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Successful Aircraft Transactions:

Keeping the molehills from becoming mountains.

by Gregory P. Cirillo & Gary I. Horowitz

The little, overlooked, or forgotten pieces of a private aircraft transaction can derail an entire deal. This month, we'll have a look at some of the things to watch for during an aircraft transaction to prevent molehills from turning into mountains.

A non-binding Letter of Intent (LOI) is usually the first step taken towards the sale/purchase of an aircraft, followed by a binding Aircraft Purchase Agreement (APA) between the buyer and seller. The LOI is a small and inexpensive document that establishes the core deal terms, but little problems in the LOI can become an impediment to finalizing the APA.

The LOI needs to be brief enough to get the deal moving forward, but detailed enough to cover any "deal-breaker" issue.

For example, what happens when the LOI is silent on who pays for aircraft movement costs? In a typical deal, an aircraft may move several times – from its current location to the pre-purchase inspection facility to the delivery location. If an LOI does not identify who will pay those movement costs, this can become a serious point of contention during the negotiations over the APA.

What if the transaction does not go through and the aircraft needs to be returned to its original base? The LOI needs to account for that detail too.

DELAYS IN COMMUNICATION

Communication delays between buyer and seller representatives during aircraft purchase negotiations are usually for some good reason (such as putting financing into place). However, any delay is too much delay when it comes to an aircraft transaction. The waiting party is anxious, which can lead to some paranoia and create problems for the transaction that were not there before.

The solution is simple – do not ignore the other party, even if you have nothing substantive to say. Find a way to keep the lines of communication open. In this regard, there is no better tool than email.

PAPERWORK PROCESS PROBLEMS

In an aircraft transaction that is moving well, the normal flow from LOI to APA is as follows: (a) one party prepares a draft of the APA and sends it to the other party in Word (not a PDF) format; (b) the other party proposes changes to the draft APA with a redline, and sends it back to the drafting party; (c) lather, rinse and repeat until it whittles down to a handful of core issues; (d) the parties talk and reconcile outstanding points of disagreement; and (e) a final APA is sent around again, tweaked as needed, and then signed.

You have a "paperwork process problem" when the non-drafting party entirely slaughters the APA to the point where the redlined APA is unintelligible to a measure of being personally insulting.

Is it really important to correct every misused "which" into the word "that"? Wholesale deletion and replacement of boilerplate clauses with "better" clauses is a recipe for delay. Certainly, when a draft contract misses the mark, or is wholly

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inadequate, it should be rectified, but rather than turning a sow's ear into a silk purse, respectfully reject the APA in its entirety, step back, come to an understanding as to the core issues, and then redraft fresh.

You also have a "paperwork process problem" when the APA drafter wants to make things difficult for everyone by circulating the draft APA in the form of a PDF, or some other electronic format that does not allow redlining or easy editing. This is a common lawyer's tactic for other types of transactions, but the aviation industry does not appreciate this kind of inefficiency.

THE CUMULATIVE FACTOR

The parties' personalities will have a significant effect on whether a transaction's culture will be collegial, cooperative or combative. If there is an atmosphere of distrust, then nickel-and-dime aircraft condition issues and APA terms can ruin a deal. In those situations, the aircraft brokers are usually the ones in the best position to smooth things over.

To prevent a minor issue from derailing a transaction, brokers will sometimes step-up to cover the costs of the unresolved issue themselves, which is a wise move, since the broker only gets paid its commission if the deal closes.

Similarly, it falls to the client to bring down the temperature if the lawyers turn the transaction into an unproductive spat.

DETAILS, DETAILS – THE CLOSING SEQUENCE

Too often, the parties do not focus on the precise sequence of events that must occur before closing. Will the aircraft be moved to the tax-friendly closing location before the purchase price is in escrow? Will the purchase price be put in escrow before closing, and if so how many days before closing? What if the buyer's lender will not release funds until the lender has a lien interest on the aircraft, and prefers to wire funds directly rather than use the escrow?

Too often an APA will gloss over the sequence and suggest that things happen all at once, when in fact that is either impractical or simply not fair. Focus on the sequence.

TUE FOLLY

Nothing may be more frustrating than a delayed aircraft closing because one of the parties forgot to register with the International Registry of Mobile Assets (IR) as a Transacting User Entity (TUE).

The IR is an international electronic record used to establish priority of interests on airframes, aircraft engines and helicopters. However, the IR is not required for all transactions and is, arguably, superfluous when title and lien interests are otherwise recorded on the assets in the home country, such as with the Federal Aviation Association (FAA) in the United States.

Regardless, lenders financing aircraft purchases will not authorize the release of funds unless they can secure their loan with an IR filing, in addition to lien interest filings with the FAA. The failure of a transacting party to register with the IR can cause a delay in closing of up to one week, which could be a breach of the APA and affect the financing terms.

PERSPECTIVE

Often the parties to a transaction have limited time and/or resources to get to closing. This results in certain issues getting less attention than they should. To avoid this, it is critical that you focus on the value of a clause.

Valuing a clause means determining the dollar exposure to the party. That could be a cost-item, or it could be a liability item. For example, parties will haggle about who will pay the costs of aircraft movement for closing, yet the contract will not specify a fuel-on-board requirement, or require the purchaser to pay for fuel-on-board at closing. So, unless the seller fuels the aircraft up to move it to closing, there is no dollar impact!

In contrast, buyers often give too little thought to pre-existing damage. There are several "levels" of damage from cosmetic up to damage requiring airworthiness recertification. This is a contract clause that matters.

Another favorite is the contract that provides that the only remedy for EITHER party is remittance of the buyer's deposit to the aggrieved party. If the seller defaults, that is not a remedy for the buyer, and it turns the entire agreement into a simple option to sell - which the seller may exercise or not.

LOOSE PARTS

There are no contractual terms that will fairly define the spare parts and loose equipment that conveys with an aircraft. Parties will haggle over whether it should include items "associated with" the aircraft, or "originally delivered by the manufacturer with" the aircraft. These descriptions are of little value and will only set up future arguments.

For certainty, the parts and equipment needs to be inventoried and listed as a schedule to the APA. When a ship-set of standard china can cost $20,000, knowing the parts and equipment that convey along with the aircraft is an important transaction element.

CONCLUSION

It is not a new or novel message, but one that is often forgotten: Transaction management requires that the parties remain focused on the goal, and cognizant of the little molehills that will crop up. Anticipating them, and having a solution, will keep them down to being molehills.

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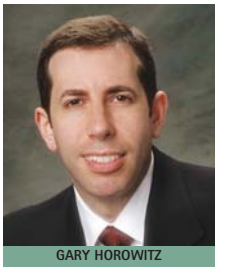

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