

Back-To-Back Aircraft Transactions:

Creative solution or horrible mess? by Greg Cirillo & Gary Horowitz

Accomplishing a successful “back-to-back” aircraft transaction is like nailing an instrument approach at Tegucigalpa Airport. It requires extraordinary attention to detail, a healthy dose of fear and alternate plans because things may not go as intended. In a “back-to-back” transaction, the aircraft is not sold directly by the seller to the buyer, but instead is sold through an intermediary (acting as interim buyer and seller) to the end-buyer.

These are difficult transactions to complete for a number of reasons, including financing problems, confidentiality issues, contractual limitations, and regulatory and tax impediments. In many cases, however, the back-to-back structure makes an impossible deal possible. For purposes of this article, “Seller” will refer to the owner of the aircraft seeking to sell it, “Buyer” will refer to the ultimate buyer of the aircraft, and “Intermediary” will refer to the party acquiring the aircraft from Seller and then conveying it to Buyer.

WHY DO A BACK-TO-BACK AIRCRAFT TRANSACTION?

CORPORATE MANDATE: A Seller may simply want an aircraft sold for a specific price, and the Seller is willing to allow the Intermediary to keep whatever premium it may be able to obtain by selling the aircraft for an amount over the Seller’s target price. This could be the case with a repossessed aircraft where the bank has a target number, and is not worried about getting top dollar.

Similarly, a Buyer may have a mandate, and the authority to purchase an aircraft with the total transaction cost approved, but perhaps without specific authority to pay for an adviser/broker. In that case, the Buyer agrees with a broker that the Buyer will purchase an aircraft of a specific type for a predetermined price, and the broker is then free to procure a qualifying aircraft and earn the equivalent of a commission by securing a lower purchase price from a Seller.



If successful, both the Buyer and Seller meet their transaction goals.

RE-SELLING A NEW DELIVERY: New aircraft purchasers may decide to sell their new aircraft before taking delivery from the

manufacturer, and their purchase agreement with the manufacturer may not permit assignment of that contract (or perhaps assignment is an undesirable step). In that case, the party taking delivery from the manufacturer is the Intermediary that is

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buying from the manufacturer and immediately selling to the Buyer.

CULTURE OR ACCOUNTING PREFERENCE: Non-U.S. aircraft Buyers may have a cultural preference against paying a broker's fee, but no problem with paying a higher purchase price with the broker's payment baked into the aircraft purchase price.

Similarly, a Buyer may wish to characterize the entire transaction price (for accounting or legal reporting purposes) as the aircraft's purchase price, without separately reporting or accounting for a commission. A back-to-back transaction allows this to happen.

OPPORTUNISTIC INTERMEDIARY: An Intermediary may have identified an aircraft that a Seller is willing to sell at a price that is advantageous for the Intermediary, the Intermediary having located a Buyer willing to purchase at a price higher than what the Seller is looking to get. In that case, the Intermediary wants to flip the aircraft from the Seller to the Buyer, making a profit on the difference.

Obviously, if the Buyer and Seller were to find each other then the Intermediary might lose any opportunity to profit from the situation, thus a back-to-back transaction is employed to keep the Intermediary in the game.

BUYER'S CONFIDENTIALITY: With a back-to-back transaction, it is possible to keep the identity of the aircraft Buyer confidential, at least through the early stages of the transaction. At some point before closing, a Seller may need to know the Buyer's identity in order to comply with export control or anti-money laundering laws.

CHALLENGES IN A BACK-TO-BACK TRANSACTION

The most important element of a back-to-back transaction is establishing what information each party will and will not know (if any); and perhaps more importantly, whether they know that it is information that they will not know.

As an illustration, if a Buyer hires an Intermediary to purchase an aircraft for \$20 million, and the Intermediary finds a Seller with a satisfactory aircraft selling for \$18 million, the Buyer must certainly be aware that the Intermediary is being paid out of the difference (as there are no volunteer brokers), but the Buyer may not be entitled to know the amount of the difference. This is an understanding between the Intermediary (often a broker) and the Buyer – the Buyer does not know the Seller's price, but the Buyer knows that it does not know.

There are other permutations. The Buyer



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may not know the Seller's identity, and the Seller may not know the Buyer's identity. The Seller is also not likely to know the Buyer's purchase price. Depending on the structure and the “secrets” being kept, the logistics of a transaction and closing can get very complex.

SELLING WHAT YOU DO NOT OWN: In a back-to-back transaction, the Intermediary is often buying with money it does not yet have, and agreeing to sell an aircraft it does not own. In Wall Street parlance, it's a “naked put.”

If the Buyer does not come through with the funds, then the Intermediary may be in breach of its agreement with the Seller, and if the Seller does not perform by delivering the aircraft, then the Intermediary may be in breach of its agreement with the Buyer.

Assuming the Seller is aware that the Intermediary is just an intermediary, the simplest solution is full disclosure – the Seller

knows that the Intermediary cannot perform unless the Buyer performs, and the Buyer knows that the Intermediary cannot perform unless the Seller performs. Optimally, if either the Buyer or Seller breaches, then the aggrieved party can pursue direct remedies for the breach and not against the Intermediary.

The applicable purchase agreements can reflect this contingency and the cut-through remedies. Of course, anything that identifies the Seller and the Buyer to each other creates the risk that the Intermediary may lose its stake in the transaction as the Seller and Buyer will have every incentive to deal with each other and without the Intermediary.

ETHICAL CONSIDERATIONS: As legal counsel, we need to know who we are representing, and on a back-to-back transaction this needs to be clear from the start. Legal counsel cannot withhold material information from his client unless required to do so; and if counsel is under such a restriction, then the client needs to know about it and consent to it.

For example, if legal counsel to the Buyer is aware of both purchase prices, but cannot tell his client about one of them, then his client needs to be aware of that inability and must consent to it.

Similarly, if a broker is participating as an Intermediary, and also engaged as an advisor to either Buyer or Seller, then it appears difficult for that Intermediary to offer advice on fair pricing when the Intermediary's compensation is premised on the disconnect between Seller and Buyer on what the aircraft's value is.

JUGGLING TWO TRANSACTIONS: By definition, a back-to-back involves two transactions that need to progress at the same general pace and on the same general terms. If the Buyer wants a three-hour test flight, the Intermediary cannot give the Buyer that test flight unless the Seller is willing to give it. This makes negotiations more difficult and time consuming.

As a practical matter, the Intermediary will also want the governing law, jurisdiction and venue for the two transactions to be the same, otherwise if recourse to the courts is ever needed, the Intermediary may find itself in two separate litigations. However, it can be monstrously difficult to get a Seller and Buyer, who are not directly contracting with each other, and may not even know of the other's existence, to agree upon (or be persuaded to use) a particular governing law, jurisdiction and venue, especially as it is likely that the Seller and Buyer are from different locations.

FINANCING: If the transaction is being financed, the complexities multiply. A lender will not advance funds until the borrower of the funds (Buyer) is able to grant the lender a lien on the aircraft, which requires the Buyer to have title. Often the Intermediary may need Buyer's lender's money to purchase the aircraft from the Seller. As a result, if the Intermediary will hold title to the aircraft, even briefly, the Intermediary needs to participate in the financing transaction.

INSURANCE: At no point in an aircraft's existence should it be uninsured. Therefore, in a back-to-back transaction, even the Intermediary's momentary ownership period needs to be covered. That can be addressed with the Buyer's insurance.

DELIVERY LOCATION: If the Intermediary takes title to the aircraft, and the delivery of the aircraft from the Seller to the Intermediary is a different location than where the Intermediary is delivering the aircraft to the Buyer, then a host of challenges arise.

In order to move the aircraft, the Intermediary will need to file an Aircraft Registration Application in the U.S., hire pilots, obtain insurance, pay movement costs and take the risk of damage occurring to the aircraft on the positioning flight.

This also creates a delay between the time when the Seller sells, and the Buyer buys, during which Buyer can breach. It is best to use a single delivery location in a back-to-back transaction.

SALES TAX: State sales tax can be a surprising problem for a back-to-back aircraft



transaction. In a typical aircraft sale, state sales tax can be avoided through a number of tax exemptions, such as a "fly-away" exemption in which the aircraft purchaser, after taking delivery, immediately removes the aircraft from the state in which the aircraft was delivered.

However, in a back-to-back transaction, if the Intermediary takes title to the aircraft and then transfers title to the aircraft to the Buyer, it is possible that in some states the technical requirements of the "fly-away" exemption are not met because the Intermediary did not immediately remove the aircraft from the state, but sold it, in which case the state could claim that the Intermediary owes sales tax on the aircraft's purchase price. The sales tax implications of each step of a back-to-back transaction must be determined and worked through. If time permits, a formal interpretive ruling from the relevant state should be obtained.

'ESCROW OF THE GODS AND THE CLOSING FROM HELL':

In a back-to-back transaction, for practical reasons, it is valuable to have a single escrow agent handle both documents and funds. A good escrow agent will understand the sensitivities in a back-to-back transaction and act in accordance with directions, if the directions are clear and complete.

As a very simple illustration, the Buyer will remit the purchase price for the Buyer-Intermediary transaction to the escrow agent, and at the closing, the escrow agent will need to be instructed to release to the Seller the lower purchase price for the Intermediary-Seller transaction from the Buyer's escrowed funds. The release of funds must be conditioned upon specific document

deliveries and instructions.

It is highly recommended that the participants in the closing conference (generally by phone) be kept to a minimum. For example, if a lienholder can agree to release its lien upon the escrow agent's wire of a payoff amount, then that lienholder need not be on the closing call.

HOW TO SUMMARIZE?

Unless (1) the aircraft-flipping Intermediary has the funding, does a standalone purchase, and then sells the aircraft after the first transaction is complete, or (2) there is disclosure of all of the facts to all the relevant parties, including the price differential, then a back-to-back transaction will be a difficult and unique event that needs to be carefully thought through and managed if it is to be successful.

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