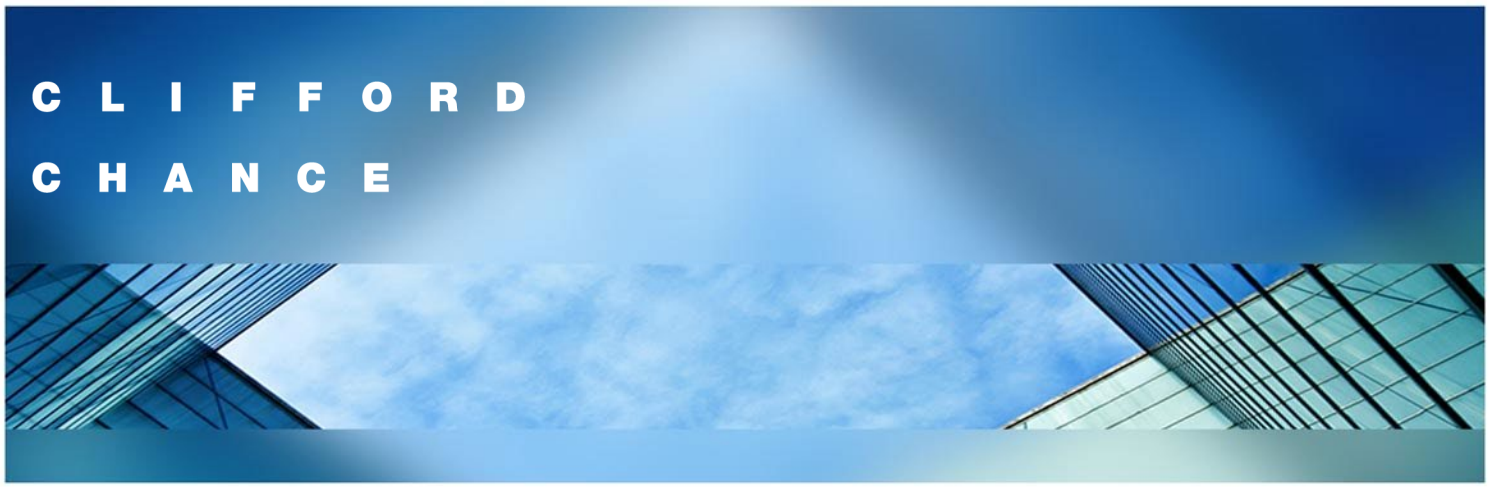

US EXPORT CONTROLS NEED TO BE PART OF YOUR PRE-FLIGHT CHECKLIST FOR COMMERCIAL AIRCRAFT TRANSFERS

Fueled by the current state of US-China relations, the US government significantly tightened US export control laws and related enforcement efforts. These measures remain in place with the current Administration and have exacerbated the pre-existing export control risks for global aviation companies and strained compliance systems.

US Export Controls Have an Extraterritorial Reach

The US Export Administration Regulations ("**EAR**") impose export requirements on a broad range of goods, including commercial aircraft. Under the EAR, the US Commerce Department's Bureau of Industry and Security ("**BIS**") requires a license for exports, re-exports, or other transfers, including sales and leases of commercial aircraft or commercial aircraft parts (e.g., engines) that are subject to the EAR to certain destinations, end users and end uses. The restrictions apply to aircraft or aircraft parts that are US-origin as well as aircraft that contain more than a *de minimis* level of export-controlled content (a sometimes complicated calculation). Most commercial aircraft are actually US-origin goods or contain adequate EAR- controlled US-origin parts or technology and are thus subject to US export control laws.

In contrast to the export control laws of most other countries, US export controls regulate exports, re-exports, sales, leases and other transfers of items subject to the EAR everywhere in the world, even if the transaction is between non-US persons and takes place outside the United States. For example, the regulations would require authorization for the transfer of US-origin aircraft parked at Heathrow (e.g., a Boeing aircraft) or non- US origin aircraft that contain 10% or more US export-controlled content (e.g., Airbus aircraft with GE engines) to Iran. Every flight to Iran is considered a re-export of the aircraft under US export controls and each would be a violation if done without the required authorization from BIS.

Further, US economic sanctions implemented and administered by the US Treasury Department's Office of Foreign Assets Control ("**OFAC**") generally

prohibit the involvement of US persons or the US financial system, including USD payments, in transactions involving sanctions targets (such as Specially Designated Nationals ("**SDNs**")) and sanctioned countries. Such prohibitions can apply even if those transactions involve non-US parties and begin/end outside the United Sates, unless OFAC has licensed or otherwise authorized such transactions. For example, US sanctions should be considered among other scenarios for all transfers that take place outside of the United States but involve USD payments.

Both OFAC and BIS enforce these requirements based not only on the actual knowledge of participating aircraft owners, operators or lessors, but also on what they "should have known." For example, OFAC's 2019 Iran-Related Civil Aviation Industry Advisory put the aviation industry on "notice" of certain deceptive practices. Accordingly, OFAC is unlikely to be sympathetic to claims an aircraft lessor was duped by one of these deceptive practices and inadvertently engaged in a prohibited transaction without the necessary authorization from OFAC.

US export controls could apply to sales, leases or other regular dealings involving aircraft that occur entirely outside the United States.

The following scenarios highlight examples of when US export controls need to be considered because of certain elements in the fact pattern:

- An Irish-based lessor repossesses a Boeing aircraft from a defaulting EU airline and re-markets to a Chinese airline – relevant elements: (i) the US-origin content of the aircraft, (ii) the new lease supplier and (iii) the PRC end user;
- A Chinese-based lessor leases an Airbus aircraft with GE engines (e.g., A330) to (a) a Southeast Asian airline and (b) a Middle East airline with an Iranian shareholder – relevant elements: (i) the US-origin content of the engines (and likely the airframe); (ii) the new lease supplier, (iii) the PRC supplier, (iv) the new end users of the aircraft and (v) additionally and specifically, in scenario (b), the Iranian shareholder;
- An Irish-based lessor purchases a Boeing aircraft from another Irish-based lessor with financing from an EU lender syndicate – relevant elements: (i) the US-origin content of the aircraft, (ii) the purchase supplier and (iii) the lessee/end user of the aircraft.

Regulatory Changes Tighten the Restrictions to Include China

The impact of US export controls on commercial aircraft is especially relevant given recent changes aimed at China and as the US implements new policies and regulations to treat Hong Kong the same as Mainland China; (Hong Kong previously under US regulations was afforded "Special Status"). These additional limitations and restrictions on exports to China and Hong Kong give rise to new export-control related risks for sales, leases and other transfers of commercial aircraft and aircraft parts to that region.

Further, recent amendments to the Military End Use and User ("**MEU**") under the EAR significantly impact export restrictions of commercial aircraft to purchasers in China or to Chinese persons/entities.

Under the MEU rule for China, which also applies to Burma, Russia and Venezuela, an exporter, re-exporter or transferor requires an EAR license if it knows or has reason to know that a covered item exported is intended for a "military end use" or to a "military end user". This license requirement applies to, among other things, certain commercial aircraft and aircraft parts (detailed in Supplement No. 2 to Part 744 of the EAR).

Previously, commercial aircraft were generally eligible for export to entities in China without a license for civil purposes even if the end users were military end users (i.e., US-origin commercial aircraft engines generally could be exported to China without a license for use on a military aircraft). Under the expanded requirements, even exports to a civil entity for a civil use could require an export license if that civil entity also develops, produces, maintains or uses military items, or otherwise "support(s) or contribute(s) to" a "military end use" as defined in Section 744.21 of the EAR. Importantly, BIS has stated that even if the item is intended for civilian use, as long as the intended end-user is a Chinese military end-user, BIS generally will deny such license applications.

In application, the MEU rule generally means a license is required for an export, re-export or transfer of any covered items to China:

- if the covered items are intended for military use (e.g., a civil aircraft engine that is intended for use on a military plane);
- if an entity is determined to be a "military end user" (i.e., the entity develops, produces, maintains or uses military items), then a license is required for the export, re-export or transfer of any covered item to that entity, *even if the item is for civilian end use* (e.g., a civil aircraft engine that is intended for use on a civil plane, but the entity also produces military planes); or
- even if an entity is not itself a "military end user" but is a civil distribution partner, and it knows that an item it distributes will ultimately end up with a "military end user" or for "military end use," the MEU licensing requirements likely apply to that transaction (e.g., a civil wholesaler receives an item and does not itself use it for a military end use, but knows that the item is ultimately destined for military end use or to military end user).

Exporter, re-exporters and transferors (such as sellers or lessors) are responsible for conducting counter-party due diligence to determine whether any intended end users, intermediate consignees or ultimate consignees who will receive the item are "a military end users" or engaged in activities intended to support "military end uses," thus implicating the MEU rule and triggering a licensing requirement.

To assist exporters in identifying MEUs, BIS amended the EAR to include a published, non-exhaustive MEU list in the EAR (the "**MEU List**"). The MEU List identifies entities that the US government has determined to be MEUs for purposes of the MEU rule and includes a number of Chinese aviation companies. If an entity is on the MEU List, it is subject to the MEU rule, and a license is required for transfers to that entity of items described in Supplement No. 2 to Part 744. The Federal Register notice promulgating the MEU list also notes that transactions with companies on the US Defense Department's Communist

Chinese Military Companies List, which includes certain Chinese aviation companies not on the MEU List, also raise a red flag – but do not necessarily trigger a license requirement – in transactions with respect to items on Supplement No. 2 to Part 744.

Publishing the MEU List puts the public on notice that the listed entities are subject to the MEU rule and the transparency afforded by the MEU List relieves some due diligence burden for exporters intending to transfer covered items to an entity on the MEU List. However, just because an entity is not on the MEU List does not mean it is not an MEU – exporters, re-exporters and transferors still need to conduct due diligence to identify MEUs that might not be on this list. Further, the list is not static – other entities can be added in the future.

Understanding the Restrictions

Commercial aircraft generally cannot be exported, re-exported, sold, leased or otherwise transferred without an export license or other authorization from the US Government to:

- embargoed countries, including Crimea, Cuba, Iran, North Korea and Syria; or
- restricted parties (e.g., an individual or entity on BIS' MEU List (or otherwise subject to the MEU rule), Entity List or Denied Persons list or an OFA C SDN). Prohibited end users include airlines such as Mahan Air, Pouya Airlines, Qeshm Air, Syrian Air, Caspian Air and Ukrainian-Mediterranean Airlines (all designated by the US Government as terrorism-related SDNs).

As discussed above, the US export controls apply even when transactions occur entirely outside the United States.

Failure to Comply Can be Costly

Failure to obtain a required license or other authorization prior to exporting or otherwise transferring a US trade-controlled commercial aircraft to embargoed locations or to restricted parties can result in serious and expensive criminal and/or civil (administrative) penalties and even the complete loss of export privileges, as well as reputational harm. Public enforcement actions demonstrate that the US Government is not afraid to punish non-US companies for activity conducted wholly outside the United States:

- Balli Group PLC, a UK-based entity, paid a USD 2 million criminal fine, served a five-year corporate probation period, and entered into a civil settlement with US Government agencies that included a civil penalty of USD 15 million and a five-year denial of export privileges for violations related to knowingly re-exporting US-origin Boeing 747 aircraft to Iran and conspiring with an Iranian airline to export or re-export US-origin aircraft to Iran without the required US government authorization.
- EgyptAir, the state-owned flag carrier of Egypt, agreed to pay a civil penalty of USD 140,000 for violations related to leasing two Boeing 737 commercial aircraft to Sudan Airways and the re-export of those aircraft to Sudan without a license.

- BIS imposed a "temporary denial order" ("**TDO**") against three Turkish companies (Trigron Lojistik Kargo Limited Sirketi, Ufuk Avia Lojistik Limited Sirketi and RA Havacilik Lojistik Ve Tasimacilik Ticaret Limited Sirketi) for illicitly procuring and supplying Iranian airlines with US-origin aircraft engines and spare parts. The TDO bars the company from both exporting items to the United States and from receiving exports from the United States.
- Société Internationale de Télécommunications Aéronautiques SCRL ("**SITA**"), a Swiss headquartered company, and OFAC entered a USD 7.8 million settlement for apparent violations of the Global Terrorism Sanctions Regulations related to providing commercial services and software subject to US jurisdiction to airlines that were sanctioned for supporting terrorism. OFAC noted, "*[t]his enforcement action highlights the benefits companies operating in high-risk industries can realize by implementing effective, thorough, and on-going risk-based compliance measures, especially when engaging in transactions concerning the aviation industry*."
- Honeywell, a publicly traded U.S. aerospace firm, agreed to pay a $13 million fine to the US Department of State to resolve allegations that it shared technical data that contained engineering prints showing dimensions, geometries and layouts for manufacturing castings and finished parts for multiple aircraft, gas turbine engines and military electronics to and/or within Canada, Ireland, Mexico, the People's Republic of China and Taiwan in violation of the ITAR. Honeywell apparently shared such technical data with unaffiliated suppliers and Honeywell subsidiaries in these countries without proper authorization under the ITAR. As part of the settlement, Honeywell agreed to audit its export compliance program and hire an external Special Compliance Monitor ("**SCO**") for at least 18 months.

We are available to discuss the new regulatory measures discussed above, specific questions or potential risks in greater depth. We can also assist with undertaking proactive measures to avoid or minimize such risks through the implementation of tailored compliance best practices and appropriate risk-based due diligence.

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