Global Transportation Finance Newsletter

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In This Issue

Buyer Beware: Court Upholds Punitive Damages Waiver in Case Alleging Fraud for "New" Aircraft Sale

In a recent decision,[1] the Texas Supreme Court upheld a contractual waiver of punitive damages despite a finding of fraud by the seller in the sale of a supposedly new aircraft that instead contained used and repaired engines. Though typically not available for breach-of-contract claims, punitive damages (also called exemplary damages) may be awarded in addition to actual damages in cases involving fraud or other types of egregious behavior, both as a punishment and to serve as a deterrent. Waivers of punitive damages are often found in contracts involving the sale and financing of aircraft assets, notwithstanding some uncertainty as to the waivers' utility and enforceability. In the case at hand, the Court upheld such a waiver and reversed the jury's award of significant punitive damages.[2]

Background[3]

In 2010, the plaintiffs (two high-net-worth individuals and their controlled entities) purchased a new[4] Challenger 300 aircraft from Bombardier through its subsidiary, Flexjet. The plaintiffs also engaged Bombardier, again through Flexjet, to provide management services for the aircraft. Rather than engaging a third party to inspect the aircraft and accept delivery, under the purchase and management agreements, the plaintiffs gave Bombardier exclusive power over inspection and technical acceptance.[5] Both the aircraft purchase agreement and the management agreement included limitation of liability clauses whereby the plaintiffs expressly waived the right to seek punitive damages.[6]

Following delivery of the aircraft, the plaintiffs became dissatisfied with Flexjet's management services and eventually cancelled the management arrangement. Upon a subsequent inspection of the aircraft, the plaintiffs discovered that rather than being new, the aircraft's engines were delivered in 2008 and had been installed and removed multiple times on at least two other aircraft. Further, one of the engines had previously been repaired for an interstage turbine temperature (**ITT**) split as well as water contamination and oil-wetted cavities.

Jeffrey T. Veber Named to Vedder Price Executive Committee

Vedder Price is pleased to announce that Jeffrey T. Veber, a Shareholder in the Global Transportation Finance team and a member of the Board of Directors, has been named to the firm's Executive Committee.

Mr. Veber has over 25 years of experience representing clients in transportation finance matters, advising lenders, including commercial and investment banks and export-credit agencies, equity participants, funds, leasing companies and other financiers and investors in a wide range of matters. These matters include cross-border leveraged leases, asset backed securitizations, structured financings, mortgage financings, back-leveraged operating lease financings, joint ventures and asset purchase agreements involving commercial aircraft and railcars.

Since joining the firm in 1994, Mr. Veber has been highly regarded in the industry as a top transportation finance lawyer.

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According to the Court, Bombardier knew of the engine's history but never told the plaintiffs. The Court further noted that one of Flexjet's pilots noticed the ITT split during the aircraft's initial flight and raised the issue with certain other Flexjet employees, all of whom believed the plaintiffs should be made aware of the engine's history, however, Bombardier operations executives ultimately directed them not to tell the plaintiffs. Further, expert testimony provided at trial stated that the engine's flight hours before being used on the aircraft were not properly recorded, and that nothing in the engine logbook showed the extent of the ITT split or its cause even though that information should have been recorded.

The plaintiffs sued Bombardier asserting several claims, including breach of contract and fraud. The jury in the trial court found in favor of the plaintiffs on both the breach of contract and fraud claims and awarded the plaintiffs both actual and punitive damages on the fraud claim. Bombardier appealed the verdict, which the court of appeals affirmed. Bombardier then appealed to the Texas Supreme Court, arguing among other things that the limitation of liability provisions in the purchase and management agreements precluded any recovery for punitive damages.

The Court's Decision

The Texas Supreme Court reversed the award of punitive damages to the plaintiffs and upheld the validity of the waiver of punitive damages clauses in such agreements, on the basis that both the purchase agreement and the aircraft management agreement: (i) were freely entered into by sophisticated parties represented by attorneys in an arm's-length transaction, and (ii) included an express limitation of Bombardier's liability for punitive damages. The Court explained "as the plaintiffs point out, we have held that 'fraud vitiates whatever it touches.' ... We have never held, however, that fraud vitiates a limitation-of-liability clause. We must respect and enforce terms of a contract that parties have freely and voluntarily entered." The Court stated that parties to a contract may bargain to limit punitive damages, as was done by the plaintiffs and Bombardier in the purchase and management agreements. While acknowledging that Bombardier's failure to provide the plaintiffs with the new engines they bargained for was "reprehensible," the Court's decision recognized the "strongly embedded public policy favoring freedom of contract."

The Court also commented on the seeming contradiction that the plaintiffs sought both to enforce the agreements in part (by seeking an award of actual damages as opposed to rescission based on the fraudulent conduct) and to invalidate the agreements in part (by striking the limitation-of-liability clauses), noting "the plaintiffs 'cannot both have [the] contract and defeat it too.'"[7]

In reaching its decision, the Court indicated that because the plaintiffs did not assert a breach-of-fiduciary-duty claim (relating to the fiduciary relationship created between the parties by a power of attorney granted to Bombardier to inspect and approve the aircraft), it elected not to decide the issue of whether a breach of fiduciary duty for fraudulent conduct would affect the validity of a contractual waiver of punitive damages.

Conclusion

Given the complexity of the case and the various issues involved with respect to both the fraud claim and the other claims asserted, a different result could be reached based on the causes of action asserted and the remedies pursued. The result of this case should not be seen as binding in jurisdictions other than Texas, and a different result could also be reached based on the venue for a case. Nonetheless, it seems the plaintiffs may have

"Jeff has already demonstrated himself as a strong leader in the firm's New York operation and globally for our transportation finance practice," said Michael A. Nemeroff, President and CEO. "His considerable experience and business acumen will help drive Vedder's continued client-focused approach and long-term business strategy. We look forward to his contributions in this well-earned leadership position."

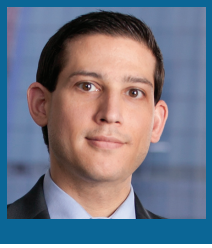
"It's an honor to serve on our Executive Committee and help lead the firm's direction and growth into the future," said Mr. Veber. "I've been privileged to work with terrific colleagues and top-notch attorneys over these last 25 years at Vedder, and I look forward to contributing my perspective to the collective success of our attorneys and clients alike."

Among his many accolades, Mr. Veber has been recognized in Euromoney's *The Best of the Best: Aviation Law, The International Who's Who of Aviation Lawyers, Chambers USA* in the category of Nationwide Transportation: Aviation: Finance, Chambers Global in the Aviation: Finance category, *Legal 500 United States* in the Transport: Aviation and Air Travel—Finance and Transport: Rail and Road—Finance categories, and in *The Best Lawyers in America* in the field of Equipment Finance Law. ▪

avoided this outcome had they taken some simple precautions, and in this regard we note the following practical tips:

First, in relation to contractual drafting, where an agreement contains a limitation-of-liability clause, consider including an exception stating that the clause will not apply in the event of fraud. Such exceptions are common, and it can be difficult for a counterparty to argue (especially to its customer) that it should be protected in the event of its own fraud or other similarly bad conduct.[8] In addition, even for a new aircraft purchase, provide sufficient detail in the purchase agreement of the expected condition of the aircraft and its components at the time of technical acceptance, including an express statement that the aircraft (and all of its components, including the engines) will be new. While not stated as a factor in its decision, the Court's note that the purchase agreement did not clearly indicate a "new" aircraft may have signaled a willingness to consider a defense based on contractual ambiguity.

Second, engage experienced advisors at the outset of any aircraft transaction to provide counsel on the various legal and technical considerations involved. Legal counsel experienced in aircraft purchases could have suggested certain contractual protections for the plaintiffs, such as the ones noted above. Similarly, an experienced technical advisor could have worked with legal counsel to craft appropriate contractual language for the required delivery condition as well as suggest a qualified inspector for the aircraft and reject technical acceptance until any nonconformity with the required condition was rectified. Aircraft are expensive and technically complex assets, and as such it behooves parties in aircraft transactions to work with experienced industry professionals who can identify potential problems at the appropriate time: before they come to fruition. ■



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Honors & Awards

Chambers Global ranks Vedder Price **Band 2** in both Aviation: Finance and Rail: Finance. Gavin Hill and Ronald Scheinberg are ranked **Band 2**, and Francis X. Nolan, III and Jeffrey Veber are ranked **Band 3.**

Chambers USA 2019 **Transportation: Aviation Finance—Nationwide** ranks Vedder Price **Band 1**— the guide's highest honor—for the ninth year in a row. Ronald Scheinberg is ranked **Band 1**, Geoffrey R. Kass and Jeffrey T. Veber are ranked **Band 2**, Adam R. Beringer and Cameron A. Gee are ranked **Band 3.**

Chambers USA 2019 **Transportation: Shipping/Maritime Finance—Nationwide** ranks Vedder Price **Band 2**. Francis X. Nolan, III is ranked **Band 2**.

Vedder Price was named the **2018 Law Firm of the Year** at the ***Airline Economics*** **Aviation 100 Awards**, thus being recognized as the top aviation law firm in the Americas.

Embraer v. Dougherty Air Trustee: Avoiding Foot Faults in Your Residual Value Guarantee Contract

In the early 1990s, airlines primarily relied on two types of aircraft to transport their passengers: (1) small turboprops and (2) single-aisle 100-seat jets. Seeking to exploit a potential gap in the market, Bombardier and Embraer introduced a new 50-seat regional jet to the airline industry. Aside from providing significant fuel savings and creating new opportunities to provide service to smaller destinations, the regional jet enabled major U.S. airlines to take advantage of the "scope clause" contained in their contracts with pilot unions. By having only 50 seats, these new regional jets were exempted from union contracts, which permitted the airlines to subcontract their operation to regional airlines that had much lower labor costs. These benefits caused regional jet manufacturing to boom—to date, Bombardier[1] and Embraer[2] have delivered more than 1,000 of their respective regional jets to their customers.

History of Residual Value Guarantees

In order to facilitate the sale of regional jets, manufacturers offered residual value guarantees (**RVGs**) to airlines and investors. In these RVGs, the manufacturer provided the airline or the investor in the aircraft with a specific guaranteed value at the end of the lease or loan term. If, at the end of the term, the fair market value of the aircraft was below the guaranteed amount, the manufacturer was required to pay the difference as long as the conditions to payment under the relevant RVG were satisfied. Many of the underlying loans and leases for these original RVGs are now expiring, and the manufacturers are looking at potentially significant liabilities. As of December 31, 2018, Bombardier's maximum exposure for its RVGs was $695 million,[3] and as of December 31, 2017, Embraer had potential exposure of $375.1 million.[4] Under the RVG, the owner of the aircraft and the manufacturer are meant to work together in the return process to maximize the value of these aircraft; however, in today's market, the secondary trading and part-out market for regional jets has diminished, so the owners of these aircraft are relying on RVGs to recoup their investments. Due to the fact that the aircraft owners and manufacturer's interests can be directly opposed to one another, a very complicated and contentious process can result.

Embraer S.A. v. Dougherty Air Trustee, LLC

In a recent case, *Embraer S.A. v. Dougherty Air Trustee, LLC,*[5] Embraer argued that it should not be required to make any residual value payment to Dougherty Air Trustee, LLC (**Dougherty**), the owner of the aircraft. As discussed below, Embraer prevailed at the New York Southern District Court,[6] and this case should serve as an important reminder to owners, lessors and other investors that they need to constantly refer to the specific terms in their own RVG to ensure that they comply fully with the requirements of the RVG.

AIRFINANCE JOURNAL

2018 Deal of the Year Awards

Vedder Price's Global Transportation Finance team took home seven "Deals of the Year" awards at the *Airfinance Journal* annual Awards Ceremony on May 2 at the Metropolitan Club New York.

Asia Pacific Deal of the Year: Vedder Price represented Macquarie Group on $4 Billion unsecured revolver and term loan

Editor's Deal of the Year: Vedder Price represented BBAM on their acquisition of the AirAsia leasing fleet from subsidiary, Asia Aviation Capital

Innovative Deal of the Year: Vedder Price represented the lenders in connection with $160 Million PDP financing with Spirit Airlines for 43 Airbus aircraft

North America Deal of the Year: Vedder Price represented Virgo Investment Group in the launch of the Zephyrus Aviation Capital Platform at $336.6 Million

Overall Capital Market Deal of the Year: Vedder Price represented ITE Management as the anchor equity investor in ALC's Thunderbolt II asset backed securitization at $450 Million

M&A Deal of the Year: Vedder Price represented Sky Leasing in $900 Million sale of Sky Aviation Leasing to Goshawk Aviation Limited

Restructuring Deal of the Year: Vedder Price represented BNP Paribas, DVB, Helaba and NAB in connection with French tax lease financing for BoComm Leasing for seven aircraft on lease to two different PRC airlines

Background of the Case

In this case, Embraer sold a new aircraft that was leased to Shuttle America Corporation (**Shuttle**) pursuant to a leasing agreement dated May 18, 2000 (the **Shuttle Lease**). The Shuttle Lease expired on November 18, 2016.[8] Simultaneously with execution of the Shuttle Lease, Embraer entered into an RVG that guaranteed the aircraft's market value at the expiration of the Shuttle Lease.[9] As is customary with RVG contracts, this RVG provided for certain "Termination Event[s]" under which Embraer would be released from its obligation to pay any amount.[10] One of these Termination Events was the termination of the Shuttle Lease prior to its expiration date. However, the RVG could be revived if "a replacement lease on substantially the same maintenance, assignment, and return terms and conditions as the [Shuttle Lease]" was entered into.[11]

In February 2016, Shuttle filed for bankruptcy, and in April 2016, the bankruptcy court entered an order rejecting the Shuttle Lease.[12] As part of the bankruptcy proceedings, Shuttle returned the aircraft to Dougherty; and Dougherty was awarded approximately $1.95 million as settlement for the rejected Shuttle Lease.[13] After Shuttle's bankruptcy, Dougherty entered into a new lease with Coleman Jet, LLC (**Coleman**)[14] to try to revive the RVG. As part of the lease (the **Coleman Lease**), Coleman entered into an assumption agreement pursuant to which it agreed to "assume all obligations of [Shuttle] under the RVG."[15] Dougherty sent a copy of the assumption agreement to Embraer and asked Embraer to execute, but Embraer never executed it.[16] In order to satisfy the return conditions under the RVG, Dougherty sent the aircraft in for maintenance but ran into issues regarding the extent of needed repairs.[17] Eventually Dougherty was able to complete the restoration maintenance, and it informed Embraer that the aircraft was ready for inspection. However, Embraer never performed any such inspection.[18] After not receiving any cooperation from Embraer, Dougherty sold the aircraft to a third party and demanded payment under the RVG from Embraer. Embraer rejected the claim and filed the declaratory judgment action described in this case.[19]

Embraer argued that (1) Dougherty was estopped from claiming any payment under the RVG, since it had already done so in addition to recovering in connection with the Shuttle bankruptcy,[20] (2) the Coleman Lease did not satisfy the requirements of a "Replacement Lease" under the RVG and (3) Coleman did not satisfy the requirements of a "Replacement Lessee" under the RVG.[21] Embraer prevailed on all three arguments, and the court granted summary judgment in favor of Embraer.

In defense of Embraer's first argument, Dougherty asserted that even though it had agreed to settle its claims with Shuttle, it did not waive its rights to make claims against third parties, including Embraer.[22] Even though the $1.95 million settlement it received from Shuttle was $585,000 less than the payment it would have been entitled to receive under the RVG,[23] the court deemed this to be a compromise made by Dougherty, and it estopped Dougherty from trying to sue Embraer for RVG payment.[24] This decision highlights the fact that aircraft owners and investors must be mindful that any settlement discussions relating to an aircraft, whether involving the manufacturer or not, can have a potential impact on their investments.

Recent Speaking Engagements

January 27-31, 2019
Corporate Jet Investor & Helicopter Investor Conferences, London

Shareholders Edward K. Gross and David M. Hernandez attended the Corporate Jet Investor and Helicopter Investor conferences in London. Mr. Gross moderated **Has Cape Town Made a Difference?** at CJI and **Financing Rotary Assets** at the Helicopter Investor conference. Mr. Hernandez moderated **Do Owners Value Safety Oversight?**

February 22, 2019
10th Annual Capital Link Greek Shipping Forum, Athens

Shareholder John F. Imhof Jr. moderated **New Sources of Financing**, a panel that discussed the emergence of new sources for maritime financing, how to utilize them and how they impact the market.

February 27, 2019
18th Annual German Ship Finance Forum, Hamburg

London Partner Dylan Potter moderated a session entitled **Retrofit Export Financing**, in which he interviewed KfW IPEX Vice President Stephen Vetter regarding the increasing use of retrofit export financing and how it impacts the maritime industry.

March 7, 2019
American College of Investment Counsel, Webinar

Shareholder Michael E. Draz presented a webinar entitled **Introduction to Aviation Finance: Key Legal Framework and Transaction Structures**, in which he provided a high-level overview of the state, federal and legal framework underpinning aircraft finance and explored some common transaction structures.

March 19-20, 2019
Airline Economics Growth Frontiers Korea 2019, Seoul

Shareholder Geoffrey Kass moderated **Aviation ABS—Kestrel Case Study and Aviation and the Capital Markets**, while Shareholder Ji Woon Kim presented **The Fundamental Mechanics of the Cape Town Convention & Global Aircraft Trading System (GATS) Update**. The conference brought together aviation leaders to exchange ideas and discuss "life cycle management and transitions" in aviation.

On Embraer's second argument, the court used the definition of a lease under New York contract law, since "lease" was not defined within the RVG. The failure to define the term "lease" gave the court the ability to analyze the substance of the Coleman Lease in detail. The court found that since Coleman was paying $0 in rent each month until the aircraft became airworthy, the contract failed due to a lack of consideration.[25] Despite the defendant's argument that Coleman promised to pay rent in the future, the court found that the "Coleman Lease was little more than a sham document which Dougherty hoped would help it recover under the RVG."[26]

Finally, the court's analysis of whether Coleman met the requirements of a "Replacement Lessee" under the RVG came down to the court's interpretation of "Expiration Date" in the RVG. At the time the parties entered into the Coleman Lease, Coleman was not authorized to operate the aircraft, but Dougherty's position was that after the completion of certain maintenance on the aircraft, Coleman would have been able to obtain the necessary approvals from the Federal Aviation Administration (the **FAA**) to get the aircraft added to Coleman's operating certificate. In one section of the RVG, the term of the RVG could be extended for up to 150-180 days in order to comply with the various return requirements.[27] Dougherty argued that this 150- to 180-day extension period should also apply to the requirement for Coleman to have authorization under all applicable laws to operate the aircraft.[28] The court rejected this argument and held that the original expiration date of November 18, 2016 applied, even though it was tied to the non-existent Shuttle Lease.[29] The court then concluded that it would not have been possible for the necessary maintenance to be completed in time for Coleman to become authorized by the FAA. Since Coleman did not satisfy the requirements of a "Replacement Lessee" by November 18, 2016, the RVG was not revived, and Dougherty had no right to claim payment under the RVG.

Conclusion

Owners of and investors in regional aircraft that are subject to RVGs and are approaching their lease or loan maturity dates need to be diligent in their approach to the maintenance and redelivery options as these aircraft near lease maturity. Most of the RVG contracts were drafted over a decade ago and, as highlighted in this case, can contain very complicated, and sometimes subjective, wording laying out the conditions that must be satisfied before a manufacturer is actually obligated to pay. The specific terms in a RVG may be highly particularized for a specific owner or operator, but each RVG will generally contain requirements on the redelivery conditions, timing deadlines and manufacturer input. It is imperative that each owner and/or investor study these provisions and involve the manufacturer as early as possible in the return process in order to ensure a positive result. ■

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Recent Speaking Engagements

(continued)

April 1, 2019
13th Annual Capital Link International Shipping Forum, New York

Shareholder John F. Imhof Jr. moderated a panel entitled **Shipping & Bank Finance**, overviewing the state of the maritime industry and its relationship with banking. Capital Link hosts maritime, transportation and U.S. investment products events for executives in the global financial and investment communities.

April 9-10, 2019
ISHKA Investing in Aviation Finance: Europe, London

Shareholder Kevin MacLeod moderated a panel entitled **Will Tradable E-notes Bring More European Investors into the ABS Product?**, offering a breakdown of tradable e-notes as well as explaining the structure, conflicts and transparency issues involved in tradable e-notes.

April 28-30, 2019
ELFA Legal Forum, San Diego

Shareholder Edward Gross participated in the **Air, Rail, Marine Roundtable**, while Shareholder Arlene Gelman spoke on the **Legal Update** panel and Associate Melissa Kopit was a panelist on the **Cross-Border Lease Transactions Breakout**.

May 7-9, 2019
ISTAT Asia, Shanghai

Shareholders Ji Woon Kim and Bill Gibson presented **How to Structure an Operating Lease** as part of a supplementary workshop that is brand new to the conference. The session provided in-depth insights into the format and contents of an operating lease and how to put the pieces together. ■

Selecting the Best Aircraft Management Company

Selecting the best aircraft management company for an owner's particular needs is a complex and time-consuming process involving many variables and requires comprehensive due diligence. The primary reason the selection process is complex and time-consuming is because business aircraft are very sophisticated and expensive machines. Aircraft operate internationally with many different regulatory requirements, necessitating highly skilled flight crews and managers. Also, there are significant costs associated with operating and maintaining business aircraft. Finally, material differences exist between aircraft managers worldwide with respect to quality of services, capabilities and expertise. As a result, aircraft owners should consult with knowledgeable advisors and develop a detailed checklist to select the best aircraft management company to meet the owner's specific needs.

Determine Operational Needs

The first step an aircraft owner should perform is an assessment of its operational needs, which generally requires an owner to consult aviation advisors that have experience negotiating with aircraft management companies. As an initial matter, aircraft management company selection should be based on the aircraft model, owner's operational profile, desired operating base and manager's qualifications, experience and level of client services. An owner also needs to evaluate whether it wants to operate the aircraft exclusively for private, noncommercial operations or to make the aircraft available for third-party commercial charters to generate supplemental charter revenue. While third-party charters create a nice revenue stream, they limit the availability of the aircraft and increase the wear and tear on the aircraft.

Identify Potential Managers

Once an owner has completed its operational needs assessment, the next step is to compile a list of potential turnkey aircraft management companies. Fortunately, several highly qualified and capable management companies exist in the United States and internationally. Owners may start researching management companies by simply reviewing the manager's website, public Internet profile, and reputation in the industry. An owner also should look for a management company that has several aircraft under management, ideally move than five, for several reasons. First, you want to hire a manager with whom other owners entrust their aircraft. Second, you want a manager that is financially stable; having more aircraft under management generally increases the manager's financial stability. Finally, a manager with a large, varied fleet of aircraft (light, medium, heavy, etc.) will allow an owner to utilize a substitute aircraft if the owner's aircraft is grounded for maintenance or the owner needs a larger or smaller aircraft for a particular trip.

Next, research whether the manager has significant experience with the aircraft type, locations, certifications and ratings, and reputation in the industry. Consider an on-site visit to assess the manager's facilities and meet the relevant personnel. Key initial questions to ask are how many and what type of aircraft does the manager manage and can the manager meet the owner's operational needs, such as supporting the owner's flight profile and third-party charter requirements? For example, if an owner wants to operate the aircraft 200 hours per each year for personal/business use and charter the aircraft an additional 200 hours per year, can the manager meet the requirements? Also, the owner should inquire about potential charter revenue and set minimum charter rates. Owners and management companies often negotiate the associated minimum charter rate and revenue split. Setting the charter rate too low will actually result in the owner losing money on each charter. Depending on the relevant facts and circumstances, the management company will generally receive 10 to 15 percent of the charter revenue.

However, it is important to stress that the best management company for one client may not be the right management company for another. One size does not fit all.

Flight Crew and Maintenance Capabilities

An owner should inquire about the manager's flight crew staffing, training and aircraft maintenance capabilities as well as how exactly the manager will be able to support the owner's operations. Staffing at management companies may vary significantly in terms of size and expertise, so it's wise to

be specific. Does the manager utilize Flight Safety or other similar flight crew training programs? Does the manager have sufficient personnel to support the owner's operations? How large is the pilot pool for the owner's aircraft, and does the manager rely heavily on contract pilots? Some owners also prefer a dedicated flight crew—they want to see the same pilot(s) every time they board their aircraft.

Regarding maintenance, the management company should discuss its applicable ratings and qualifications, i.e., whether it possesses a repair station certification and employs mechanics qualified and rated to perform maintenance on the aircraft. A manager should also have the capabilities to maintain the aircraft on-site (with the exception of comprehensive schedule maintenance and engine overhauls) without outsourcing maintenance work. Managers should be aware of pending governmental maintenance mandates and potential upgrades. It is generally preferable to have maintenance performed by the manager as opposed to having it outsourced because it is less expensive and the manager will have a better sense of the aircraft condition, which tends to minimize downtime. Also, if you have a management arrangement, an owner should not have to pay retail for maintenance.

Financial, Accounting and Risk Considerations

Given the various costs and expenses associated with operating an aircraft, financial and accounting discrepancies are not uncommon and therefore financial and accounting considerations should also be addressed with a high level of scrutiny and detail. After initial discussions, an aircraft manager should provide a detailed term sheet with cost/expense estimates and an annual budget. An owner should demand transparency and audit rights, and the ability to contest questionable amounts should be expressly included in the management agreement. It is important that an owner have the explicit right in the associated management agreement to dispute any unfamiliar or irregular charges. The best aircraft management arrangements are based on trust and transparency, which should be reflected in the underlying agreements.

Generally, monthly management fees should be virtually the same across the region. The differences in costs stem from flight crew salaries, training, benefits, fuel, maintenance, parts, insurance (hull and liability), hangar fees and support services/ catering. All of these items should be itemized in the annual budget. Many management companies are able to pass on fuel discounts to their customers at home and at other locations, so inquire about fuel discounts. An owner needs to confirm that there are no "hidden" charges in order to avoid being shocked upon receipt of an invoice.

Risk considerations should also be discussed as they relate to the management company's safety record, as noted above, as well as insurance protections and indemnifications. An owner should obtain a copy of the insurance policy and confirm limits are sufficient to cover the owner's financial situation. Owners should also fully understand what indemnifications are contained in the associated management agreement. An indemnity is a contractual obligation of one party (indemnitor) to compensate the loss incurred by the other party (indemnitee) due to the act of the indemnitor. However, some agreements provide that the owner must compensate the manager for the manager's loss due to the actions of the manager even if the manager was negligent. In other words, an owner must fully understand what is being agreed to when signing a management agreement, and often management agreements are reviewed and negotiated by an owner's legal advisors and consultants.

Safety Record and Qualifications

Last, but not least, an owner should assess the manager's safety regulatory compliance history, safety record, rating and qualifications. The owner should inquire about the manager's regulatory compliance record and whether the manager has been involved in any accidents or incidents within the last five years or been the subject of any government enforcement actions. An owner should also ask whether the manager is member or is audited by an industry-recognized audit agency, Wyvern, Argus or International Business Aviation Council (IS-BAO). An owner should determine whether the management company has implemented a Safety Management System or similar safety protocol.

An owner also should determine the manager's compliance in the applicable jurisdictions in which it operates. An owner should ask how long the manager has been in business and the extent of its operations, and also ask whether it would be willing to provide references. To be clear, if an owner is

entrusting its $60 million Gulfstream G-650 to a manager, the owner needs to be thorough.

In sum, it is important to stress that the best management company for a particular owner may not necessarily be the best management company for another owner. Interestingly, we occasionally have two clients that have very different experiences with the same management company, so consider various aircraft management companies to ensure that you are getting the best possible aircraft manager for your unique aircraft management needs. Finally, the aircraft management agreement should be thoroughly reviewed and negotiated. It is very rare for owners to enter into management agreements without requesting revisions to address an owner's unique needs or industry standards. ■

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Footnotes

Buyer Beware: Court Upholds Punitive Damages Waiver in Case Alleging Fraud for "New" Aircraft Sale

1 The case is *Bombardier Aerospace Corporation v. SPEP Aircraft Holdings, LLC*; PE 300 Leasing, LLC; Saracen Pure Energy Partners, LP; Crane Capital Group, Inc.; James R. Crane; Floridian Golf Resort, LLC; Champion Energy Marketing, LLC; and Crane Worldwide Logistics, LLC. The Court's opinion can be found at: http://www.txcourts.gov/media/1443450/170578.pdf

2 The amount of punitive damages awarded was more than double the amount of actual damages. The ruling did not affect the actual damages award.

3 The factual and procedural backgrounds set forth herein are based exclusively on those outlined in the Texas Supreme Court's decision.

4 The Court stated that the purchase agreement never clearly indicated that the aircraft would be new. Nonetheless, the Court noted that "[i]n the purchase negotiations, [the individuals] specified they were agreeing to purchase a new aircraft" and it seems to have been accepted without contention that the aircraft would be new at delivery.

5 According to the court, the plaintiffs did not hire a third party as they believed that, among other things, "a new airplane. . .wouldn't. . .require an inspection."

6 The purchase agreement provided that "Flexjet will not be liable to either customer for any indirect, special, consequential damages or punitive damages arising out of any lack or loss of use of any aircraft, equipment, spare parts, maintenance, repair or services rendered or delivered under this purchase agreement." The management agreement provided that "[n]either party hereto may be held liable to the other party for any indirect, special or consequential damages and/or punitive damages for any reason, including delay or failure to furnish the aircraft or by the performance or non-performance of any management services covered by this Management Agreement."

7 In this regard we note that "severability clauses" are also commonly included as part of the contractual "boilerplate" in aircraft purchase and finance transactions. Such clauses state that if any provision of the contract is found to be invalid, the invalidity will render only that provision ineffective without invalidating the remainder of the contract. It is unclear whether the purchase and management agreements contained such a clause, and the Court's decision did not include any discussion on the effectiveness of such clauses.

8 One common formulation is that the clause will not apply in the event of "fraud, gross negligence or willful misconduct."

Embraer v. Dougherty Air Trustee: Avoiding Foot Faults in Your Residual Value Guarantee Contract

1 "Milestone delivery ranks CRJ Series as the most successful regional aircraft program ever and one of the best-selling commercial jetliner programs in history"(2003), https://www.bombardier.com/en/media/newsList/details.1381-milestone-delivery-ranks-crj-series-as-the-most-successful-regional-aircraft-program-ever-and-one-of-the-best-selling-commercial-jetliner-programs-in-history.bombardiercom.html (last visited March 4 2019).

2 "20 years of success and customer commitment" (2015) https://www.embraercommercialaviation.com/news/20-years-success-customer-commitment/ (last visited March 4, 2019).

3 Bombardier Inc. 2018 Financial Report, at 247 (February 14, 2019).

4 Embraer S.A., Annual Report (Form 20-F), at 9 (March 23, 2018).

5 *Embraer S.A. v. Dougherty Air Trustee, LLC*, No. 17 Civ. 850 (PAC) (S.D.N.Y. Dec. 12, 2018).

6 Dougherty has appealed the District Court's decision, and such appeal is currently pending at the Second Circuit U.S. Court of Appeals.

7 *Id.*

8 *Id.*

9 *Id.*

10 *Id.* at *3.

11 *Id.*

12 *Id.* at *5.

13 *Id.* at *6.

14 *Id.* at *8.

15 *Id.* at *7.

16 *Id.* at *8.

17 *Id.* at *9.

18 *Id.* at *10.

19 *Id.* at *9.

20 *Id.* at *11.

21 *Id.* at *19.

22 *Id.* at *13.

23 *Id.* at *16.

24 *Id.* at *18.

25 *Id.* at *20.

26 *Id.* at *21.

27 *Id.* at *5.

28 *Id.* at *22.

29 *Id.* at *23.

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Global Transportation Finance

The Vedder Price Global Transportation Finance team is one of the largest, most experienced and best recognized transportation finance practices in the world. Our professionals serve a broad base of clients across all transportation sectors, including the aviation, aerospace, railroad and marine industries, and are positioned to serve both U.S.-based and international clients who execute deals worldwide.