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Business Aircraft Purchasing Protocols

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After more than a year of collapse and stagnation, business aircraft sales are recovering. This is a good time to (re)consider how you approach a corporate aircraft acquisition.

The acquisition of an aircraft for corporate or personal use is inevitably a unique transaction for the buyer. It is vital that the buying process be undertaken with a clear delegation of responsibility and chain of authority to avoid costly errors. The buyer's team composition can vary, with both internal and external expertise, but the functional roles that need to be filled are: (i) executive action, (ii) finance and tax review, (iii) operational analysis and

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market access and (iv) documentation and legal compliance. Most importantly, the team should be formed and directionalized before any aircraft search begins.

Purchasing Team

Starting at the top, you need an executive who can independently and promptly make critical decisions and sign key documents. This is often an executive officer or an officer in the "corporate services" division of a large corporation. The executive will need to make decisions ranging from signing corporate finance documents to approving lavatory fixtures. Without someone in this role, the acquisition process becomes an exercise in frustration and uncertainty. If you cannot have a "leader" who will be available at a moment's notice, then you may need a two-tiered approach where one sub-leader can make strategic decisions, and the big-dollar decisions get made upstairs.

Next, you need a finance/tax person to manage the financial aspects as well as the enormous range of tax issues and opportunities that the aircraft will present. This person needs to be involved at the start because tax considerations play a critical role in determining the actual, after-tax cost of acquiring and operating a business aircraft. The tax strategy requires an integrated aviation regulatory analysis because what works for the IRS may not work for the federal aviation regulators (Federal

Aviation Administration (FAA) and the Department of Transportation (DOT)). The finance person needs to manage the financing relationship and get that process in motion early. Most major lenders will give you a non-binding memorandum establishing the financing terms based upon an assumed aircraft value. In recent months, lender commitments have been of dubious value given that appraisals have often undercut contract prices, leaving the buyer with insufficient financing.

Third is the technical expert/adviser who assists in your aircraft selection and helps you meet your mission objectives. This person could be your chief pilot, but only if that person has specific experience in aircraft evaluation beyond his or her chief pilot role. More often, a specific adviser is engaged who is also an aircraft broker or agent. If a broker/adviser is engaged to provide these services, it is critical that the chief pilot and all others be disengaged from technical expert/adviser responsibilities or subordinated to the technical expert/adviser. Internal redundancy and/or conflict is very disruptive to an aircraft acquisition. It is not unusual for a single buyer to overstimulate the market by having two or more representatives making inquiries about the same type of aircraft, thereby increasing the perceived demand for the aircraft. The buyer also loses credibility if a seller determines that two people in the market claim to represent one buyer. A transaction without strict oversight can degenerate into a collection of under-the-table side deals and sub-brokerages, all to the detriment of the buyer.

Once you have identified the target aircraft, the team will expand to include one or more people responsible for regulatory (FAA and DOT) compliance, drafting and reviewing transaction documents, starting with offer letters and broker agreements, and progressing to the purchase agreement

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and agreements relating to aircraft use, storage, maintenance, repair, insurance and crew. This could be done by an in-house attorney or an outside attorney or a combination of the two.

Letter Of Intent

After the buying team is organized and functioning and the desired aircraft has been identified, the buyer and seller should negotiate and sign a Letter of Intent (LOI) for the aircraft's purchase. The LOI is a very small and inexpensive step, but it will determine the transaction's direction. Although generally non-binding, the LOI allows the buyer and seller to establish general expectations and a roadmap for the deal. Without an LOI, the parties either plow forward with inadequate direction and expectations, or they tend to get bogged down in the Aircraft Purchase Agreement details, and the transaction may stall out or blow up. The LOI should cover the following main points: (1) describe what is being purchased (make, model, serial numbers, configuration, maintenance status and presumed condition); (2) set the purchase price; (3) establish the amount of the buyer's deposit, who will hold it, the conditions for its return or forfeiture and who pays the escrow agent's fee; (4) work out the pre-purchase aircraft inspection regime, allocation of costs and acceptance criteria – select the inspection facility, the scope of the inspection, including test flights, timing and who pays the costs for the inspection and the movement of the aircraft to the inspection facility, and establish the parties' rights and obligations after a successful or unsuccessful inspection; (5) agree to negotiate and enter into a definitive Purchase Agreement within a short timeframe.

Aircraft Purchase Agreement

After the LOI has been signed, the parties need to execute an Aircraft Purchase Agreement (APA). The APA spells out the details for the aircraft's purchase, establishes the pre-closing process and timeframe for completing the transaction, and binds the parties to the deal. If terms under the APA contradict the LOI, as is often the case if the LOI is not carefully drafted, then there has been a step backwards in the process, and in the best case, additional negotiations between the buyer and seller become necessary. A good APA will allow the parties to unambiguously understand their rights and responsibilities during each stage of the transaction, thereby preventing conflict that wastes time and resources. In

particular, the APA should clearly lay out each party's pre-closing obligations since a closing can be delayed by minor oversights, such as failing to timely register with the International Registry.

Inspection

The inspection of the aircraft generally starts at the LOI stage, and can continue well after the APA is signed. The most common inspection regime is a two-stage inspection. The first inspection is a document review and aircraft ground inspection to get the buyer over the "hump." The preliminary inspection involves minimal aircraft downtime, and is largely to establish that the aircraft shows well and is the make and model represented, with the right equipment and with records that are substantially correct and complete with aircraft damage history fully disclosed. A preliminary inspection may be used to give the buyer an idea of whether the interior is acceptable or needs to be refurbished.

The preliminary inspection is the first fork in the decision tree – the buyer can reject the aircraft or proceed to a deeper, second inspection. The second inspection involves a greater investment by the buyer (often \$50,000 or more paid to an authorized inspection facility), and a greater risk to the seller (more aircraft downtime and a risk of finding a major discrepancy). Usually, the inspection is done after the APA is executed and determines whether the aircraft meets the detailed physical standards as established in the APA.

Your adviser/broker, and if applicable your chief pilot, will be the primary on-site representatives creating the inspection scope and working with the seller's adviser when a discrepancy is identified. Make certain that your on-site adviser(s) has the signed APA on hand defining the scope of the inspection, the applicable deadlines and the delivery condition and that your adviser understands the key language describing what is a deviation or discrepancy from the required delivery condition. Your adviser should consult with counsel when a disagreement arises as to responsibility for rectifying a discrepancy. Lastly, make it clear that the inspection report belongs to the buyer, and cannot be released by the seller to future buyers without your consent.

Pre-Closing Actions

There are three broad categories of pre-closing activities after the APA is signed and before the closing: (1) delivery matters, (2) tax planning and (3) preparation

for post-closing operations. The APA should lay out the buyer's pre-closing delivery obligations, which include pre-positioning documents for filing with the FAA, registration with the International Registry as a Transacting User Entity (TUE), performing lien searches and finalizing financing and possible prefunding of the purchase price with the escrow agent. Prior to closing, the buyer will want to have its state sales/use tax and personal property tax planning strategy in place, or risk an unpleasant surprise from the state in which the aircraft is delivered or hangared (or both). The buyer will also want to do federal tax planning in order to maximize deductible aircraft expenses and depreciation, and avoid unnecessary federal excise taxes on air transportation services. Finally, the buyer needs to work out the post-closing ownership and operation structure by creating an aircraft management team and taking care of such details as insurance, an aircraft maintenance program and a hangar facility.

Closing

Aircraft closings are "Virtual Closings" due to geography. Aircraft title and lien documents for U.S. aircraft need to be recorded in Oklahoma City, Oklahoma (OKC), and mostly in original form. Other filings take place electronically with the International Registry (IR) (nominally in Ireland). The aircraft is usually idling in a state chosen for tax reasons. The closing "event" involves the release of documents for filing in OKC and the IR, release of the purchase price payment by the escrow agent to the seller, and formal delivery of the aircraft to a buyer's representative.

Post-Closing Wrap-Up

After the buyer takes delivery and title to its aircraft, the buyer's post-closing concerns should include: (i) gathering up the documents ASAP since they will be in multiple locations, (ii) making certain that the temporary U.S. registration ("pink slip") is on the aircraft together with a copy of any lease, and (iii) applying for authority to engage in international operations, since you cannot do that on a temporary registration.

If a buyer can follow these aircraft purchasing protocols, it will be assured of an organized aircraft purchasing process with minimal unnecessary conflict or ambiguity, and good prospects for completing the aircraft purchase on the buyer's terms and to the buyer's satisfaction.