



Maintaining Flexibility When Acquiring a Position on a New Jet Aircraft

Entering into a purchase agreement for a conceptual aircraft is a unique experience even for savvy business professionals familiar with purchase contracts. These agreements can provide a purchaser with the opportunity to potentially acquire a new aircraft in exchange for a commitment of a relatively nominal down payment. From a manufacturer's perspective, these agreements can gauge the interest of prospective purchasers and determine if there is sufficient demand for them to proceed. The aircraft manufacturer typically develops a "mock-up" and provides pre-engineered estimates of specifications before initiating the expensive and time-consuming certification process. Naturally, the design of the aircraft is preliminary, at best, and the manufacturer therefore needs to have significant leeway in dimensions, performance specifications, and even delivery date. This "contract before design" often results in cumbersome contracts that on their face appear to provide an unusual degree of flexibility to the manufacturer.

Both the manufacturer and purchaser recognize that initial position holders would generally acquire a right to obtain the aircraft at a more favorable price than will ultimately be available once certification and deliveries begin. Therefore, the manufacturer commonly will restrict the transfer of these favorable rights to avoid competing with these position holders on the sale of new aircraft at a higher price. Unfortunately, aircraft purchasers operate in dynamic environments as well. Over a five or more year period some will overestimate or underestimate their need for a particular aircraft. Others will find that a model introduced at a later time might serve their needs more effectively. Finally, some will find financial or physical limitations on their ability to use the aircraft.

CONTROL YOUR EXPOSURE WITH A SPECIAL PURPOSE ENTITY

Demand is high and price increases on newly manufactured aircraft have become somewhat systematic. Therefore, the aircraft position increases in value based on both the favorable pricing and the ability to move up time of delivery. The progress payments are usually required in an amount generally equal to 10% to 20% of the purchase price of the aircraft; therefore leverage can create a significant return on investment as model prices increase. Aircraft purchase contracts universally allow the manufacturer to retain progress payments should a purchaser default. However, the contracts may further allow the manufacturer to seek additional damages beyond forfeiture of deposits; leverage may magnify losses as well.

If an individual enters into a purchase agreement to acquire an aircraft, and it contains a customary “no resale” provision, he may find that he is unable to sell his position to another purchaser and is forced with a dilemma of either breaching the contract or taking title to an aircraft he doesn’t want or need so that he may resell it. Obviously, his exposure is limited to his ability to pay, but without entity protection he may be forced to liquidate a significant portion of his individual nest egg.

Even if the contract contains a “no resale” provision, the agreement is transferable through the sale of the entity. If a purchaser acquires an aircraft position in his newly formed corporation, it will generally provide both adequate personal protection and transferability. However, a prospective purchaser may prefer not to hold the aircraft in a corporate solution and this methodology may therefore impair the marketability of the agreement. If a purchaser acquires a position through an LLC, the entity has the unique ability of being exempt from income tax filing requirements for the non-business user or taxed as a corporation, a partnership, or a disregarded entity at the election of the taxpayer. This flexible legal entity provides the liability protection of the corporation without preventing the prospective purchaser of the interest from using the aircraft as he ultimately chooses. We therefore believe the entity of choice for most taxpayers is a newly formed limited liability company set up for the purpose of holding the aircraft position.

OTHER ITEMS FOR CONSIDERATION WHEN ACQUIRING AN AIRCRAFT POSITION

The contract submitted to you by the manufacturer, by necessity, maximizes his flexibility and was drafted by his lawyers to protect his interest. Although they are generally not designed to be over-reaching, an over-zealous attorney may draft a contract with elements that should concern the potential buyer. These often include the following:

1. The delivery date of the aircraft is often tied to the certification date of the model. This certification date is naturally not guaranteed, but is often very broadly written and provides little recourse to the purchaser. It is reasonable for a purchaser to insist that if the certification milestone is not met after some appropriate period of time, the purchaser should have a right to demand a refund of his deposits.
2. Many of the companies that would like to enter into the jet market have the best of intentions and no capital. It is not reasonable for the purchaser to expect Textron, Embraer, or General Dynamics and the like, to escrow your funds. However, good business sense, and the memory of Sapphire, Visionaire, and Century Jet, reminds us of the importance of escrow arrangements. Start-up companies commonly provide for escrow agreements, but review escrow instructions to understand your rights to demand deposit refunds.
3. Be certain that the contract terms are both fixed, and provide only reasonable latitude and specifications. Some agreements call for non-refundable deposits even when the purchase price of the aircraft has not yet been determined, or the specifications have not been agreed upon.

4. One jet manufacturer proposed in a purchase agreement that if a purchaser chose to sell either his position or his aircraft within a one-year period following delivery, that the manufacturer would have a right of first refusal. Obviously, this would provide the manufacturer protection from the sale of its purchasers, but ignored the need for flexibility by their customers. This provision was unilaterally withdrawn by the manufacturer upon the receipt of a barrage of complaints from prospective customers.

Most importantly, it is essential that the contract terms be closely reviewed. The \$25,000 deposit that you casually make to acquire the aircraft may result in a multi-million dollar commitment deserving of your utmost care.

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