

# Global Sanctions Against Russia Present Potential Challenges to Aviation Finance & Leasing Companies

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In 2014, the **United States, Canada, and the European Union**, among others, implemented individual sanctions against Russia *in response to Russia's military incursion into Ukraine*. Each of these *sanctions may have significant ramifications for financiers, lessors and sellers in the aviation finance and leasing industry* that seek to do business in Russia. It is important for these industry participants to recognize the purpose and scope of these sanctions in order to take the steps necessary to minimizing both risk of non-compliance and contractual risk. The discussion below provides a general overview of the sanctions against Russia, and a discussion of the potential impact these sanctions could have on aviation finance and leasing industry participants as well as steps these industry participants should take to *minimize risk associated with business operations in Russia and Crimea and with Russian and Crimean individuals*.

## Prohibited Activities

The United States Treasury Department's Office of **Foreign Assets Control (OFAC)** has enacted several provisions restricting access to the U.S. debt and equity markets by major Russian banks, energy companies, and defense companies. These sanctions prohibit U.S. persons, including their foreign branches or subsidiaries owned or controlled by U.S. entities, from providing financial services or assistance in new debt and equity that has a maturity date exceeding a relatively short period of time (e.g., 30-days) to certain Russian companies identified in the Sectoral Sanctions Identification List (the SSI). The U.S. also restricts the export of certain goods and technology to certain Russian companies on the SSI. Late last year, OFAC widened these Russian related Ukrainian sanctions when it promulgated restrictions specific to the Crimea region of Ukraine. These provisions prohibit new investments in Crimea by U.S. persons, imports (direct or indirect) from Crimea into the U.S., exports or re-exports from the U.S. (or a U.S. person), and the provision of any assistance to a foreign person in a transaction prohibited by these sanctions. OFAC has also enacted blocking provisions for the property of certain Crimean persons.

Similarly, Canada, through its *Special Economic Measures Act*, has also placed restrictions on certain Russian banks and other targeted industries within Russia. The Canadian regulations restrict access to Canadian debt and equity markets for transactions with a maturity date exceeding 30 days. Finally, the European Union also has enacted restrictions similar to those enacted in the United States and Canada. The EU restrictions prohibit citizens of EU member states and corporations

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domiciled in EU member states from dealing with financial instruments having a maturity of greater than 30-days with certain Russian entities and also restrict the exporting of goods or technology that can be used by the Russian military. The EU also has enacted comprehensive sanctions targeting trade and investment against Crimea and Sevastopol.

Besides restricting targeted Russian companies from access to financial services and certain goods and technologies, the United States, Canada, and the EU also specifically blocked or froze the property and assets belonging to specifically enumerated persons (as well as those believed to be controlled by, or acting on behalf of such blocked persons). Although the restrictions of all three sanctions are similar, the Russian entities and individuals targeted vary in the United States, Canada, and the EU regulations. As a result of these variations, companies therefore, are wise to conduct jurisdiction specific due diligence prior to consummating a transaction in Russia or with Russian individuals or entities.

## **Impact of Sanctions on the Aviation Finance and Leasing Industry**

Penalties for violating the Russian sanctions can be substantial. However, the sanctions are by design targeted to reach specific individuals and entities believed to be engaged in actions (or those closely associated with them) contributing to Russia's current activities in the Ukraine. In other words, the sanctions in no way serve as a complete bar to doing business in Russia.

What does this mean for the aviation finance and leasing industry? Generally, the burden of compliance with these sanctions rests on the industry participants seeking to do business. For example, if a U.S. aircraft lessor wants to execute a lease in Russia today, the lessor should be mindful of the U.S. regulations both prohibiting U.S. "persons" from transacting in new debt (and equity) for certain Russian entities and blocking the property and assets of certain Russian individuals. To maximize compliance with the sanctions, U.S. companies should:

- Obtain the name (and if an individual, the date and place of birth) of each Russian purchaser seeking to enter into a lease agreement with the U.S. company for an aircraft. Check the names (and if individuals, the dates and places of birth) of the Russian purchasers against the Russian companies listed on the SSI, and for Russian individuals, the names of individuals listed on the Specially Designated Nationals List (SDN).
- Ensure that technology or equipment that the U.S. aviation company sells or finances for a company in Russia is restricted from being put to military use.
- Ensure that no debt financing is provided to Russian financial institutions or defense companies exceeding 30-days maturity, and no new equity financing of persons determined to be subject to the Directive, i.e., the Russian financial institutions identified in the SSI.
- Confirm that the purchaser, lessee or finance counterparty in any aircraft transaction is not an entity identified in the SSI or the SDN.

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In addition to the steps above, it is imperative for companies to keep apprised of changes to the various lists of covered Russian entities and individuals sanctioned by the U.S., Canada, and EU since the sanctions tend to operate independently of one another.

How could the interplay of the U.S., Canadian, and EU sanctions impact aviation finance and leasing industry participants? There is no per se reciprocity between the jurisdictions imposing the sanctions discussed above, and the overlap between the U.S., Canadian, and EU sanctions is a source of confusion. A recent example is illustrative. On August 4, 2014, Dobrolyot Airlines, a Russian subsidiary of Aeroflot (also a Russian company), had its lease agreement for two Boeing aircraft annulled due to the enactment of Canadian sanctions. As a result, Dobrolyot was forced to suspend various flights. Interestingly, Dobrolyot is not restricted by U.S. sanctions; in fact, Dobrolyot signed a contract with Boeing a few days later for the purchase of 16 new commercial aircraft. Why was the lease of U.S. manufactured aircraft annulled by the EU sanctions but the contract for the sale of the aircraft by the U.S. manufacturer permitted?

With regard to the annulled lease agreement, Dobrolyot was leasing its two Boeing 737-800s from BBAM, an aviation leasing firm. BBAM is 50% owned by Onex Corp., based in Toronto, Canada. In early August 2014, Canada expanded its list of sanctioned entities to include Dobrolyot. BBAM's lease agreement with Dobrolyot appears to have contained an "illegality clause." Typically, inclusion of an illegality clause in a lease agreement either results in the immediate right of the lessor to terminate the lease, or to a period of mitigation where the parties may attempt to restructure the transaction in a fashion that is not illegal. If such attempts are unsuccessful, the lessor then has the right to terminate the lease. Since the Canadian sanctions prohibited dealings with Dobrolyot, BBAM, probably at the direction of Onex Corp., annulled the lease agreement with Dobrolyot. In contrast, the sale of the 16 commercial aircraft by Boeing to Dobrolyot, which was announced shortly thereafter, was permitted because Dobrolyot is not restricted by the U.S. sanctions.

This example illustrates the caution aviation finance and leasing industry participants must use in transactions involving Russian entities or individuals. As the BBAM scenario showed, the economic sanctions may have the effect of annulling or cancelling existing agreements. The devil, as always, is in the detail. Nonetheless, there are several things industry participants can do to minimize their contractual risk in the event that the enactment of sanctions result in it being illegal for a financier or lessor to fulfill a contractual obligation.

First, if a financier or lessor is a party to an arrangement that is rendered illegal as a result of the enactment of sanctions, the financier or lessor should formally notify its Russian counterparty of the circumstance and expressly reserve any rights the financier or lessor has under the agreement to terminate it, pending further investigation of the impact of the sanctions. Second, companies should be certain to include an "illegality" clause in their agreements to guard against the risk that new economic sanctions prohibit the continuation of a sale, lease or financing arrangement. For maximum protection, this clause should be accompanied with a clause providing indemnity for all losses the seller or financier may sustain as a result of the termination. Finally, financiers should consider including a negative covenant prohibiting an aircraft subject to a sale or financing from being operated in a way that would violate applicable sanctions. A case-by-case analysis will be required to determine the coverage of the sanctions against Russian entities and individuals. Rightly, many within the aviation finance and leasing industry have recognized that the recently imposed Russian sanctions make doing business in Russia a risky proposition. However, keeping abreast of them and following the aforementioned guidelines will minimize the risks of conducting business that touches Russia and Crimea or Russian and Crimean individuals.

Violations of OFAC sanctions can lead to severe civil and criminal penalties, including jail terms of individual executives. Given the complexity of these business transactions, the number of parties involved, and the continuous adjustments to the sanctions, aviation finance and leasing industry participants should seek legal guidance prior to engaging in transactions that may pose a high degree of legal risk. To this end, should questions arise about the impact of the sanctions discussed above, or any of the sanctions the OFAC administers, OFAC attorneys will provide non-binding general and informal guidance telephonically, in writing, or through face-to-face meetings. Where the transaction details merit explicit U.S. approval, industry participants can formally apply for a "license" from OFAC to engage in the transaction. These licenses can be obtained through a formal written request to OFAC stating in detail the proposed transaction.

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