



CRITICAL FIRST STEPS IN BUYING AND SELLING AN AIRCRAFT

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As we participate in roughly 200 aircraft sale transactions annually, we are acutely aware that every deal is different. There is no universal rule for how a transaction should be structured, papered and processed. However, there are a few elements which every buyer and seller should consider, and having an experienced aviation and tax counsel during all phases can make the transaction proceed smoothly and without costly or time-consuming mistakes.

The primary documents in most transactions are the purchase offer, or letter of intent (the "LOI"), and the definitive aircraft purchase agreement (the "Purchase Agreement"). It is best if counsel are brought into the negotiations prior to the execution of the LOI because, while the LOI is normally a summary of the main deal terms, the failure to address certain key terms in the LOI can create a risk of "sandbagging" when the drafting party presents the first draft of the Purchase Agreement. That is, when the first draft of the Purchase Agreement includes a new term that the receiving party deems economically or legally material, the deal negotiation must recommence.

To assist the buyer and seller alike in anticipating the issues to be addressed at the LOI stage, we herein address the key matters that we normally seek to resolve before the Purchase Agreement is drafted. In subsequent articles we will cover certain of these matters in greater detail.

The Inspection Process

Among the most important matters to be addressed in the LOI are the scope and costs of pre-purchase inspection and corrective work, and the parties' respective rights to discontinue, or obligations to con-

tinue, the transaction depending upon the inspection's results. For example:

- Who pays to ferry the aircraft from seller's home base to the inspection facility; and will the ferry flight serve as the buyer's test flight?
- What is the scope of the inspection, and what is the scope of the corrective work to be performed by the Seller?
- Are airworthiness discrepancies determined solely by the buyer, by the parties' mutual agreement, or by the inspection facility?
- May the buyer unilaterally walk away during or after the inspection, or must the buyer close the transaction assuming the seller remedies the discrepancies?
- May the seller elect not to remedy the discrepancies and walk away; and if so, does this change the responsibility for the buyer to pay for the costs of the inspection and to ferry the aircraft back to seller's home base?
- At what point does the buyer's earnest money deposit become non-refundable?

These and other questions should be resolved before the Purchase Agreement is drafted.

Timing is another matter that the parties should address at the LOI stage. It is not normally a good idea for the pre-purchase inspection to begin until the Purchase Agreement is in place. So in coordinating an input date with the inspection facility, the parties should anticipate about one (1) week after the LOI to finalize the Purchase Agreement.

And if possible, the parties should state the closing date in terms of when the discrepancy remediation is completed (i.e., within X business days), rather than on or by a certain date. This formula might need further to be adjusted to accommodate the buyer's financing arrangements, as it can often take from two (2) to four (4) weeks after the LOI for the buyer to ready its credit facility or leasing structure with its financier.

Assignment to Qualified Intermediary or to Newco

If the buyer is conducting a tax-free exchange, this should also be referenced in the LOI; and, timing considerations should be reflected in the LOI as well as the ability to assign the agreement to a Qualified Intermediary or Exchange Accommodation Titleholder. Moreover, both for liability protection planning and under some sales and use tax strategies, it may be necessary for the buyer to assign the Purchase Agreement to an affiliated company (including to a newly-formed special purpose entity).

Delivery Location

For transactions involving delivery in the United States, the issue of where the closing takes place is important if state sales tax is to be avoided or limited. It is normally the buyer's obligation to pay to the seller, or to the state, the sales tax applicable in the state where the aircraft delivery occurs. However, some states' sales tax do not apply to aircraft; others provide for exemptions where the aircraft is purchased for resale, is to be flown out of the state soon after the sale, among many other exemptions.

Where it is not possible for buyer's counsel to conduct the relevant state's sales tax research prior to the execution of the LOI, the parties should agree that the delivery location will be mutually agreed to prior to closing. Of course, it is important to agree on which party will bear the costs and risk of loss in connection with ferrying the aircraft from the inspection facility to the selected delivery location.

Conclusion

Space does not permit us here to treat all of the issues to be considered at the LOI stage. However, it is important that aviation and tax counsel be consulted early on in the LOI negotiation process.

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