
Structuring Aircraft Acquisition Transactions: Purchase, Lease and Financing Alternatives for Aircraft Operators and their Counsel

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Today's faculty features:

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Structuring Aircraft Acquisition Transactions: Purchase, Lease, and Financing Alternatives for Aircraft Operators and their Counsel

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"If it flies and it's not a bird, we can do the legal work."

Today's Approach

- For the next 90 minutes, we're going to talk about the ways you can acquire an airplane or helicopter in the United States.
- Small Cirrus SF50? Large Airbus A380?
- Your first? Just adding to your fleet?
- No matter. The legal rules are pretty much the same.
- Fussy and messy, but usually ... pretty much the same.
- So while lots of rules and customs apply to aircraft, with many “yes, but” nuances, they’re well known to aviation specialists and followed in most countries.

Unique Attributes of Aircraft Versus Other Assets

- Let's start with the differences between aircraft and other large assets you may have bought, financed, or leased.
- By "us," I mean "us" and "we" as purchasers, borrowers, lessees, and their lawyers.
- We'll have to worry about what the sellers, financiers, and lessors are thinking, but our focus will be:
 - on what aircraft operators should be worrying about, and
 - on the legal areas their lawyers should be addressing
- Anything we don't cover, please just email us. We have a lot of info, and we're happy to share it with you.

Unique Attributes of Aircraft Versus Other Assets

- So what are the attributes that differentiate rotorcraft and fixed-wing aircraft from other equipment?
 - technically as complex as transport equipment can get:
 - tens of thousands or millions of “serialized” parts
 - having “certificated” part numbers that must be tracked at all times,
 - from supply bin to the engine or airframe
 - from aircraft to aircraft within the operator’s fleet
 - from operator to operator
 - from third-party repair facility to repair facility

Unique Attributes of Aircraft Versus Other Assets

- each of these parts is interchangeable within the same model aircraft, so the financier and the lessor will worry about “his” parts being switched out with parts having less service life left on them
- super-sensitivity to safety (airworthiness)
- highly regimented and government-mandated maintenance programs, with timed “checks” involving varying levels of mandated maintenance, repair, and overhaul (MRO)
- so value turns on specialized “back to birth” maintenance records every time a deal is done
- aircraft assets are very expensive
- all are highly mobile so they typically operate in several countries

Structures For Acquiring Aircraft

- All these attributes will become your worries in the deal documents, no matter what the structure is.
- So with these thoughts in mind, let's turn to the three basic structures we'll walk through today:
 - the secured loan
 - the finance lease and its variants
 - the operating or “true” lease

Measure Twice, Cut Once

- All three begin with two themes:
 1. the team
 2. speed
- And here, we borrow from the world of the master tailor – measure twice, cut once, and stitch swiftly.

The Team

- Every business effort needs a good team, and aircraft deals call for the right team of experts:
 - aircraft evaluator to analyze residual values and other economic factors for each aircraft & its maintenance “health”
 - aviation tax accountant to optimize tax treatment
 - aviation insurance specialist to evaluate what coverage is needed in each part of the world
 - aviation lawyer to advise on what’s worth worrying about on the legal end, and what’s not worth the bother

The Team

- *right team (cont'd):*
 - FAA counsel in Oklahoma City
 - foreign local experts if deal involves countries outside USA
 - And of course you, and your legal counsel, to quarterback the process at every step ...

Speed

- ... which takes us to the second starting theme:

*****Speed*****

- Can't stress this enough:
 - frame open items
 - decide them
 - paper them (with the fewest words)
 - move on
- Longer it takes, more chance there is of deal fatigue or deal bust.

Secured Loan v Finance Lease v Operating Lease

- We're now ready to take up the 3 basic ways to acquire aircraft: secured loan, finance lease, or operating lease.
- For all 3 structures, this presentation will focus on what legal steps you'll be planning for purchasing, financing, or leasing an aircraft that you may not have to plan for other equipment.
- These legal steps will apply whether we talk about:
 - rotorcraft / fixed-wing aircraft / drones
 - business jets / regional jets / big commercial planes
 - air passengers / air cargo

Secured Loan v Finance Lease v Operating Lease

- Conventional wisdom says follow these steps:
 - find a good broker,
 - locate the aircraft you want,
 - sign an LOI,
 - do a pre-buy inspection, and **then:**
 - go to your lender to see if the lender will loan you the money to buy it, or
 - seek a financier who will extend you the credit you need for a finance lease, or
 - see if the aircraft of your desire can be put under a “true” (operating) lease.

Secured Loan v Finance Lease v Operating Lease

- But there is a better way:
- Shop your lender, financier, or lessor first, see what aircraft they will cover, see how much credit they will extend, and **then** seek out your desired aircraft in the marketplace.
- Why?
- Because this will open the door to not only “who’s” lending/financing/leasing and “what’s” being covered, but also “**how**” it’s being done, so you can evaluate the advantages and disadvantages of the secured loan versus finance lease versus operating lease.

Secured Loan v Finance Lease v Operating Lease

- So who will be ideal for you and your needs?
- Your own local bank, or a “bigger” nearby bank, but if they don’t lend on aircraft often, you’ll likely have to give a personal/parental guarantee or put up other collateral that you don’t have or don’t want to tie up.
- Manufacturers eager to sell their new or used aircraft.
- Lease/finance companies who specialize in aviation.
- Small Business Administration.
- Governmental export credit agencies (ECAs) who give loans or guarantees to help a cross-border aircraft deal.
- Seller: “must sell” but can’t wait for your credit to clear.

Secured Loan v Finance Lease v Operating Lease

- First, you'll want to ask about the last few deals they've done for the kind of aircraft you've targeted.
- Second, you'll want to ask about key financing terms:
 - loan to value % / down payment / installments
 - term / amortization / rate / currency / prepay penalty
 - appraisal / due diligence / entity / time to close
 - domestic only / foreign operations permitted
- Third, you'll be asking a few more questions for a lease:
 - minimum lease term? / prepaid rent? / security deposit?
 - maintenance reserves? / power by the hour (PBH)?
 - lease return conditions? / buy at end? / early out?

Secured Loan v Finance Lease v Operating Lease

- Last question you'll want to ask for a lease: "How will my *lease rate factor* be determined?"
- This is a surcharge that lessors often "load" onto a lease rate to account for:
 - your creditworthiness
 - difficulty to re-deploy the aircraft if you default
- The lessor will predict damages/losses from default, assign a probability, and then add a surcharge to the lease rate. That's your *lease rate factor*, and it's driven by things like: what aircraft / where located / where must it go to start earning money again for the lessor?

Secured Loan v Finance Lease v Operating Lease

- During your discussion of terms, each lender, financier, and lessor will showcase the different structures he can offer you and the associated economic terms.
- This is where you'll begin to evaluate the pluses and minuses of each structure.

Secured Loan v Finance Lease v Operating Lease

- *Advantages of a secured loan:*
 - It's your aircraft.
 - You own it.
 - It's on your balance sheet.
 - You can do with it whatever the law permits.
 - Loan documents will have restrictions, but you can negotiate those in most instances so you can do what you want with something that belongs to you (for example, operate it out of the country or put it into whatever revenue service you wish).
 - And it stays yours when the loan is paid off.

Secured Loan v Finance Lease v Operating Lease

- Disadvantages of a secured loan:
 - You assume the “residual value” risk.
 - If the market value goes down, you take the hit.
 - How could that happen even when the market is hot for the aircraft you chose?
 - A bad crash occurs (H225)
 - An “Airworthiness Directive” is issued (737MAX)
 - All of a sudden you hold an unmarketable asset (and if grounded, may stop generating revenue).
 - Your credit-rating may not be so good, so you’re paying a high cost of capital for the loan.

Secured Loan v Finance Lease v Operating Lease

- Disadvantages of a secured loan (cont'd):
- Despite your best efforts, your loan documents have enough negative covenants to choke a horse, so you can't operate the aircraft the way your business needs to operate.
- You have too much other debt so you can't borrow enough to purchase the aircraft you want for the kind of operations you're needing to conduct.
- Even assuming you get the loan you want, the lender has full recourse to you on the loan, and may even require a personal/parental guarantee.

Secured Loan v Finance Lease v Operating Lease

- If the secured loan doesn't warm your heart, a financier may offer up a finance lease.
- In a finance lease, the financier (not you) buys the aircraft and the two of you sign a finance lease, where the financier may be called "lessor" and you "lessee."
- The cash to buy the aircraft comes out of the financier's own pocket, or it may be put up by other investors, or the financier may borrow the money to pay for the aircraft (and this is called a **leveraged** finance lease).
- Either way, you pay only the rent to the financier, which is high enough to cover the price paid by him (or his investors) plus a return on the investment.

Secured Loan v Finance Lease v Operating Lease

- Many finance lease advantages flow to the finance group that makes the investment to buy the aircraft.
- They can engage in “trust arrangements,” “special purpose entities,” and other investment vehicles, which are driven by tax, accounting, and investment benefits to **them**.
- Here are some benefits to **you** as an acquirer:
 - ✓ the “prepay” you put up at the outset may be less than the “down payment” your lender demanded
 - ✓ as aircraft owner, the financier (not you) usually takes the depreciation, meaning lower rent to you

Secured Loan v Finance Lease v Operating Lease

- *benefits of finance lease to you (cont'd):*
 - ✓ the financier may have more income than you do, so he's better able to take depreciation than you do
 - ✓ your overall cost of capital in a finance lease may be less than what it would be in a secured loan
 - ✓ the financier will probably pay less of a price than you would (he has buying power you don't), so this should lower your rent too
 - ✓ the financier can bring a high-priced aircraft to you by spreading/leveraging the investment on his side via equity and/or debt participations

Secured Loan v Finance Lease v Operating Lease

- *benefits of finance lease to you (cont'd):*
 - ✓ if the aircraft is operated in countries where a mortgage is not viewed as strongly as title, the finance lease may work better since the financier (not you) is the owner of the aircraft, so he can be the registrant and hence brandish title if/when needed to de-register the aircraft
- So a finance lease may make an acquisition happen that might not happen through a secured loan, and even when it can happen through either structure, the finance lease may be less expensive for you and give you more flexibility than a secured loan might.

Secured Loan v Finance Lease v Operating Lease

- Disadvantages of a finance lease:
 - you're still the purchaser in reality
 - you'll still have to buy the aircraft at lease end
 - so you still bear "residual value" risk
 - most of the same restrictions may apply as you had in the secured loan, as we'll see shortly

Secured Loan v Finance Lease v Operating Lease

- So have we covered most of the advantages and disadvantages between these two structures?
- Well, no,
 - there are many other benefits and burdens when you use a secured loan versus a finance lease to acquire an aircraft, but they're of a tax and accounting nature, so they're beyond the legal focus of this seminar, and
 - there are variants to the finance lease, and ECAs can get involved to help export/import, but most common are:
 - the leveraged finance lease (more later), and
 - the sale-leaseback (that we'll illustrate next).

Secured Loan v Finance Lease v Operating Lease

- A financier may showcase the sale & leaseback to meet your needs, where you sell your aircraft to the financier, and the financier leases it back to you.
- Advantages of a sale-leaseback:
 - works well when you already have an aircraft in your fleet, and you'd like to:
 - increase your liquidity
 - improve your finances by paying down debt
 - add fleet flexibility by acquiring other aircraft
 - achieve tax advantages
 - aircraft never leaves you, so revenue stream stays put

Secured Loan v Finance Lease v Operating Lease

- Disadvantages of a sale-leaseback:
 - you'll take on the usual restrictions of most leasing arrangements, as you'll see in a moment
 - you'll no longer own the aircraft, so you'll lose the flexibility of selling it if that's important to you
 - you'll also lose the residual value of the asset (again, because you no longer own it)
 - and you may lose other benefits too, like depreciation deductions

Secured Loan v Finance Lease v Operating Lease

- We now turn to the advantages and disadvantages of an operating (“true”) lease.
- In an operating lease, the aircraft will be leased to you by its owner.
- You will:
 - operate it for a time,
 - maintain it,
 - insure it,
 - pay rent, and
 - then physically return it to the owner, who will put it back into the marketplace by re-leasing it or selling it to someone else.

Secured Loan v Finance Lease v Operating Lease

- That's called a "dry lease" because all you get is the "metal" – the aircraft by itself with no crew.
- Many people talk about a "wet lease" where:
 - "wet lessor" provides everything with the aircraft (crew included),
 - but here, you're just buying "lift," so it's really a transportation services agreement, and
 - "wet lessor" has "operational control" – a hot button with the FAA – where he controls the crew and all aspects of every flight, so he does all of what you would do in a dry lease—maintain/insure/operate the aircraft.
- Today, we'll talk only about dry/true/operating leases.

Secured Loan v Finance Lease v Operating Lease

- Advantages to you of an operating lease:
 - gives you maximum flexibility to use the aircraft you need, when you need it, for only so long as you need it
 - you don't have "residual value" risk; your lessor does
 - you can avoid certain taxes abroad (VAT/import)
 - you'll pay less cash at outset than in other structures
 - if you will use your aircraft to generate revenue, you can do better against your competitors by accessing the newest, most fuel-efficient, and technologically advanced aircraft at all times

Secured Loan v Finance Lease v Operating Lease

- *Advantages to you of an operating lease (cont'd):*
 - there are tax and accounting advantages that you should discuss with your business experts in light of the current FASB accounting standards and other rules
 - you can avoid currency risks or interest rate fluctuations
 - easier to justify doing an operating lease under your existing loan covenants than doing another secured loan or a finance lease

Secured Loan v Finance Lease v Operating Lease

- Disadvantages of an operating lease:
 - most expensive structure; you'll pay for flexibility and avoiding the residual value risk
 - maintenance requirements for the aircraft will be most onerous on you; many lessors will require you:
 - to put a PBH contract in place for the lease term
 - put aside \$xx for every flight hour that your aircraft logs, as a “maintenance reserve” for scheduled and unscheduled MRO events
 - harder to end an operating lease early than prepaying a loan or exercising a purchase option in a finance lease

Secured Loan v Finance Lease v Operating Lease

- Disadvantages of an operating lease (cont'd):
 - you're not building equity in an asset
 - but if you like the aircraft as an asset and want to keep it, many lessors will give you a deal if you want to buy it, even though you did not stitch a purchase option into the operating lease at the outset (say because you had good tax/accounting/other reasons for not doing so)
 - again, you'll pay for the flexibility, but it may be worth it
- In a moment, we'll turn to the major clauses in each structure we just compared, but you'll appreciate them a lot better if we first go over a handful of laws you'll want to know about when dealing with aircraft.

Key Laws

- Sheer mobility make aircraft truly global, so we have US laws (federal and state), as well as laws of other countries and international treaties, to plow through for each of the attributes that differentiate aircraft from other equipment.
- But those laws and treaties are well developed, and work well together, so if there's a default, they're there to protect the value of the asset that's being leased or financed, as well as the revenue streams that go with it.
- The laws you'll most want to work with are in the Appendix which has key take-aways for you.

Secured Loan to Acquire the Aircraft

- Beyond the laws, what clauses should your legal documents contain for an aircraft acquisition deal that your documents won't need to have for other equipment?
- We're now ready to answer that question for each of the three acquisition structures we've been discussing:
 - secured loan
 - finance lease
 - operating lease

Secured Loan to Acquire the Aircraft

- The secured loan actually starts with the purchase agreement that will cover the aircraft.
- You will have to negotiate a purchase agreement to cover the acquisition and borrow the funds from your lender to pay the price to the seller.
- Your lender will take and perfect a security interest (mortgage) in the aircraft and any revenue stream.
- You've determined with your lender what he'll loan on the aircraft you've targeted, and you have located a seller willing to sell you an aircraft you're ready to buy, so what's next?

Purchase Agreement

- The shortest possible LOI you can write. Just a letter:
This is my indication of interest to buy your aircraft for \$xx according to a mutually acceptable purchase agreement and the customary practice of a pre-buy inspection, technical acceptance, final acceptance, and closing on or before mm/dd/yyyy. None of this will bind either of us until we have both signed a purchase agreement (which this is not). I propose we use Joe Bagadonuts, Esq., as escrow agent. Once we both sign below, I'll send \$yy cash to Joe as a security deposit, and you'll take the aircraft off the market for the next 30 days while we negotiate. Either of us can stop at any time, and if that happens, or if the 30 days expires, Joe will refund my deposit to me, and neither of us will be liable to the other.

Purchase Agreement

- Better yet, forget the LOI and go right to the first draft of the purchase agreement.
- You will have done a visual inspection (a “walk around”) of the aircraft at the maintenance facility:
 - where the pre-buy inspection will occur in earnest, and
 - where all the work will be done to ready the aircraft for final acceptance at closing.
- This is key because once you’ve done the walk-around, you don’t want the aircraft airborne or moved for any reason, as the pre-buy inspection and work are carried out so final acceptance and closing can occur.

Purchase Agreement

- This will not always be possible, so to reset your thinking:
 - go to the aircraft and do the walk-around (be present)
 - sign the LOI (if there will be one)
 - put up your cash deposit (if necessary)
 - insist that seller (with his own pilots & his own insurance) ferry the aircraft to the facility where it'll stay on the ground until closing
 - inspect the flight logs to ensure there was no “incident” during that ferry flight (*Sully: Miracle on the Hudson*)
 - generate the purchase agreement as fast as you can while the aircraft stays put at the facility until closing

Purchase Agreement

- So what to put in the purchase agreement?
- Start with the “Aircraft Requirements” – airframe, engines, records, and the rest per the spec sheet – and say that all must be:
 - current on the aircraft manufacturer’s recommended maintenance program;
 - with all FAA “ADs” and manufacturers’ mandatory “SBs” having been complied with;
 - in an airworthy condition, free of major damage history and material corrosion;
 - with all “back to birth” records intact; and
 - engine service program paid up (maker’s warranties too)

Purchase Agreement

- *To business people and lawyers alike*, can't stress this enough: Get all over these requirements like ugly on an ape. Make sure you understand every word on the spec sheet, and include the sheet as an Exhibit.
- Next, lay out the Pre-Purchase Inspection (PPI):
 - scope, in the precise vernacular of the manufacturer
 - who'll pay for it (and what happens if you reject at end)
 - added work you'll want while aircraft is opened up
 - 1-hour test flight at end to make sure all was done right
 - seller to pay for all work needed to meet AC Reqts
 - accept/reject traffic rules when you see PPI Report

Purchase Agreement

- If the PPI Report is “dirty,” either you or the seller will back out, you’ll get your deposit back, and the deal will be off.
- But if the PPI Report is “clean” (no surprises; work OK):
 - you’ll sign a “Technical Acceptance” for the aircraft;
 - your deposit will become non-refundable as long as
 - seller meets closing requirements, and
 - aircraft is deliverable at closing; and
 - the maintenance facility will do the PPI Report’s work.
- So the next thing to lay out are the traffic rules for the closing.

Purchase Agreement

- Apart from usual stuff like payoffs, wire transfer of the price, and the usual rest, here's what to worry about:
 - FAA Bill of Sale
 - Warranty Bill of Sale
 - Application for Aircraft Registration
 - you and seller must become TUEs (Transaction User Entities) on the Cape Town International Registry (IR)
 - you and seller should authorize someone to act as PUE on the IR (PUE functions like escrow agent)
 - you should pore over the pre-closing “lien search memo” done by your escrow agent, and plan to hose off any liens or “International Interests” on the IR

Purchase Agreement

- So what does all this jargon mean?
- We'll get into the Cape Town IR shortly when we talk about the operating lease, but for now:
 - think of the FAA registry and the Cape Town IR as the two places where your purchase agreement and other legal interests in your aircraft with its engines/propellers must be recorded so you're protected, and just as importantly, your lender is protected;
 - remember, your lender's worries are your worries; and
 - choose your escrow agent so he can do the FAA step (must occur first), then do the IR step, and later issue a "clean title" opinion when closing is done.

Purchase Agreement

- We like to choose someone in Oklahoma City as FAA counsel who can also be the PUE and escrow agent.
- That way, they can do:
 - pre-closing lien search memo
 - closing: usually telephonic / “release” sig pages / wire \$
 - FAA registrations
 - IR recordings (PUE acts on green light from TUEs)
 - post-closing legal opinion to show all is well
- This will make you happy and your lender happier.
- It should also save you money, by avoiding extra escrow costs and lender counsel fees.

Purchase Agreement

- What else for the closing?
 - Your seller or the maintenance facility should deliver at closing a certification that all the work has been done per the PPI Report.
 - You'll deliver a signed "Aircraft Delivery Receipt" that you're fully accepting the aircraft in its then condition.
- With the closing mapped out, the delivery is next:
 - most closings are now done electronically, but your pilots will be on the ground to take your aircraft when the closing is done
 - here you have tax planning to do, insurance to put in place, and a maintenance service agreement to sign

Purchase Agreement

- So the rest of your purchase agreement will be occupied with clauses on:
 - warranties / indemnities / force majeure / remedies
 - taxation / governing law / forum-selection / boilerplate
- Rather than tell you about *all* these, let's just focus on what should be on your worry list for aircraft:
 - if you've done your PPI rules right, you shouldn't need more than an "as is / where is" warranty for used AC
 - if your AC is new, you'll get the manufacturer warranties, and you'll have to take what he gives you
 - either way, you'll do a PBH or other maintenance plan

Purchase Agreement

- *the rest of your purchase agreement (cont'd):*
 - indemnity is part of your insurance plan to protect you and your seller, against all you'll be doing post-closing
 - here you have to worry about hull & liability insurance
 - aviation insurance is for specialists, and we can put you in contact with some very good people
 - force majeure is a special worry for aircraft, because more can happen than lightning, hail, or hurricane
 - ADs/SBs (e.g., 737MAX), but you planned the Aircraft Requirements right, so you can sleep easy, because these are on seller per the first clause in the agreement, and you can walk away or force seller to comply.

Purchase Agreement

- *the rest of your purchase agreement (cont'd):*
 - we view taxation like ripe French cheese, so it's something you should enjoy with your tax specialist, but we offer some thoughts below that helped meet the needs of a recent deal we did so you can run them by your tax advisor to see if they're useful to your needs
 - we can also refer you to Strafford's seminars on tax treatment of airplane purchases, and to aviation tax experts we know for more guidance
 - on remedies and choice of law/courts, we suggest making specific performance the primary remedy, and choosing "rocket docket" arbitration to resolve disputes

Purchase Agreement

- Some thoughts on taxation from recent aircraft deal:
 - LLC1 was formed in WY to act as buyer
 - LLC1 took title in AZ and flew aircraft immediately to CO where LLC1 signed 48-month dry lease with LLC2
 - LLC2 has presence in CO
 - goal was to take advantage of:
 - sales-tax exemption in AZ
 - LLC2-to-LLC1 lease payments being sourced to CO
 - spreading CO use taxes over 48 lease installments
 - LLC1 using lease installments toward making loan payments to secured lender

Purchase Agreement

- Other factors considered on aviation tax front:
 - interplay of taxes involved: sales / use / property / excise
 - delivery location / base location / places of use
 - flight logs showing origin codes / destination codes
 - hangar arrangements
 - state registration (registering in DE = no shield)
 - multiple states can (and do) impose use taxes
 - aircraft management agreement
 - uses: pure personal / own business / “common carrier”
 - presence of: non-aircraft property / office / business
 - analysis of all exemptions in light of facts from above

Loan/Security Agreement

- Work done so far on the purchase agreement solves many worries in loan/security agreement.
- Every secured lender has his own loan/security agreement, but two core clauses are common to virtually all secured loans: insurance & lien rights
- For insurance, the lender will want (complicated) endorsements on the policy, so lender can be:
 - the sole payee for any damage or loss to the aircraft
 - an additional insured for any aviation liability
 - advised before insurance coverage is altered in any way
 - protected against breaches of your warranties to insurer
 - sure aircraft is flown only in countries where insured

Loan/Security Agreement

- Lien rights are a second key worry of the secured lender (hence yours), because it's really all he's got if you don't pay.
- So he must perfect his lien at the FAA & Cape Town IR.
- Therefore, a core clause in every aircraft mortgage and security agreement does two things:
 - grant a lien to your secured lender in the following:
 - the aircraft with all accessions and records,
 - maintenance reserves/rights/warranties, and
 - aircraft revenues you may get from third party
 - grant your secured lender the power of “de-registration”

Loan/Security Agreement

- The blanket lien is easy to understand. It'll get perfected via filings at FAA / Cape Town IR / UCC.
- But the IDERA power “Irrevocable Deregistration and Export Request Authorization” is tailored for aircraft:
 - you're signing away your rights to choose where your aircraft will be registered and operated
 - so if you default, your secured lender can
 - repo the aircraft & sell it per UCC rules, and then
 - go to the FAA, de-register it, and export/re-register it worldwide
 - at the Cape Town IR, your lender will cancel/record different interests to divest you of your rights

Loan/Security Agreement

- So while every lender has his own loan documents, virtually all contain the blanket lien and the power of de-registration.
- For countries that have not signed the Cape Town Convention, the same result can be accomplished via a more traditional “Power of Attorney,” but:
 - some countries will deal only with the party who is the aircraft’s operator or record title holder, and
 - once the aircraft is registered in your name, the aviation authority in that country may deal only with you.
- So in some countries, you’ll have more work to do (usually with foreign counsel) to comfort your lender.

Loan/Security Agreement

- Like what? Like getting for the lender:
 - an undertaking,
 - usually in the form of a letter from that aviation authority in that country,
 - saying that the aviation authority will rely on the PoA you just gave your lender, and will permit your lender to de-register the aircraft from that country's register,
 - even over your objection.
- Beware, though: aviation authorities are governmental units with sovereign immunity, so if they defy their own undertaking, your lender can't make them obey.
- You'll have to work this on a country by country basis.

Finance Lease v Operating Lease

- Many of the points so far will apply to most leasing arrangements, especially a finance lease, because after all, a finance lease is a financing structure.
- There are differences, though, and the best way to cover the major clauses that you'll want to get right as a lessee in most aircraft leases is:
 - to cover the ones that are common to both a finance lease and an operating lease, and then
 - cover the ones peculiar to the finance lease structure.
- Just more intuitive that way.

Finance Lease v Operating Lease

- So the story starts with the lessor – both of them, the finance lessor and the operating lessor – who will want you to know that the aircraft is really the lessor's, and you better not make any mistake about that.
- For the operating lessor, that'll be true in every sense of the word:
 - he probably knows aircraft inside out, and
 - he's probably thinking he's just giving you a "service."
- So the aircraft will start out as not yours, and that'll be true when you return it at the end of the lease term, so nothing better happen to it, and it better be in good shape when you hand it back, or you'll pay!

Finance Lease v Operating Lease

- But is that equally true for the finance lessor?
- Well, yes and no:
 - The finance lessor:
 - will use his own funds to acquire the aircraft you want to lease, or
 - he may get other investors to put up part of the price, or
 - he may even borrow at least some of the funds from someone else to purchase the aircraft from the manufacturer or the current owner.
 - So all this makes it feel like the aircraft is really the lessor's, right?

Finance Lease v Operating Lease

- But many finance lessors won't have the expertise that operating lessors have, so they see themselves as just a financier for an asset that will be yours when you've paid for it by end of the lease term.
- Yet finance lessors won't always divide the benefits and burdens of ownership between lessor and lessee as you might think. For example:
 - the finance lessor may want to be “owner” so he can take the tax benefit of depreciating the aircraft, but may not be “owner” for registering the aircraft at the FAA
 - the finance lessor may want you to pay all the taxes that an “owner” would pay, but will want to control the aircraft like an “owner” until you've fully paid for it.

Finance Lease v Operating Lease

- Again, the easiest way to cover these nuances is to first focus on the clauses that both operating and finance lessors will care about, and then move to the additional clauses that will be on the finance lessor's radar screen.
- Both kinds of lessors will of course want to transfer their worries to you in implementing each structure, so their worries will become your worries, if you are to get the deal you want, when you want it.

Common Clauses

- There are ***Seven Sets*** of clauses that you'll see in just about all aircraft leases, whether operating or finance.
- They will be on the worry list of virtually every aircraft lessor.
- So when we refer to “lessor” in these common clauses, we mean both operating lessors and finance lessors.

Common Clauses

- **First Set**: “where to file” clauses:
 - FAA
 - Cape Town IR
 - UCC
 - foreign places
- Your lessor will think about “file everywhere” traffic rules, and include IR and UCC filings even when he doesn’t have to; they’ll help him in court when facts are “messy,” and it doesn’t hurt you, so help him file.
- The lessor will have registered at the IR as a TUE.
- You as lessee will also register as TUE.
- Registering at IR = akin to Internet account w/security.

Common Clauses

- You and the lessor will typically appoint someone to act as the PUE so PUE can do all IR filings via online authorizations given by TUEs to PUE, usually at closing.
- Clauses to choreograph sequence at closing:
 - de-register aircraft from current registry if deal will cause aircraft to be registered in different country
 - apply to register aircraft in new “owner” name
 - file docs at FAA (or at foreign registry)
 - do IR filings
 - do UCC perfection (filing; possession of chattel paper)
- Do post-closing searches to confirm FAA/IR/ UCC filings appear of record as intended, and get legal opinion.

Common Clauses

- **Second Set**: Clauses to maintain condition of aircraft (need traffic rules beyond “good condition”):
- FAA, EASA, and other airworthiness authorities around the world mandate specific maintenance program and maintenance records to capture scheduled and unscheduled maintenance events, and every move of “serialized” parts
- FAA conducts unannounced inspections, and if quality “escapes,” maintenance “escapes,” or missing or faulty records are found, aircraft can be grounded, so need default and cure clauses.
- Manufacturer will have recommended maintenance program too, so clauses should require adherence to this above and beyond regulatory mandate.

Common Clauses

- Need clauses for maintenance reserves or PBH contract to ensure funds are available for all (un)scheduled maintenance, ADs, SBs, FOD, and TSO/TSN (Time Since Overhaul / Time Since New) requirements of deal.
- Anti-Discrimination clause so leased aircraft receive equal treatment as other aircraft in operator's fleet.
- Title-shifting clauses & engine pooling arrangements to capture interchangeability of engines & serialized parts (track title to replacements; killer at re-market).
- Clauses for third-party MRO and field inspections.
- Clauses on use of STC/PMA and "rogue" parts.
- Clauses for integrity of maintenance records (records are critical when AD, SB, or "escape" occurs).

Common Clauses

- Let's do a deeper dive into maintenance reserves and PBH agreements. Both have an intuitive feel.

Maintenance Reserves

- Your lessor will require you to deposit cash at specified times into a bank account that the lessor will control so money is available to do MRO work as it arises, either through
 - scheduled “checks” prescribed by the maker of the airframe, engines, propellers, and other major parts, or
 - through unscheduled “events” when things break down like all machines do
- Your lessor will then perfect a lien over the deposit account where the maintenance reserves reside.

Common Clauses

PBH (Power By the Hour) Agreements

- Here, you pay a third-party MRO provider a fixed dollar amount per flight hour, and the MRO provider will supply a complete program for maintaining major components and replacing parts as needed, to ensure that your aircraft meets all MRO requirements imposed by aviation authorities or the manufacturer
- Most lessors regard PBH as the best way to balance MRO costs with MRO risks, so they'll push you toward PBH as a first option and resort to the maintenance reserve approach only as a fallback.
- So what's to worry about (and push back on) from the legal end as an operator when your lessor says, "You need a PBH agreement ..."?

Common Clauses

- Could devote a whole day on PBH clauses, but that's not our main focus today, so here is one example to show you how complicated PBH clauses are:
 - In a typical PBH program, each major component like an aircraft engine is “added” to the PBH program.
 - But where did you get each engine that will be put into the PBH program?
 - Do you have back-to-birth records?
 - Did it come from a “pool”?
 - Do you even have the Bill of Sale by which you first acquired it?
 - Or did it come from a prior lessor with whom you're no longer dealing?

Common Clauses

- *complicated PBH clauses (cont'd):*
 - PBH provider may ask you to warrant things about the engine from a time that pre-dates your acquisition of it.
 - Get rid of such legal rules. Same for new engines.
 - Even if the existing/new engines are allowed into the PBH program “with no questions asked,” what are the rules that govern BER (Beyond Economic Repair) exchanges?
 - Suppose the engine goes in for scheduled maintenance, but it’s cheaper for the PBH provider to do a swap than to repair what you turned in?
 - Make sure you don’t have to supply info you don’t have or give warranties about the BER engine as it’s being replaced by another engine from the PBH provider.

Common Clauses

- **Third Set**: Insurance clauses:
- We've already discussed the aircraft "insurance speak," which is driven by market practices, so advice here as before is to have a deep-dive discussion with an experienced aviation insurance broker and your legal team to make sure all insurance provisions mesh with the rest of the clauses in your deal docs.
- Liability insurance will have an additional sensitivity for lessors because they'll want to make sure they have coverage as additional insureds for a period after the lease/financing ends.

Common Clauses

- **Fourth Set**: Use and Operation Restrictions:
- Always hotly negotiated.
- If aircraft operated under Part 91, make sure no illegal “transportation for hire” and no blurring of “operational control” of aircraft.
- If Part 135 charter (“air taxi”) will be permitted, make sure traffic rules spell out who, what, where, how much, and the rest, and deal with excess wear & tear
- If management agreement enters the picture, ensure bright line between Part 91 and Part 135 flights, and ensure maintenance program is obeyed.
- Always pin down “operational control” per FAA rules.

Common Clauses

- Will your lessor permit you to sublease the aircraft?
- If so, your lessor will probably want to ensure that:
 - the sublease is a “true” lease, so there is no risk of your being deemed to have “sold” the aircraft from under him (via a finance sublease);
 - there is a complete “flowdown” of your lease’s restrictions into the sublease; and
 - the sublessee has agreed to be bound by the same rules that bind you to your lessor.
- Next on your lessor’s list of worries will be traffic rules to guard against preexisting debt and unrecorded liens for unpaid airport/storage/fuel/MRO/ATC/like fees.

Common Clauses

- Will you be permitted to register the aircraft in a country other than the US?
- If so, you'll need to solve the legal worries that your lessor will have with the aircraft crossing the US border.
- Lessor will ask – How will I protect the aircraft:
 - from first minute when aircraft enters foreign country?
 - while aircraft is operating in that country?
 - and how will I extract it at lease end / if you default?
- In a purely domestic deal, your lessor will:
 - check your company to make sure it's in good standing
 - make sure the aircraft is registered at the FAA
 - record his lease at FAA and at IR
 - file UCC-1s on your aircraft and your revenue streams

Common Clauses

- When you cross borders, though:
 - What company will you use to operate aircraft?
 - Will you “domesticate” your US company abroad?
 - A teaming agreement with someone local?
 - May be easier to form a new company.
 - ✓ Rules on how the new company will be governed.
 - ✓ Maybe do a trust arrangement as done in US
 - ✓ Must find right local “partner” or “trustee.”
 - ✓ Offer your financier a board seat with veto rights.
 - Has country signed Chicago/Geneva/Cape Town?
 - Who can register aircraft? Owner? Operator?
 - What about lease itself? Recordable? Trumping Rights?
 - Country CAA mandates on aircraft maintenance?
 - Where will aircraft go for MRO? PBH? Reserves?

Common Clauses

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- What about “ghost” liens that foreigners can slap on the aircraft per the country’s local laws?
 - “usual suspects” here – M&M/hangar/tax liens – OK
 - “severe” liens not OK (will extra collateral be needed?):
 - airport authority may have right to seize your aircraft and even sell it from under you and your lessor, when you don’t pay charges for air navigation or for using the airport
 - worse, that right to seize & sell applies even when previous operator of your aircraft is the bad guy who did not pay
 - it may also apply to the aircraft you’re about to lease when the unpaid charges are from another aircraft you’re operating in that country

Common Clauses

- Lessor's biggest worry abroad – How can I:
 - repossess the aircraft if you default,
 - extract it out of the country where you're operating, and
 - re-deploy it to another operator in another country?
- Some countries will not permit an actual repo, so only a court-ordered sale may be available.
- Even when repo is available, can't just grab & export.
- Lessor must also be able to de-register aircraft from country's registry because CAAs in most other countries will not permit new registration w/o evidence aircraft has been de-registered from existing country where lessor repo'd.

Common Clauses

- Best you'll probably be able to do here is what we've already discussed:
 - sign POA giving your lessor the right to de-register aircraft even if you object
 - get the CAA to sign letter of undertaking that promises unilateral de-registration by your lessor
 - sign an IDERA and tender it to the CAA for recordation along with the lease covering the aircraft
- Even if the country has not signed the Cape Town Convention, this might give your lessor enough comfort to cross this off his worry list, but after recent events in Russia, we're in a whole new world.

Common Clauses

- Some operators have a fear about giving such unbridled power to the lessor, lest he de-register the aircraft prematurely.
- That's a legitimate fear. We represented an operator once where his lessor went into bankruptcy and wanted to bring the aircraft into the bankruptcy estate, so the lessor used a repo man who just grabbed the aircraft, de-registered it using the lessor's power, and hauled the aircraft off, all without any lessee default in the picture. Lessee suffered tremendously.
- But here too, after Russian events, lessors won't be sympathetic to this operator fear.

Common Clauses

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- Another set of problems has to do with re-configuring your aircraft as part of the acquisition process, but before you plan to export it to the destination country where you plan to put it into commercial operation.
- This situation arises often enough, and it has unexpected legal bumps for international deals, so it's worth covering as a special area of worry with your lessor (many US and foreign parties see value in having their aircraft "conversions" done here in the US).
- Two examples of legal bumps as you set up the export:
 - #1: how to qualify for sales tax exemptions
 - #2: how to overcome regulatory hurdles

Common Clauses

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- #1: To qualify for sales tax exemption:
 - you may not meet requirements for “fly away” exemption, because the aircraft may be in the State too long as it is being re-configured,
 - so you may have to structure the deal so it qualifies for “purchase-for-resale” exemption
 - set up two companies who do an actual purchase and resale

Common Clauses

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- #2: To eliminate problems of regulatory compliance with the re-configuration in both the US and the foreign country, here's a good structure that works:
 - N-register the aircraft with the FAA as part of your deal
 - have the re-configuration done per FAA rules
 - plan for the foreign CAA to come to the US to inspect & bless the re-configured aircraft before you carry out your export, so that your aircraft can be registered at the foreign CAA before export is initiated from the US
 - once foreign CAA inspector is done, get your Export CoA from the FAA, de-register from FAA, register in foreign CAA, and complete the export of the foreign-registered aircraft via ferry flight and pilots who are insured to fly that aircraft on your AOC (Air Operator Certificate)

Common Clauses

- **Fifth Set**: Return Conditions:
- Most important set of clauses because so much can go wrong here, yet residual value hangs in the balance.
- Put your appraisal expert and your aviation lawyer in a room and ask them to come up with detailed wording of each return condition, *tailored to the specific model aircraft & engines involved*.
- Then ask them to show you how the technical and the legal rules fit hand-in-glove in **five** areas which are likely to get “litigated” if/when the aircraft comes off lease (especially with an operating lease).
- Most lessors will press hard here, so be fussy yourself.

Common Clauses

(1) maintenance records for the aircraft, engines, and all components: must be accurate, complete, up-to-date, and in full compliance with:

- ✓ maintenance program mandated by all aviation authorities that have a say in how the aircraft must be maintained
- ✓ OEM's recommended maintenance parameters
- ✓ ADs (Airworthiness Directives – scope & timing)
- ✓ mandatory SBs (Service Bulletins)

If you can't prove it through a sound record, you may have to do maintenance over again to keep your CoA or to get an Export CoA, no matter what physical condition the aircraft is in – and remember this is all on your dime.

Common Clauses

- (2) If you as operator had authority to de-commission some of the aircraft's functionality without violating any regulatory requirement – this occurs often – all offline functionality must be brought back online before return of the aircraft.
- (3) Engines must pass boroscope test and other inspections peculiar to the engine model involved.
- (4) Specify how much “life” must remain on critical components since overhaul/new (TSO/TSN), and deal with maintenance reserves and how much you as lessee must pay lessor when you return an “older” aircraft at lease end than you got at lease start, or vice versa when you as lessee return a “younger” aircraft.

Common Clauses

(5) Make sure aircraft has not only a current CoA but also an Export CoA if the lessor plans to export at re-lease. And here cover all ADs and SBs that are not due yet, but will become due at or near the re-lease.

- These **5 areas** are in addition to obvious rules in the Return Conditions like:
 - ✓ “no liens” (especially unrecorded ones from airports, hangars, fuel suppliers, and the like)
 - ✓ flight test and other physical inspections must be done
- You can get hosed here, so extra thinking is needed for you to cut the best deal you can with your lessor on lease return.

Common Clauses

- **Sixth Set**: Truth In Leasing FAA Advisory Circular:
- TIL is a set of FAA rules to avoid blurring who has “operational control” of the aircraft at each flight.
- TIL requires a specifically worded clause to be inserted into a lease or conditional sale agreement covering an aircraft weighing more than 12,500 pounds.
- Advisory Circular issued on Feb 16 2016 which shows FAA really turning the screws on practices that blur who has “operational control.”
- This means more ramp checks by FAA, so . . .

Common Clauses

- Expect your lease to have clauses that will ensure you meet TIL requirements with required TIL clause and all.
- Expect your lessor to enforce rules like these:
 - your lease must be carried on board the aircraft
 - your Part 91 and Part 135 operations must have operating regimes that reflect squeaky clean rules on who has “operational control” for each flight
 - your passengers and crew must be educated so they know who has “operational control” of the flight and so they can answer questions that may be asked by FAA during a ramp check
- May feel invasive to you, but remember your lessor can't afford to have you grounded, because you'll lose revenue and stop paying rent.

Common Clauses

- **Seventh Set**: Lessor wants the right to assign the lease to assignees as the lessor wants.
- *Wait*. Why should this be a concern? Understandable, isn't it?
 - The finance lessor may need to assign his rights to someone who will loan part of the funds to acquire the aircraft, so the finance lease **must** be assignable, right?
 - And the operating lessor will need to assign to his own lender the lease stream from you, as part of the inventory and accounts receivable financing that his lender is giving him, right?
- Well, yes, but ...

Common Clauses

- ... four things:
 - 1) not if the lessor's assignee – a complete stranger to you – does not respect your quiet enjoyment of the aircraft, so it's OK to agree to lessor assignability as long as a robust QE covenant will bind the assignee to you just as the lessor is bound to you
 - 2) what if the lessor owes you things, like a security deposit or maintenance reserves at the end of the operating lease term?
 - 3) what about your indemnities to your lessor (e.g., against withholding taxes), and his assignee is a foreigner? should you get stuck with extra w/h risk?

Common Clauses

- 4) and what if you're owned by a private equity company? many PE firms are concerned about assignees who are hedge funds, and who will take an assignment from your lessor just to "exact value" out of you, knowing that your PE backers will capitulate rather than see you impaired
- In each instance, you'll want:
 - to get assignee's written commitment that he'll live up to what your lessor owes you
 - to keep your lessor on the hook, in case assignee breaches
 - to exclude opportunistic assignees like hedge funds

Finance Lease Clauses

- Finally, we turn to the additional clauses you'll want to get right in a finance lease structure.
- Just so we have an easy framework to work with, assume the following business deal:
 - you have found a used aircraft that fits your needs in the US, but it's registered in a foreign country
 - you can't get bank financing on terms you like, but you have found a financier who will do a finance lease with you as finance lessee
 - rent = monthly with \$xx rent prepayment at closing
 - you'll own the aircraft at the end of 60 months

Finance Lease Clauses

- The ***first*** set of clauses on your finance lessor's mind will focus on how the aircraft will be taken from the seller?
- Shades of the Purchase Agreement we've already discussed. You have that under your belt, so you can put it the "done" pile, right?
- Well, not so fast.
- The finance lessor may want to take an assignment of the Purchase Agreement, so you'll need an assignability clause in the Purchase Agreement that will permit you to transfer your purchasing rights to the finance lessor.

Finance Lease Clauses

- This assignability will be key for the “owner” attributes that the lessor may wish to retain until the end of the lease term when you’ve paid off the aircraft:
 - The lessor may have calculated the benefit of depreciation in giving you lower lease installments.
 - And if the lessor lined up investors to fund part of the acquisition cost, or took out a loan for that cost, then the finance lessor:
 - may be working with a leveraged finance lease, and
 - so he may need to place ownership of the aircraft in a “special purchase entity” like an “owner trust” where the finance lessor will be the “owner trustee.”

Finance Lease Clauses

- This structure will allow the finance lessor to:
 - have the aircraft registered at the FAA and the Cape Town IR in the name of the “owner trustee”;
 - achieve UCC “purchase money loan” protection for the investment that he and his investors are making;
 - have the “bundle” of rights on the finance lessor’s side of the deal achieve priority over the rights of your existing lenders who may have a blanket lien over all of your collateral, including “after-acquired” property like the aircraft you’re about to put into operation; and
 - make this structure better able to withstand your bankruptcy.

Finance Lease Clauses

- You can see how all this applies to used and new aircraft alike.
- In the case of a new aircraft, you'll work with the manufacturer to make sure you can assign your purchase rights to the finance lessor.
- And this raises the **second** set of clauses you should worry about: warranties/PBH & product defects:
 - airframe / engines / spare parts / propellers / avionics
 - manufacturers are different, so you must “collect” & assign warranties & PBH (MRO) plans (new/unexpired)
 - and: expect lessor to say you're responsible for defects, so don't expect to escape rent if you can't use aircraft

Finance Lease Clauses

- The **third** set of clauses you'll want to focus on in a finance lease: accounting & tax treatment of the lease.
- This treatment is beyond our scope for today, but here are two good places to start with your tax/acct experts:
 - new accounting rules on “off-balance sheet” treatment of your finance lease: FASB’s new standard on leases, Accounting Standard Codification (ASC) 842
 - tax benefits of ownership:
 - depreciation deductions (are you or your finance lessor better able to take this advantage? if you, then maybe you should be registered “owner” at FAA)
 - interest expense deductions if lease treated as debt

Finance Lease Clauses

- Your tax discussion should focus on the “triple net” nature of the finance lease that will be most likely.
- In addition to base rent, you’ll be asked to pay for maintenance, insurance, and taxes, with no setoff or other abatement, so your **fourth** concern in a finance lease will be the tax indemnity, where lessor will ask you to indemnify against taxes like these:
 - sales / use / property / rental / VAT / withholding
 - what about loss of lessor’s depreciation deductions?
 - maybe, but only if loss stems from something you did or said (in your reps & warranties)

Finance Lease Clauses

- Your ***fifth*** concern in a finance lease is a small but important twist on “hull” insurance that you probably won’t worry about in an operating lease: the declining value of the aircraft over the lease term.
 - In the operating lease situation, you readily agreed to keep the aircraft insured at a fixed value, because the lease term was probably not so long that the aircraft value would decline materially.
 - In a finance lease, though, the plan is for you to have the aircraft over most if not all its useful economic life, and its value will undoubtedly decrease over time.
 - So you’ll want to have a declining schedule of “agreed values” that you must keep insured.

Finance Lease Clauses

- The **sixth** set of clauses you'll have to worry about in a finance lease have to do with options to renew, return, or purchase the aircraft:
 - chances are slim you'll have to worry about these in an operating lease, because you won't have leeway: you're leasing for a (short) term & then returning; end of story
 - in a finance lease, though, you should push for the choice of renewal versus purchase at end of each term:
 - renewal will give you more time to pay off the "loan"
 - and if you can set the dollar amount for either a renewal or a purchase at lease signature, you'll be able to take advantage of increased market values

Finance Lease Clauses

- For the **seventh** set of clauses, let's cross into the dark side: your default under the finance lease.
- Stuff happens (e.g., you don't make enough revenue from your aircraft), and you can't pay rest of lease.
- Resisting the "events of default" that your lessor will force on you through a "hell or high water" clause will be futile, but there are things you can do for yourself:
 - compute what you'll owe the lessor so he gets an ROI on residual value, but not a double-dip
 - do calculation on an after-tax basis
 - so instead of just accelerating, do PV minus aircraft FMV

Finance Lease Clauses

- The ***eighth*** set of clauses to worry about in a finance lease: hurdles to overcome when importing an aircraft into the US from a foreign country.
- Already discussed US export hurdles as part of the clauses common to both operating and finance leases.
 - You'll have most of those same hurdles when you're exporting from a country other than the US.
 - But for a finance lease, you'll have one more hurdle when importing into the US, because an aircraft may be registered at the FAA only by someone who the FAA sees as a "US citizen."

Finance Lease Clauses

- So at the top of your worry list will be how your foreign lessor will meet the US citizenship tests of the FAA
- A lessee in our example can opt for one of 2 structures.
- The first choice is the NCOT – Non-Citizen Owner Trust:
 - Foreign lessor can engage one of the several US financial institutions which specialize in setting up NCOTs that meet the FAA’s US citizenship rules.
 - The financial institution will be the “owner trustee” and a US citizen, while the finance lessor will be the trust’s “owner participant” (beneficiary).
 - The finance lease itself will be signed by the owner trustee as finance lessor and you as finance lessee.
 - The aircraft will be registered with the trust as “owner.”

Finance Lease Clauses

- A few years ago, there was an industry uproar when the FAA cast doubt about the future recognition that NCOTs would receive.
- But this died down when the FAA issued a “Clarification” that spelled out how the trustee of a NCOT must supply info on aircraft/operations/records, which would allow the FAA to monitor non-US ownership of N-registered aircraft.
- This showed FAA acceptance of NCOTs as a worldwide tool for foreigners to invest in aircraft, use FAA maintenance/overhaul/conversion programs, and use the US as base for aircraft deals and repossessions.

Finance Lease Clauses

- A second choice for the finance lessor in our example is more self-help (and will probably be less costly to you as finance lessee):
 - The evidence of finance lessor’s ownership of the aircraft could be filed at the FAA – e.g., a Bill of Sale.
 - The finance lease with him as lessor and you as lessee would also be filed at the FAA.
 - The aircraft would be registered in your (lessee’s) name as “owner.”
 - You’ll probably have to obtain a legal opinion from the FAA’s Aeronautical Center Counsel confirming that the finance lease is a “conditional sale agreement” which would make you the “owner” in the FAA’s eyes.

Closing Remarks

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- Closing Remarks
- Ready for Questions

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Appendix: Key Laws

- So what laws will you have to work with as a group when financing or leasing aircraft that you don't have to work with when dealing with other equipment?
 - Chicago Convention / Geneva Convention
 - Cape Town Convention and its aircraft Protocol
 - US Federal Aviation Act
 - Uniform Commercial Code
 - State tax laws
 - product liability laws
 - the laws of the foreign country where the aircraft was registered just before your deal, or *will* be registered and operated when your deal closes

Appendix: Key Laws

- A good place to begin the legal story for today is in 1944 & 1948, with adoption of the Chicago & Geneva Conventions.
- Their concepts for lessors and financiers are simple, yet elegant, as each signatory country has agreed to these points:
 - “I won’t home-town airplanes from your country when they’re in my country, if you don’t home-town my airplanes when they’re in your country.”
 - “When your airplane is registered in a registry maintained by the central aviation authority in your country and comes into my country, I’ll regulate its airworthiness since it’s in my airspace, but I’ll respect its nationality if it has its CoR and CoA on board.”
 - “An airplane can be registered in only one national registry at a time, but the airplane can switch registration from yours to mine, so long as it’s first de-registered from yours, mortgagee agrees, and my registration rules are met.”

Appendix: Key Laws

- You can see how important this is to those who lease and finance aircraft:
 - The aircraft can be tracked no matter where it is throughout the world.
 - They can rest easy that the safety and maintenance of the aircraft, and hence its value, will (as a rule) be preserved.
- A key legal point, though, is to plan for de-registration, because it won't matter who has physical control of the aircraft and all its records – he won't be able to register it in another country, and the deal will fall apart at the closing.
- So you should worry about this, because it actually happens more than you might think.

Appendix: Key Laws

- Next came the US Federal Aviation Act, and from it emerged:
 - the central US aircraft registry located in Oklahoma City and administered by the FAA
 - comprehensive rules of the FAA to regulate how aircraft are registered, de-registered, and mandated for safety, airworthiness, maintenance, and a mind-bending set of other ways
- Other countries adopted analogous aviation laws and created central registries for aircraft ownership and lien recordations, often as separate registries and with less specificity than the US Act

Appendix: Key Laws

- Law firms in Oklahoma City can provide enormous help here for lessors and financiers to navigate through the maze of FAA rules.
- They specialize in what docs must be filed at the FAA and in the tricky rules of what each doc must say to be FAA-recordable (down to ink color for signatures):
 - from the initial application to register the airframe
 - to the last piece of paper needed to de-register the aircraft from the FAA registry (whether to do a new deal or to repossess the aircraft from a deal that's gone sour)
- Just as importantly, FAA counsel will explain what docs the FAA will **refuse** to record – and there are many.

Appendix: Key Laws

- Four quick take-aways for our time today:
 - 1--only the aircraft "owner" (rather than operator) may register the airframe at the FAA
 - this is driven partly by analysis of a "true lease" versus a "security arrangement" or "conditional sale agreement" between lessor and lessee
 - but just because someone registers the aircraft as the "owner" in the eyes of the FAA does not mean that the registrant is the actual title holder; that's determined by title searches and signed documents
 - 2--only US citizens may register aircraft with the FAA

Appendix: Key Laws

- *Four quick take-aways (cont'd):*

3--non-US citizens will do a NCOT (Non-Citizen Owner Trust) or meet FAA rules for aircraft “primarily operated in the US” (more on NCOTs later)

4--FAA registration trumps UCC Article 9, so legal analysis here asks:

“where to perfect the interest of the financier/lessor”

--versus--

“what priority his interest will have if he does versus if he doesn’t”

... and then there is the Cape Town Convention ...

Appendix: Key Laws

- Next law you'll want to know about is the Cape Town Convention and its aircraft Protocol which took effect in 2006 (USA and some 74 countries have ratified it).
- Think of it as an International Registry where buyers, sellers, lessors, and financiers can create rights in "aircraft objects" and then have priority and quick interim remedies against those objects when a default has occurred in the deal.
- International Registry (IR) is located in Dublin, Ireland; all recordations made online via computers 24 hours a day, by "Transacting User Entities" (TUEs; parties to the deal) or by a "Professional User Entity" (PUE; escrow agent, FAA counsel, or other intermediary who acts on authorization by TUEs), and there's a "Closing Room."

Appendix: Key Laws

- What “aircraft objects”? The following by model and serial number:
 - airframes whose “type certificate” says can carry 8 or more persons (count crew in the 8) or goods weighing more than 2,750 kilograms (plus installed parts other than engines)
 - jet engines having 1,750 or more pounds of thrust (and at least 550-rated take-off shaft horsepower, if turbine or piston powered)(plus parts installed)
 - helicopters whose “type certificate” says can carry 5 or more persons (count crew in the 5) or goods weighing more than 450 kilograms (plus parts installed)
 - all maintenance and other records for each object

Appendix: Key Laws

- What can be recorded against these “aircraft objects”?
 - a “contract of sale”
 - an “international interest”
 - secured party’s rights under a security agreement
 - lessor’s rights under a lease – finance/operating
- certain other recordations are permitted
 - assignments of international interests
 - prospective international interests

Appendix: Key Laws

- All kinds of tricky rules on when Cape Town Convention and its aircraft Protocol apply (meaning you **must** record), but recordations are permitted even when they're not required, so it's a good idea to record at the IR even if only as a supplement to "must" recordations elsewhere.
- Also tricky rules on helicopter engines and rotors, and fixed-wing aircraft propellers.
- What if you don't record when you must? You're dead:
 - if you're the buyer, your rights in your aircraft objects will be trumped by IR recordations made before and after you closed on your purchase
 - same for the lessor/financier: their rights will be trumped by all prior and later IR recordations
- Beauty of recording when Cape Town applies? Filer trumps all unrecorded and later-recorded interests, even if he's fully aware of them.

Appendix: Key Laws

- Existing in parallel to these laws and treaties are
 - the Uniform Commercial Code
 - State tax laws
 - product liability laws
- except for the federal/FAA preemption rule, the UCC functions for aircraft like the UCC does for other equipment
- suggestion here is to “file everywhere” for aircraft, even when it’s not a must
- when facts are “messy” in court, many judges will reward the party who filed when he did not have to because of the “notice” that such filings are often deemed to impart to the filer’s adversary

Appendix: Key Laws

- State tax laws also function pretty much the same way for aircraft as they do for other equipment.
- But some state tax laws provide tax exemptions for aircraft that do not apply to other equipment.

Appendix: Key Laws

- On product liability, three take-aways:
 - some state laws impose liabilities on lenders, financiers, lessors, and owners of aircraft even when they don't control the aircraft; this is also true in some foreign countries
 - US federal law limits liability of lenders, lessors, financiers, and even owners of aircraft, when they don't control or actually possess the aircraft
 - even so, lenders/financers/lessors will configure the deal documents so they have the benefit of:
 - indemnities from you as borrower/lessee, and
 - insurance to protect them from the “exceptions” or from litigants who will sue them no matter what