

BUYING A BUSINESS JET ON THE U.S. MARKET (Step 2)

Advanced purchase thoughts for the Chinese business leader

By Jim Cooling and Kathleen Breckenridge

With preliminary considerations for buying a business jet for sale on the U.S. market given due care and attention - and answered satisfactorily - it is time for the negotiations to begin. Following are some key steps in the process, along with further considerations that should be taken into account at each stage of the process.

Letter of Intent and Pre-Purchase Inspection

A Letter of Intent (LOI) is the preferred method to negotiate the basics of the purchase such as price, deposit, basic delivery terms and conditions, removal of the aircraft from the market and protection of a purchaser's deposit.

The LOI is not a binding contract. It documents the primary points of the negotiation until a detailed purchase agreement can be negotiated, often between legal counsel.

Usually the purchaser will want the LOI to provide that the deposit be refundable until a technical pre-purchase inspection of the aircraft is completed and accepted. The purchaser will also want the assistance of a technical representative for this inspection.

This step provides the purchaser with a better understanding of the condition of the aircraft. Also, if the aircraft is to be registered in another country, the purchaser can determine what may be needed to qualify for an Export Certificate of Airworthiness to that country, or meet the requirements of that registration.

Before the pre-purchase inspection of the aircraft itself, the purchaser's technical representative may conduct a preliminary "visual" inspection of the aircraft, as well as a review of the maintenance records and logbooks.

In the case of a new aircraft to be built to the purchaser's specifications, the LOI may set forth the purchaser's right to have a technical representative observe and inspect the aircraft during the manufacturing process.

The purchaser's LOI may require a test flight before the pre-purchase inspection, and it should also specify a deadline for completion of the definitive purchase agreement. Once the LOI is signed and the deposit made, the parties will negotiate the purchase agreement that becomes the binding contract of purchase.

Purchase Agreement/Purchaser's Protections

The primary points in the LOI will be incorporated into the Purchase Agreement along with many other terms and provisions.

The purchase agreement terms should protect the refundability of the deposit until the conclusion and acceptance of the pre-purchase inspection. The pre-purchase inspection will be conducted, typically, by an independent inspection facility that reports directly to the purchaser, or to both parties.

The purchaser will also require, in addition to its own due diligence in reviewing the aircraft records, certain assurances from the seller concerning the conditions of delivery. For used aircraft the seller should disclose any history of damage or corrosion on the aircraft, no matter how it may have been repaired, up to the time of

closing. For U.S. aircraft, the FAA maintains a number of records to be reviewed by the purchaser's technical representative.

The seller may have the aircraft enrolled in various warranty and maintenance programs, and the purchaser should be sure these are transferable by the seller, and paid for up to the date of closing.

The purchaser may want to have the right to assign the purchase agreement to an affiliated company for various purposes, and the purchase agreement should permit this. For example, the purchaser may want to establish an owner-trust for registration purposes, or use another entity to take delivery for tax purposes, such as with a "1031 exchange" under U.S. tax laws. The purchaser may want to place ownership of the aircraft with a lender for financing purposes.

With new aircraft, the purchaser typically must make progress payments to the manufacturer in addition to the first deposit, as the aircraft is built. With some newer designs of aircraft, the projected delivery date may be years in the future. During that time, the market may change dramatically, or the purchaser may encounter a change in its financial circumstances.

The manufacturer will insist upon a "liquidated damages" clause in the event the purchaser ultimately does not take delivery of the aircraft. This clause establishes a certain amount to be paid to the seller by the purchaser. The purchaser may be able to negotiate the conditions for payment or refund depending upon the timing and nature of any failure to take delivery. This clause may be coupled with "sole recourse" language stating that the purchaser shall have no other liability.

In case of delivery delays on the part of the manufacturer the purchase agreement may provide for liquidated damages in favor of the purchaser, return of funds, or other penalties. This is usually only an issue for new aircraft being purchased from a manufacturer. The purchase agreement will also specify deadlines for the manufacturer to make delivery, acquire type certification, conduct test flights and otherwise meet certain milestones in development or manufacture of the aircraft.

Because aircraft are so mobile, the purchaser will want to be certain that the seller who will receive the money is able to transfer good title to the aircraft. The purchase agreement should always provide that the purchaser will receive a Warranty Bill of Sale along with the seller's warranties of good and marketable title.

The purchaser will want an independent assurance of title from a title company or counsel's opinion, when available. Title insurance may also be available, and the parties can negotiate whether title insurance is obtained and who is to pay for it.

The pre-purchase inspection was mentioned above. In a transaction with a U.S. seller, an overseas purchaser should consider this to be critical. The purchaser will want the right to reject the aircraft, and get a refund of the deposit, if the aircraft is unacceptable for any valid reason.

The seller should be required to correct, at a minimum, any problems that make the aircraft unsafe or illegal to fly. These are called airworthiness discrepancies, and the purchaser's technical representative or inspection facility should find them.

If the purchaser intends to move the aircraft to another country after acquisition, the purchase agreement should require the seller to place the aircraft in proper condition for issuance of an Export Certificate of Airworthiness.

For new aircraft, the desired country of registration is usually communicated to the manufacturer early enough that the aircraft, when finally delivered, will comply with all requirements for the Export Certificate of Airworthiness to that country.

Tax and Insurance Considerations

A closing date for completion of the acquisition will be established after the purchaser has finished the pre-purchase inspection and all discrepancies are corrected by the seller.

In the United States, the purchaser must consider the State into which the aircraft will be delivered, because each State has its own law relating to sales tax, or a related tax known as 'use tax'. Some States are considered tax-free and tax-friendly for aircraft closings, but the choice of location is not simple.

The timing of the delivery may also be important with respect to income tax laws - for example, in the case of a '1031 exchange' or other acquisition that may be related to the sale of another aircraft.

The purchaser will want to make advance arrangements for aircraft insurance, both for the aircraft itself (known as 'hull insurance') and for liability insurance coverage. This insurance should be in place before the purchaser accepts delivery.

If financing is involved, this aspect of insurance will be coordinated with the lender, who will also impose certain insurance requirements through the loan or lease documents. The purchaser should have in hand a satisfactory certificate of insurance guaranteeing coverage prior to the closing.

Closing (Completion of the Purchase)

The Closing is the event at which the final portion of the purchase price is paid by the purchaser, and the aircraft is delivered by the seller. Normally in the U.S., such a closing will be coordinated with a title company in Oklahoma City, Oklahoma, because that is the location of the FAA Records Center where recordation of the acquisition documents takes place simultaneously with the Closing.

The title company (as escrow agent) collects all the signed documents and funds and conducts the FAA filings. Thereafter, the title company distributes the final documentation among the parties.

For a U.S.-registered aircraft that will maintain its U.S. registration after purchase (perhaps through an owner trust), the FAA will require a series of documents. These include:

- The trust agreement;
- An acknowledgement of U.S. citizenship by the owner-trustee;
- The FAA or Warranty Bill of Sale;
- The Aircraft Registration Application in the name of the owner-trustee;
- The FAA Form 8050-135 for registration of the interest on the International Registry;
- Any mortgage or security agreement of the Lender; and
- Any lien releases from the seller to provide clear title to the aircraft.

Export and Deregistration

For a U.S. aircraft that will be changing to a registration in another country, an additional series of documents will be required. In addition to those mentioned above, this includes lien releases from the seller providing clear title to aircraft.

Further, the purchase must have evidence satisfactory to the FAA that: Each holder of a recorded right has been satisfied, or has consented to the transfer; A written request for cancellation of Certificate of Aircraft Registration has been submitted; Written certification is available that all registered interests with priority have been discharged, or have consented to cancellation of the Certificate of Aircraft Registration, and; An approved form of notification to the country of export by the FAA is filed.

If the aircraft is delivered in the U.S. and is to be flown out of the U.S. immediately afterward, the purchaser must arrange in advance for the needs of that particular flight and each intermediate point of landing.

U.S. customs regulations require that a U.S. aircraft sold in the U.S. for registration or basing overseas must be formally exported from the U.S. when it leaves the country. The seller and purchaser will need to cooperate to affect the customs export, which requires a Shipper's Export Declaration to be filed with Customs and Border Protection (most often performed by an established customs broker).

International Registry

Any aircraft transaction involving an aircraft registered in the U.S. will require FAA registration. In addition, the transaction should be registered with the Cape Town International Registry. At present there are 28 countries, including China and the United States, that are signatories to the Cape Town Convention on International Interests in a Mobile Equipment and the Protocol on Aircraft Objects.

To fully perfect title in signatory countries, a qualifying aircraft (as to weight, engine thrust, etc.) must have its contract of sale registered. To register the interest, both the purchaser and seller must apply to become Transactional User Entities and appoint a Professional User Entity (usually an escrow agent) to register the interest.

Lenders in countries that are signatories will also want to register their international interest on the registry and will require the contract of sale to be registered.

Conclusion

The acquisition of a business jet may seem complex to the Chinese business leader, but with careful planning the process is manageable, and the satisfaction of owning and operating a business jet worldwide is readily achievable.

Whether the business jet is purchased from a U.S. seller or otherwise, the Chinese business leader would be best served by the assistance of an experienced aviation broker, and aviation legal counsel who specialize in international aviation transactions.

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Back-to-Back Transactions

For various reasons, aircraft are occasionally sold in back-to-back transactions. These transactions are commonly used when a trade-in aircraft is involved that would not allow a direct purchase, or for tax or other considerations. The transaction is often structured as a sale by a seller to a broker, and then the aircraft is immediately sold by the broker in a simultaneous transaction to a third-party purchaser.

The Purchase and Sale Agreements are negotiated simultaneously and are “mirror images” of each other so that the broker can require everything that it needs to provide to its ultimate buyer in the way of representations and warranties, warranty of title, scope of inspection, delivery conditions, and the like. The pre-purchase inspections and closings are virtually simultaneous.

Closing is done with all required documents in escrow with no funds released until the escrow agent has authority to release, transfer and file the bills of sale and the aircraft is in the condition ready for immediate issuance of a certificate of airworthiness for the country of registry. The first sale in a back-to-back transaction is typically not recorded although the country of registry requires all the necessary paperwork to validate the passage of title.

Another advantage to a seller is that the seller limits its liability risk by not being in the chain of title to the subsequent buyer. The seller also avoids dealing with an unknown party. A back-to-back transaction should be acceptable to a buyer so long as any deposit is properly protected and they are able to acquire the aircraft in good condition, with good title, at the agreed purchase price.