

FAA to Alter Rules for Non-Citizen Trust Ownership

Summer 2012

In early 2011, the Federal Aviation Administration (FAA) ignited a minor firestorm when it temporarily halted approval of ownership trusts as permitted owners of U.S. registered aircraft. The FAA's action froze many aircraft transactions and cast doubt on foreign buyers' ability to register aircraft in the U.S. The FAA moratorium was in response to situations in which the trustee of an aircraft ownership trust seemed unable to provide the FAA with basic information as to the aircraft's operational status. The FAA quickly "unfroze" the processing of ownership trust applications, and over the past 14 months has worked with interested industry participants on a "policy clarification" for non-citizen aircraft ownership trusts (NCTs). A final position is expected in the Summer of 2012, but the likely outcome is fairly clear. NCTs will continue, but with an enhanced role for trustees.

The Role of Aircraft Ownership Trusts

The United States has an "owner registry" system—meaning that the legal owner of an aircraft is tasked with registering it. In contrast, many nations have an "operator registry" requiring the aircraft's operator to register the aircraft. U.S. law (49 USC 44102) requires that any person or entity registering (owning) a U.S.-registered aircraft be a U.S. citizen. Notably, U.S. law does not concern itself with the citizenship of the aircraft operator, so there is no limitation on foreign lessees operating U.S.-registered aircraft. This quirk in the law makes one wonder why there is a U.S. citizenship requirement at all.

For decades, foreign buyers seeking to avail themselves of the benefits of U.S. (or N) registration have employed ownership trusts to satisfy the U.S. citizenship standard. U.S. registration offers an owner greater resale possibilities, broader financing options and a positive perception that the aircraft has been operated and maintained under a stringent regulatory regime. In forming a trust, the ownership of the aircraft is changed so that the foreign entity (the trustor) owns the beneficial interest in the trust (known as the trust estate), while the aircraft's legal owner is the trust, which is controlled by the trustee. The trustee is generally an affiliate of a major U.S. financial institution. The trustee, as a U.S. citizen, needs a high degree of autonomy in order to satisfy the U.S. statutory citizenship standard. Typically, a business jet in an ownership trust structure is titled in the trust's name, and possession of the aircraft is returned to the foreign ex-owner by a lease or similar agreement. NCTs are not specifically addressed in U.S. statutes, but the FAA approves of them as aircraft owners via written interpretations and policies. As a result, the FAA's "fix" to the perceived problem of

non-U.S. citizens operating N-registered aircraft through absentee ownership trusts is not regulatory rulemaking, but rather a Proposed Policy Clarification, or "PPC."

In an NCT structure, the trustee is generally passive and uninvolved in day-to-day aircraft operations, unless there is a financing or sale of the aircraft, or other event requiring the aircraft owner to act. This would be the case in any owner/lessee relationship where the owner entrusts complete responsibility to the lessee. Based on the above incidents, the FAA decided that trustees were too passive and uninvolved, and that the NCT was too detached from aircraft operations to permit the FAA to do its job of overseeing regulatory compliance.

The FAA published the PPC on February 9, 2012 and laid out a series of changes to prior policy on NCTs. In May 2012, the aircraft industry participants responded. To summarize the key changes (and industry opposition):

- **FAA Form Trust Agreement.** The FAA proposed a "standard non-citizen trust agreement" to capture many of the points described below. In response, the industry represented by the Aviation Working Group, Industry Consultative Group (ICG) asked the FAA not to establish a form agreement, but rather to offer form clauses for inclusion in trust agreements, thus allowing trustors and trustees to vary other agreement provisions to reflect their commercial intent. It is doubtful that the FAA would require trusts to adhere strictly to a single form, as long as deviations do not undermine the PPC's objectives.
- **Disclosure of Leases to Foreign Trustors.** The FAA acknowledges that foreign trustors are frequently given exclusive possession and physical control over the aircraft by the trust, often reflected in leases or operating agreements. In the past, NCTs often failed to provide copies of these "side agreements" to the FAA for review with the trust agreement, and in some cases these side agreements undermined or contradicted the trust agreement. The PPC proposes to have all side agreements filed with the FAA for review (and if no side agreements are filed, the trustee is to attest that no agreements exist). The ICG accepts this filing requirement, but asks that the FAA discard these documents once they have approved the trust as a U.S. citizen, in order to protect the privacy of the foreign trustors. It is highly unusual for a federal agency to destroy or return documents used in reaching a regulatory decision, and it will be interesting to see what the FAA does in response to this concern.
- **Trustee Autonomy (Removal).** The FAA intends to severely restrict the foreign trustor's ability to influence the trustee, including limiting the trustor's ability to remove (fire) the trustee unless there is cause to do so. The ICG suggests specific standards for removing the trustee for cause (*i.e.*, "willful misconduct or gross negligence").
- **Enhanced Trustee Involvement.** In perhaps the one area that truly responds to the problem first identified by the FAA (the "know-nothing" trustee), the FAA proposed requiring that trustees be capable of responding to the FAA's informational inquiries about the aircraft, its ownership and operations. Specifically, the PPC expects a trustee to be able to identify the operator and principal base of operations for an NCT-owned aircraft within two business days, and to identify crew, future operations and maintenance records within five business days. The ICG is hoping to convince the FAA to back off a specific numeric standard, and instead adopt a descriptive standard for timely responses. NCT-owned aircraft are often located in remote locations, and producing crew and maintenance records can be

difficult as a practical matter.

- **Control of the Aircraft.** The FAA and the ICG continue to wrestle with the difficult question of how to ensure trustee control of the aircraft operations, while at the same time permitting the foreign trustor to have sole use of the aircraft. The FAA continues to speak in absolutes, implying that the trustee must exercise control of operations continuously; while the ICG asks that the control requirement be conditional, meaning that the trustee have the ability to control the aircraft when necessary to protect the interests of the United States, but allowing for transfers of control by leases or operating agreements in the ordinary course. It is difficult to reconcile the FAA's implication of continuous trustee control with the acknowledgement of exclusive operating leases to foreign trustors.

Conclusions

As a practical matter, if you currently have an aircraft in an NCT, or if you are putting one into an NCT, this ownership method will remain available to you for the foreseeable future. What remains to be seen is how the role of the trustee will change. If the FAA has its way, then trustees will have a great deal of additional work to do, including regular tracking of NCT aircraft operations. Trust structures are usually priced with a relatively modest startup and annual fees; and any unusual work required by the trustee is charged to the trustor. The FAA's proposed changes will greatly increase the burden on trustees, and foreign buyers can expect to see higher startup and annual fees, and security deposit requirements to secure a trustee's ability to be paid for extraordinary actions required by the FAA.