

Back To Basics:

Aircraft purchasing protocols.

by Gregory P. Cirillo & Gary I. Horowitz

Cautious optimism is starting to take a hold. After more than a year of stagnation, aircraft sales are recovering. Buyers and sellers are seeing eye-to-eye on prices, and lenders are stepping up with viable terms to help get deals done. This is a good time to (re)consider how you approach a corporate aircraft transaction – from the purchaser’s perspective. Call it *Aircraft Purchases 101*.

The acquisition of an aircraft for corporate or personal use is inevitably a unique transaction for the buyer. Even companies in the business of acquiring heavy, expensive equipment find themselves lost in new territory when buying a corporate aircraft. 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 market access, and (iv) document negotiation 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 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’s actions will range 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 cost of acquiring and operating a business aircraft.

The finance person needs to have the ability to direct deposits once a suitable aircraft has been identified and take the lead in securing external financing.

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 questionable value given that appraisals have often undercut contract prices, leaving the buyer with a financial gap to cover. Nevertheless, it is important to start the financing search early, and seek multiple lender proposals.

Third (and for now the last of the core team members) is the technical expert/advis-

er, 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 advisor is engaged that 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 over-stimulate the market by having two or more representatives making inquiries about the same 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 legitimate buyer needs to establish its credibility quickly because the market is rife with dabblers and occasional frauds. >

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 and seller.

Once you have identified the target aircraft, the team will expand to include someone 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 and agreements relating to aircraft use, storage, maintenance, repair, insurance and crew.

After selecting an aircraft and before closing, the buyer must develop an ownership and operational structure that is legally compliant and consistent with the buyer's tax strategy. This could be done by an in-house attorney, or an outside attorney (like your authors). In-house attorneys, although expert in many areas, are generally not familiar with aircraft transactions and the federal aviation regulatory structure, so engaging external legal counsel may save time as well as mitigate risk.

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 and not jump right into the Aircraft Purchase Agreement.

The LOI is a very small, and inexpensive step, but it will determine the direction of the transaction to follow. Although generally non-binding, the LOI allows the buyer and seller to work-out the core terms of the deal and roadmap the transaction. 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 ten main points:

1. Describe the aircraft, engines, equipment and documents that will convey.
2. Determine 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. Agree upon the physical condition that the aircraft must be in at the time of delivery, along with clear title and no liens.
5. Work-out the pre-purchase aircraft inspection regime and 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.
6. Establish the buyer's right to accept or



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reject the aircraft after the inspection is complete, and determine the seller's obligations to correct discrepancies (at seller's cost) if the buyer accepts the aircraft after the inspection and agrees to take delivery.

7. Pick a time for closing.
8. Clarify who pays for aircraft movement costs.
9. Have the seller agree that buyer has the exclusive right to purchase the aircraft during this time and will otherwise take the aircraft off the market.
10. Agree to enter into a definitive Purchase Agreement within a short time-frame.

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.

The APA fleshes out the LOI. 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 additional negotiations between the buyer and seller become necessary.

A good APA will be easily readable and unfold like a story with a beginning, middle and end. A successful APA will allow the parties to 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 that the records are substantially correct and complete with 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 road – 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). An aircraft transaction that falls apart after a major inspection can deter future buyers. This inspection can take a few weeks or longer if facilities are booked up.

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. Typically, the inspection facility will open two accounts – one for the seller's expenses (fixing discrepancies) and one for the buyer's expenses (paying for the inspection and covering discretionary fixes that the buyer elects to undertake).

Your adviser/broker - and if applicable

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your chief pilot - will be the primary on-site representatives creating the inspection scope, and working with the seller's adviser should a discrepancy be 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 is much activity after the APA is signed and before the closing, and so the buyer's team needs to work together to complete the deal on time. There are three broad categories of pre-closing activities - Delivery Matters, Tax Planning, and 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 (e.g., the Aircraft Registration Application (AC Form 8050-1), and a Statement of U.S. Citizenship if the buyer is an LLC), registration with the International Registry as a Transacting User Entity (TUE), performing lien searches, finalizing financing, possible pre-funding of the purchase price with the escrow agent, preparing and putting a trust in place if the buyer is a non-U.S. entity, and obtaining a flywire if there will be international operations shortly after closing.

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

Most first-time buyers of used aircraft find the closing process to be much less exciting and dynamic than expected. Logically, it should be like any large asset or real estate closing, with paper flying, and last minute details being worked out. This tends to not be the case 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. Therefore, key papers like bills of sale, registration, leases and lien releases will be in OKC before the closing date.

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.

Of course, there will be last minute revisions reflected in side letters, or changed

pages emailed to the escrow agent/law firm in OKC, but for the most part, the closing is routine. There is rarely a face-to-face closing with a conference table full of papers and haggard executives 'noodling' out the details.

Closing *can* get exciting when time zones become a factor. For example, to sell an aircraft under U.S. registry to a buyer who will put it under U.K. registry, with a mortgage, you need to engineer the closing such that it happens during a window of time when the U.S. registry and the U.K. registry are both open so that the U.S. registry will issue the "all clear" de-registration statement, thereby allowing the U.K. registry to accept title and lien documents.

Closings also become more challenging when banks are involved because they want liens on the aircraft when they have a loan outstanding, so the seller's bank will want payment before releasing a lien, and the buyer's bank will want a lien before releasing payment; thus the use of escrows and the importance of a simultaneous closing.

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 the above aircraft purchasing protocols, it will be assured 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.

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