

The Metropolitan Corporate Counsel®

www.metrocorp-counsel.com

Volume 18, No. 11

© 2010 The Metropolitan Corporate Counsel, Inc.

November 2010

Clear Title – Looking Beyond The FAA Registry When Buying A Corporate Aircraft

**Greg Cirillo
and Gary I. Horowitz**

HCH Legal, LLC

Clear title. It is the single most important element in an aircraft transaction. It is the one objective that cannot be compromised and the one condition to closing that, if unsatisfied, will end a transaction. Generally, the only commitment (a warranty) that a seller makes to the buyer that continues past the closing date is clear title. In this era of repossession, voluntary surrender and distressed aircraft sales, the concept of clear title has gained prominence, and justifies heightened caution. This article will focus on a few situations and events that may affect title, yet escape typical due diligence.

What is clear title? It is an expression

Greg Cirillo is a Member of HCH Legal, LLC. He represents businesses, entrepreneurs and high-net-worth individuals in a wide range of transactions including venture formation, finance, corporate control, licensing, succession planning, mergers and acquisitions. Mr. Cirillo has a multinational practice in aviation transactions, including aircraft acquisitions and related contracts, equipment finance and Federal Aviation Administration (FAA) / Department of Transportation (DOT) regulatory compliance. He can be reached at (301) 800-0001. Gary I. Horowitz is a Member of HCH Legal, LLC. He represents aircraft owners and operators in the purchase, sale, exchange, lease, management and finance of business and commercial aircraft. Mr. Horowitz advises on and structures the acquisition and operation of aircraft for federal and state tax efficiency. He can be reached at (301) 800-0001.



**Greg
Cirillo**



**Gary I.
Horowitz**

reflecting that ownership of the aircraft is transferred free and clear of all mortgages, liens, leases or encumbrances and that there are no legal questions or ambiguities as to the aircraft's ownership. For the buyer, clear title means that you buy and own the aircraft, completely and exclusively, and without risk that a third party will claim either ownership or a lien interest. Conversely, as a seller, clear title is the essence of what you are selling in exchange for the purchase price. Even if a seller is able to sell an aircraft with title problems, the seller may still be responsible in the future to defend the buyer's title to the aircraft at seller's expense. Getting clear title requires that: (1) the seller originally acquired clear title, (2) the seller resolves any existing impairments on title, and (3) the seller lawfully conveys legal title.

Limited Comfort – The FAA (Or Other National) Registry

Federal law established the Federal Aviation Administration (FAA) Civil Aircraft Registry as the location for filing title and lien documents affecting U.S. registered aircraft. Many foreign aircraft registries serve the same role; and the recently created International Registry (IR) duplicates and internationalizes that function for many countries that adopted the underlying Capetown Convention that created the IR.

It must be stressed, however, that the national and international registries themselves *do not create or prove* clear title, but merely provide a place to register title and liens, and find notice of filings affecting title.

Establishing and conveying good and clear title is a question of law, and many registries (including the FAA Registry) defer to the law applicable to the underlying transaction. Specifically, the parties to an aircraft transaction will rely upon applicable local law to determine if title was properly conveyed, or for example if a mortgage was properly created or released, although the FAA Registry governs the filing of the ownership or lien documents. As a result, a bill of sale on the FAA Registry does not establish title, rather it gives notice that two parties intended and attempted to convey title. Whether they succeeded in transferring title depends on the facts underlying that transaction and whether they conveyed title in compliance with applicable law.

When Is The FAA Registry's Title Record Unreliable?

- *Defective Title Transfer.* A title transfer (via bill of sale) on the FAA Registry is only as valid as the underlying transaction. If a third party has a lawful challenge to the title transfer, then that challenge undermines the new owner's title. *This issue has particular relevance today, as many aircraft are being sold following a bank foreclosure, or as part of a voluntary or involuntary liquidation or reorganization.* Often these are hostile transactions involving a reluctant owner being forced to relinquish title, and/or a liquidation resisted by a roster of angry creditors including hangar operators and aircraft management companies that are owed money. These extraordinary foreclosure/liquidation procedures include detailed procedural steps – found in state laws as

Please email the authors at gcirillo@hchlegal.com or ghorowitz@hchlegal.com with questions about this article.

well as federal law – and the failure to follow these steps could leave the prior owner or conflicting creditors with a lingering claim. A foreclosure and title transfer often involves some “loose ends” or aggressive interpretation of an ambiguous notice or publication requirement. As we are currently seeing in the residential foreclosure market, the laws designed to protect property owners will present challenges when trying to convey clear title.

Fortunately, even if a title claim remains unresolved or vague, most U.S. states will consider an innocent buyer to have clear title as a “bona fide purchaser” of the aircraft, provided that the buyer pays fair value to the seller, and most importantly, the buyer is not aware of the adverse claim at the time of the purchase. This latter point is important because in some foreclosures, the financial institution selling the aircraft to the new owner will attempt to insulate itself from lingering liability by actually identifying potential adverse claims to the new buyer. In addition, some claims relating to hangar rent or management fees may be recorded with the FAA Registry. Having notice of these claims could undermine “bona fide purchaser” status and result in impaired title.

- *Defective Lien Creation or Lien Termination.* As with title transfers, the valid creation of a lien (or termination of a lien) is determined by the law governing the transaction, not the FAA Registry. A buyer relying on mortgage releases or lease terminations should look past the paperwork on the FAA Registry and perform enough due diligence to determine that the releases and terminations are valid. The concept of “bona fide purchaser” can also protect a buyer who is not aware of an unresolved lien on an aircraft.

- *Liens Created Without Filing.* Certain liens may attach to an aircraft without any filing, such as mechanic’s liens. These types of liens are valid and fully enforceable against the aircraft owner, and may even trump prior secured liens. However, such liens are generally not enforceable against a “bona fide purchaser” without proper notice, which is usually by way of filing a lien statement with the FAA Registry.

Clearing Title Techniques

Clearing title on the FAA Registry for liens and encumbrances can be a simple process. In order to release a recorded lien, the AC Form 8050-41 (Conveyance Recordation Notice) issued by the FAA when the lien was filed contains a “Release” which can be signed by the security holder and filed with the FAA to release the recorded

lien. On the IR, liens may be discharged by filing an Entry Point Filing Form (AC Form 8050-135) with a Release of lien at the FAA, which the FAA uses to issue an approval code called the IRN Code that is then used to discharge the lien interest on the IR.

What happens when a lienholder refuses to sign a Release? This is where things get difficult. As mentioned before, aircraft liens are controlled by state law, even though they are recorded with the FAA. Therefore, an aircraft lien can be extinguished by operation of a state’s commercial code. For example, if a secured party repossesses and forecloses on an aircraft, a subordinate lien held by an unpaid hangar operator is extinguished under state law. Therefore, the hangar operator’s filed FAA lien is no longer valid against the aircraft – but it is still recorded on the FAA Registry because no Release has been filed and, surprise, surprise, the hangar operator refuses to sign a Release even though his lien is now unenforceable. Without a signed Release, this invalid, unenforceable and extinguished lien still clouds title. Try explaining to a potential aircraft buyer that they are getting clear title even though there’s an unreleased hangar operator’s lien filed against the aircraft at the FAA Registry. In this situation, the best option may be to negotiate with the hangar operator for some payment in exchange for the lienholder’s signed Release. In the alternative, a judgment can be sought and obtained from the court with proper jurisdiction to declare that the subordinate lien has been extinguished, and this judgment can be filed with the FAA to clear title in lieu of the subordinate lienholder’s Release. The problem with seeking a court judgment is the time and cost involved, which can be compounded by the urgency of an aircraft buyer anxious to take ownership of the aircraft with a clear title.

In some situations, it may not be possible to clear title quickly, but the seller and buyer still want to go forward with the transaction. In such events, the parties may agree to hold back a portion of the purchase price under an escrow agreement in which the seller has a certain amount of time to clear title, or the buyer gets back the escrowed amounts.

Legal Opinions And Title Insurance

Some aircraft buyers seek title protection by purchasing title insurance. Aircraft title insurance is rarely purchased in aircraft transactions because title issues can usually be resolved. However, when a title ambiguity cannot be reconciled, title insurance may be an option. Instead of title insurance, most buyers rely on the aircraft registries to

reveal title defects, which may be fixed before closing, and that “bona fide purchasers” of aircraft are usually absolved from preexisting claims.

As another alternative, you may offer (as seller) or rely on (as buyer) a legal opinion to attest to the validity of title transfer and termination of all liens and leases. If you use one of the excellent aviation law specialists in Oklahoma City, where the FAA Registry resides, make certain that his opinion includes the legal sufficiency of the documents purporting to convey or affect title. You may need a back-up opinion from local counsel to cover these points. A legal opinion serves two purposes. First and most importantly, it puts a burden of due diligence on an expert to examine title issues. If legal counsel seems willing to print and sign an opinion without due diligence, then you need to question the opinion’s value. Secondly, a legal opinion puts the issuing law firm at risk of legal malpractice if the opinion is wrong, but this is by no means as useful as an insurance claim, which is easier to process than a legal malpractice suit.

Unexpected Post-Closing Title Problems

Even when it appears that a buyer is taking clear title to an aircraft, challenges to title and lien claims can crop up after the closing, and the new owner will want the aircraft’s seller to take care of the problem and clear title. If the seller provided the buyer with a warranty bill of sale, the seller will be obligated to defend title. At closing, an option for the buyer to consider, particularly when there may be title issues, is to request that the seller provide a warranty bill of sale in which the seller promises to forever warrant and defend title as good, clear, marketable and free of all liens, claims and encumbrances, against all claims and demands whatsoever. A warranty bill of sale can provide good protection to a new owner’s title in the aircraft, but a promise to warrant and defend title “forever” is a long time. A warranty is only as strong as the party giving the warranty. Oftentimes, aircraft are owned and sold by a single-purpose company with no assets other than the aircraft, and so it can be futile to enforce the promise of such an entity to defend the new owner’s title, especially since such single-purpose entities are often terminated after the aircraft is sold. In such situations, consider having the warranty of title guaranteed by a parent company (with assets) or an individual.

Obtaining clear title to an aircraft is a priority closing item that requires cautious attention in order to avoid post-closing title ambiguity and lien claims, which can become quagmires.