) and The American Law Institute (**ALI**), the sponsors of the UCC (the "**Sponsors**"), appointed a Joint Committee to consider whether changes were advisable to accommodate emerging technologies, such as artificial intelligence, distributed ledger technology and virtual currency. The Joint Committee ultimately received permission of the Sponsors to act as a drafting committee (the "**Committee**") for amendments to the UCC dealing, predominantly, with aligning the UCC with emerging technologies.

The Draft Amendments. The Committee has generated a number of drafts (the most recent of which was in April of 2022; the "**Draft**") containing the proposed amendments. The Draft is intended to reflect the various comments discussed during such Committee meetings last month, and should approximate what is likely to be the final version. The following is a quick, non-exhaustive summary of the Draft, focused primarily on the most impactful equipment finance-related amendments:

Generally. The Draft amendments and the associated Official Comments cover, among other things: digital assets (controllable electronic records), electronic money, chattel paper, so-called "bundled transactions" (consisting of the sale or lease of goods together with licensing of software and the provision of services as an integrated transaction), documents of title, payment systems and miscellaneous (non-emerging tech) UCC amendments. Among the most significant amendments is the creation of a new Article 12 covering the commercial law implications of digital assets. However, as explained below, there are also many other proposed amendments to existing Articles 1, 2, 2A, 3, 4, 8 and 9 of the UCC, and if made are likely to have a commercial impact.

Digital Assets. New Article 12 is intended to govern the transfer of property rights in certain intangible digital assets ("*controllable electronic records*"; "**CERs**") that have been or may be created using new technologies. Distributive ledger technology, including blockchain technology, is the platform for many of the digital assets that currently exist and that, according to the Prefatory Note [to new Article 12], "were a major impetus for the revision project." These digital assets include certain types of virtual (non-fiat) currency (e.g., bitcoin) and NFTs, but expressly exclude electronic chattel paper. Under new Article 12, CERs must be subject to "control." Similar to "control" over chattel paper, control of a CER involves powers over a CER that are functionally equivalent to possession of tangible property.

New Article 12 also covers certain payment rights "tethered" to CERs - "*controllable accounts*" and "*controllable payment intangibles.*" These digital payment rights should be familiar to participants in receivables' financings, and are a subset of "accounts" and "payment intangibles," respectively. To qualify as a controllable account or controllable payment intangible, the related account debtor must agree to make payments to the person that has control of the CER evidencing the right to such payments. The substantive provisions of Article 12 include the rights of "*qualifying purchasers*" of CERs, the rights and duties of account debtors on controllable accounts and controllable payment intangibles and rules on governing law. Concepts similar to these already existing in the UCC with respect to the non-digital forms of these payment rights (i.e., compliant promissory notes) would allow these digital payment rights the attributes of negotiability.

Many of the Article 9 amendments relate to purchases and other security interests in CERs, including as to controllable accounts and controllable payment intangibles. Purchasers and secured lenders may perfect (i.e., achieve priority over third-party claims) their interests in these assets by obtaining "control" of the asset or filing a financing statement in the appropriate state's filing office. Similar to the chattel paper perfection provisions of Article 9, a security interest perfected by control can have priority over a security interest perfected by filing.

Both the new Article 12 and amendments to Article 9 include new choice-of-law rules that could have an impact on how transactions within the scope of these Articles are documented, or the associated rights and interests of a party may be protected or afforded priority.

Transactional Considerations. The digitization of the contracting process will ultimately impact how aspects of most of the asset financing transactions involving all types of equipment, including transportation and tech assets, are created, executed, transacted, financed, sold, maintained and enforced. Whether an asset is a controllable electronic record (and therefore within the scope of Article 12) depends on whether the characteristics of the asset and the protocols of any system on which the asset is recorded make it suitable for the application of Article 12's substantive rules. Market participants who intend to transact using smart contracts on a blockchain platform, including digital payment instruments and payments by non-fiat cryptocurrencies, must have a practical understanding of the related commercial law implications in order to gain a competitive advantage by leveraging the opportunities related to these emerging technologies.

Chattel Paper. There are a number of proposed amendments to Article 9 of the UCC, including a revised definition of "chattel paper" and updated provisions applicable to perfection of security interests in chattel paper.

The new definition. As amended, the definition of "chattel paper" (see §9-102(11)) will no longer refer to the tangible or electronic record evidencing the right to payment and associated goods securing that payment or being leased in consideration of that payment. Instead, the term "chattel paper" will refer to the secured party's or lessor's associated right to payment of a monetary obligation either secured by specific goods or owed by a lessee under a lease agreement with respect to specific goods, in either case if evidenced by a tangible or electronic record. The definition has also been revised to allow for chattel paper treatment of the payment rights associated with a "bundled transaction," either in its entirety or with respect to the goods being financed or leased. The coverage of "bundled transactions" in the context of chattel paper includes a "predominant purpose" test similar to what is now included in the amended scope provision in Article 2A with respect to "hybrid leases," as explained below.

Perfection. The Draft also amends (as new § 9-314A) the manner by which a purchaser or other secured party may perfect its security interest in chattel paper. Although perfection may still be achieved by filing a financing statement, a purchaser or other secured party may perfect its security interest and, if it satisfies the other related requirements, achieve "super-priority," by having "control" of all tangible and electronic authoritative copies of the records evidencing the chattel paper. This amendment is intended to cover payment rights even if evidenced by more than a single record (e.g., a tangible supplement or addendum to an electronic record, or vice versa) or if a record in one medium is replaced by a record in another medium.

Control. "Control" is then achieved by taking possession of any tangible authoritative copy or control of any electronic authoritative copy, of the record evidencing the chattel paper. Subsections (a) and (b) of Section 9-105 are substantially unchanged. The revised conditions of "control" provided in new subsection (c) are meant to reflect the attributes of records maintained on a blockchain platform or other distributed ledger technology, including the existence of multiple authoritative copies of that record. The safe harbor under existing Section 9-105(b) contemplates a "single authoritative copy," which would not be the case with a record maintained on a blockchain or other distributed ledger. Subsection (c) allows a purchaser to obtain control when there are multiple authoritative copies. However, similar to subsection (b), a purchaser must prove that it has obtained control of an electronic copy of a record evidencing chattel paper by being able to identify each electronic copy as authoritative or nonauthoritative, and identifying itself as the assignee of each authoritative copy. Also similar to subsection (b), the purchaser must have the exclusive power to both prevent others from adding or changing an identified assignee, and transfer control of the authoritative copies of that record.

The amendments, however, ensure that control of electronic chattel paper under an existing system compliant with existing Section 9-105(b) would also satisfy the requirements for control under the amended version of Section 9-105. The drafting purpose underlying these amendments, as explained in the Reporter's Note to new Section 9-314A, is: "*To accommodate current practices and future technology, the draft would allow the parties considerable flexibility in determining the method used to establish whether a particular copy is authoritative, as long as third parties are able to reasonably identify the authoritative copies that must be possessed or controlled to achieve perfection.*"

Transactional Considerations. These amendments will have a significant impact on asset-backed receivables that will be financed or purchased in capital markets transactions. Originators of and investors in securitized receivables will need to be aware of the implications of the amendments as to how the related transactions are created, executed, transferred and held, and also the attributes of the systems that they rely upon to do so. Among other things, participants in capital markets transactions involving leases or secured financings of receivables evidenced by records maintained on a distributed ledger, like blockchain, will need to be certain that the system technology clearly align with the related perfection and priority implications of new subsection (c) of Section 9-105.

Hybrid ("Bundled") Transactions. For context, the Reporter's Note describes "bundled transactions", generally, as transactions in which the passing of title to goods from the seller to the buyer in return for a price (i.e., a sale), or the transfer of the right to possession and use of goods for a term in return for consideration (i.e., a lease), is part of a larger transaction. The related amendments in the Draft refer to these transactions as either "hybrid transactions" if the integrated transaction includes a sale of goods or a "hybrid lease" if the integrated transaction includes a lease of goods.

However, there are currently a spectrum of transaction types involving goods and non-goods that might be considered bundled transactions for the purposes of these amendments, including "*as a service*" transactions. The equipment finance industry has referred to this rapidly growing transactional trend as "servitization." Examples of these transactions could include: a tech services contract which includes a lease or sale of laptops; related access to servers and a license of the related software; a copier lease or sales contract coupled with an agreement to provide related supplies and maintenance: and an imaging availability agreement providing for a lease or sale of imaging equipment and an agreement to provide related consumables and maintenance and software update services.

The Committee's approach to covering the commercial law implications of this emerging trend towards these integrated transactions was to expand the scope provisions of Article 2A (see § 2A-102) and Article 2 (§ 2-102) of the UCC in order to clarify when and the extent to which provisions of those Articles should be applied to "hybrid leases" under Article 2A or "hybrid transactions" under Article 2. These new categories of transactions are briefly explained below:

Leases. As amended in the Draft, Section 2A-102 now provides that: the entirety of Article 2A applies to the transaction if "*the lease-of-goods aspects of a hybrid lease predominate*" (see new Subsection (2)); and if "*the lease-of-goods aspects of a hybrid lease do not predominate: (A) only the provisions of this* [Article 2A] *which relate primarily to the lease-of-goods aspects of the transaction and not to the transaction as a whole apply*" (see new Subsection (3)(A)). Further, new Subsection (3)(C) provides that if "*the lease-of-goods aspects of a hybrid lease do not predominate: (C) Section 2A-407 applies to the promises of a person that is the lessee in a finance lease to the extent the promises are consideration for the right to possession and use of the leased goods.*"

Related to that amendment, the term "*hybrid lease*" has also been added as subsection (1)(aa) to the definitions in Section 2A-103, and as so defined means "*a single transaction involving a lease of goods and: (i) the provision of services; (ii) a sale of other goods; or (iii) a sale, lease, or license of property other than goods.*" The Official Comment includes as an example of a hybrid lease, a single transaction involving a lease of a copier by the lessor together with a sale of paper, staples and toner, and the provision of routine maintenance and repair services, all in return for periodic payments by the lessee.

If enacted as currently drafted, new Subsection (3)(C) of the amended scope provision of Article 2A should afford considerable advantages for lessors, financing providers and investors participating in these types of integrated (bundled) transactions, assuming that the integrated lease satisfies the "finance lease" criteria in Section 2A-103(1)(g) (essentially, the lessor is merely the financier and not the supplier of the leased equipment). The significance of having Section 2A-407 apply to either the entire hybrid lease under Section 2A-102(3)(A), or to the promises of the lessee of the type described in Section 2A-102(3)(C), is that the lessee's promise to pay rent with respect to either the entire transaction or at least the integrated lease would be statutorily irrevocable and independent upon the lessee's acceptance of the copier (i.e., "*hell or highwater*").

As context, using the above-referenced hybrid copier lease as an example, assuming that the lease of the copier aspects of that integrated transaction predominate, and that the copier lease is a "finance lease," the lessee's obligation to pay the entire amount due under the hybrid lease should be "*hell or high water*" upon the lessee's acceptance of the copier. Or, if the lease of the copier aspects do not predominate, but the integrated copier lease is a "finance lease," the lessee's obligation to pay the rent for the copier will be "*hell or high water*." Further, the related Official Comment in the Draft provides some guidance as to how to structure and document a hybrid lease so as to support the application of these finance lease protections.

Sales. As context, similar amendments were made to Section 2-102, the scope provision of Article 2. As amended in the Draft, the scope of Article 2 would include the application of its provisions to the entirety of a hybrid transaction under Section 2-102(2) if "*the sale-of-goods aspects of a hybrid transaction predominate,*" but under Section 2-102(3) if "*the sale-of-goods aspects of a hybrid transaction do not predominate, only the provisions of this [Article 2] which relate primarily to the sale-of-goods aspects of the transaction and not to the transaction as a whole apply*."

Related to that amendment, the term "*hybrid transaction*" has also been added as subsection (5) to the definitions in Section 2-106, and as so defined means "*a single transaction involving a sale of goods and: (A) the provision of services; (B) a lease of other goods; or (C) a sale, lease, or license of property other than goods.*"

Useful Reporter's Notes were included in the Draft following the amended version of Section 2-102 that are intended to provide guidance as to the scope amendments under both Article 2 and Article 2A. The Notes explain, in the context of Article 2, what might be considered a "hybrid transaction" – "*transactions that cover both goods and non-goods, such as transactions that involve the sale of goods and either the provision of services or the transfer of property other than goods. (These transactions are often referred to as "hybrid," "mixed," or "bundled" transactions.)*"

The Notes also explain the "*predominant purpose*" and "*gravamen*" approaches embraced by the revisions to Section 2-102. Per the Reporter, "[a]*s a general matter, courts have applied Article 2 to such transactions when the goods aspect of the transaction predominates and have declined to apply this Article when the non-goods aspect predominates*," and new Subsection (b) of revised Section 2-102 adopts this "predominant purpose" approach. Further per the Reporter, when an issue relates solely to the goods aspect of the transaction (e.g., conformity of the goods to the contract), it is appropriate to apply Article 2 to that issue, even if the goods aspect of the transaction does not predominate. The Reporter notes that this "gravamen" approach has expressly been applied by some courts and implicitly adopted by others, and is adopted by new Subsection (c) of revised Section 2-102. The Reporter also notes the trepidation regarding certain aspects of the amendments. The Reporter's Note to Section 2A-102 cross-references but does not repeat the explanations in the Reporter's Note to Section 2-102.

Transactional Considerations. The Reporter's Note explains the purpose of these scope amendments as follows:

"*Operating on the assumption that, in part due to emerging technologies, hybrid transactions are increasing and will continue to increase – in total numbers, in the dollar amount of their collective price, and as a percentage of number transactions involving a sale or lease of goods – the draft seeks to provide more clarity to the law by adopting the bifurcation approach and providing extensive comments on how to apply it.*" As mentioned above, if ultimately accepted and included in the final version of the UCC amendments, achieving finance lease - "*hell or highwater*" status of all or a part of a hybrid lease would be a very meaningful achievement for the equipment finance industry. The amendments will significantly impact how these emerging transactions will be structured and documented, and will have beneficial implications when the related receivables are included in asset-backed capital markets transactions.

Conclusion; Status of the Process. The ALI/ULC Committee will continue to refine the Draft. The Committee's current plan is for the amendments to be finalized in 2022 with a view to obtaining approval of the ALI membership at the ALI Annual Meeting in May 2022 and of the ULC at its Annual Meeting in July 2022. The amendments would then be offered for enactment by the states. If the amendments as currently drafted are enacted by most if not all of the states, transacting on blockchain platforms, financing digital payment rights, and relying on virtual currencies as an exchange of value will be facilitated and accelerated. Further, the systems and practices in originating and financing receivables related to leases or secured financings of equipment, especially if digitized, will require adjustments by the parties to those transactions. Lastly, the emerging "servitization" trend in most of the equipment finance market should be much more attractive to originators, financing providers and investors as a result of the statutory clarity regarding the reliability of the customer's payment obligations.

When the Committee was first formed, invitations were sent to large groups of potential stakeholders including trade organizations, financial institutions, technology companies, government agencies and others were invited to be "observers." The author of this article is one of the few "observers" invited to provide guidance to the Committee regarding equipment finance matters, and one of the three industry lawyers who participated in a working group with the chair of the Committee and the Reporter and Associate Reporter focusing on hybrid transactions and sales, and contributed significantly to the text of the amendments to Section 2A-102 and the related Official Comments and examples. We will continue to share developments and perspectives in future GTF newsletters regarding all of the amendments that are likely to be impactful to industry participants.

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Endnotes

Buying Aircraft – PDPs, Financial Assistance and Liquidated Damages:

1. SpiceJet Ltd v De Havilland Aircraft of Canada Ltd [2021] EWCA Civ 1834.

Senate Passes Ocean Shipping Reform Act of 2022: Overhaul of The Shipping Act Expected

[1] Senator Klobuchar also introduced the Ocean Shipping Competition Reform Act of 2022 (S. 3586), which has been referred to the Committee on the Judiciary.

[2] OSRA 2021 was received in the Senate on December 9, 2021, and referred to the Committee on Commerce, Science, and Transportation.

[3] 46 U.S.C. §§ 40101 – 41309.

[4] A "common carrier" is broadly defined to include ocean common carriers and non-vessel-operating common carriers. *Id*. at § 40102(7).

[5] An "ocean common carrier" is a "vessel-operating common carrier." *Id*. at § 40102(18).

[6] An "ocean transportation intermediary" is an "ocean freight forwarder" ("OFF") or a "non-vessel-operating common carrier" ("NVOCC"). *Id*. at § 40102(20) An OFF is a person that, "(A) in the United States, dispatches shipments from the United States via a common carrier and books or otherwise arranges space for those shipments on behalf of shippers; and (B) processes the documentation or performs related activities incident to those shipments." *Id*. at 40102(19) A NVOCC is a common carrier that "(A) does not operate the vessels by which the ocean transportation is provided; and (B) is a shipper in its relationship with an ocean common carrier." *Id*. at 40102(17).

[7] The OSRA 2022 provisions on retaliation should be read in conjunction with the Commission's recent Statement on Retaliation, issued on December 28, 2021 (Docket No. 21-15).

[8] Id. at § 41104(a)(3).

[9] *Id*.

[10] 46 C.F.R. Part 545.

[11] Id. at § 545.5.

[12] *See* Federal Maritime Commission, *Demurrage and Detention Billing Requirements*, Advance Notice of Proposed Rulemaking, Docket No. 22-04, 87 Fed. Reg. 8506 – 8509 (Feb. 15, 2022).

[13] Unlike OSRA 2021, however, section 7 of OSRA 2022 does not require legal compliance statements or certifications to be made by MTOs in connection with their demurrage charges.

[14] 46 C.F.R. § 545.5. In recent testimony before the Senate Committee on Commerce, Science, and Transportation, FMC Commissioner Rebecca Dye emphasized the point that the Interpretive Rule is not "merely guidance," but that it "acts as the 'interpretation' of demurrage and detention charges as potential 'unreasonable practices' under section 41102(c) of [the Shipping Act]." See The Ocean Shipping Reform Act, Hearings Before the Senate Committee on Commerce, Science, and Transportation, 117th Cong., 2d Sess. (March 3, 2022) (Testimony of Rebecca F. Dye).

[15] 46 U.S.C. § 41302.

[16] *See* Congressional Record at H4131 (Apr. 4, 2022).

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