When Bad Things Happen to Good Deals: Things Financiers Should Worry About

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Overview

• Key issues for financiers
• Lessons from other deal nightmares
• Ways to mitigate risks
• Questions
Key Issues for Financiers - Transaction Risks

- Borrower
  - Compliance with the loan documents
  - Is the borrower trustworthy?
  - HNW individuals who become “distressed” or “former” HNW individuals
  - Operating the aircraft to/over prohibited areas
  - Performing maintenance in accordance with applicable requirements
  - Desperate people often do desperate, stupid things
  - Be prepared for liens
  - Grey/illegal charter
Key Issues for Financiers - Transaction Risks

- Governmental risks
  - Regulatory responsibilities as the “owner”
  - Potential for seizure (June 2012 Brazilian seizure of N-registered aircraft for allegedly evading Brazilian taxes: 10% private operators)
  - Very stubborn, business aviation make for good revenue targets
  - De-registration issues, self-help, court order
  - Political instability (Russia, Iran, Middle East and Cuba)
Key Issues for Financiers - Transaction Risks

- Brazilian tax authorities seized about a dozen N-registered business jets and one Bermuda-registered aircraft that were physically in Brazil
  - Tax authorities claim that the seized aircraft are subject of complex registration schemes designed to evade Brazilian taxes
  - The current status of the aircraft is unknown
- Argentina default & impact on owners and operators
- Venezuela’s political and financial crisis
- United States non-citizenship trust and the FAA & government bashing business aviation
Key Issues for Financiers - Transaction Risks

- Maintenance Providers
  - Quality of maintenance & oversight (EASA, CAA, FAA, etc.)
  - Liens, enforceability and impact on title, sale, loan documents
  - Logbooks (always “lost” during a dispute)
  - Lienholders: Validity of lien?
    - Properly filed? In U.S., state and federal action required
Lessons Learned from Other Deal Nightmares (#1)

• Borrower leased aircraft to Sublessee, who hired NYC-based aircraft charter operator to operate the aircraft. Aircraft was financed by VFS Financing, a GE subsidiary.

• Sublessee attempted to purchase 475 kg of gold at a profit from an entity located in the Democratic Republic of the Congo (DRC).

• Flew the aircraft to the DRC, provided an ICC indicted warlord with $6.5, but the warlord then seized the aircraft and crew.

• After payment of significant fines and “other” payments, crew and aircraft were released and the aircraft was flown back to the U.S., where it was immediately seized and sold by the GE.
Lessons Learned from Other Deal Nightmares (#2)

• Borrower sold aircraft to a Middle Eastern entity (NewCo), which then retained a Middle Eastern-based aircraft charter operator to manage and charter the aircraft. NewCo also traded-in its aircraft as part of the transaction to Borrower’s broker.

• NewCo, which had been sending all loan payments to an escrow company, hired a new CFO, and the new CFO decided to send the next payment directly to the bank. The Bank refused the wire from NewCo and the Bank explained that NewCo was not the Borrower or legitimate registered owner of the aircraft.

• Bank claimed that the Borrower never received consent to sell the aircraft.

• NewCo surrendered the aircraft to the Bank and sued the Borrower. The parties reached a confidential settlement.
Lessons Learned from Other Deal Nightmares (#3)

• Two high net worth borrowers obtained a $25 million loan for an aircraft in 2007 at the height of the aircraft market. In 2011, they defaulted on the loan, accumulated over $1.25 million in liens from various service providers.

• Borrowers were very hostile to the Bank and demanded that they be able to market and sell the aircraft because they believed the Bank would simply dump the Aircraft. They also demanded that the Bank pay the service providers.

• Bank refused to allow Borrowers to sell, sold to a third party for approximately $6 million and paid the service providers about $400,000.

• After Borrowers defaulted on multiple forbearance agreements, the Bank sued the Borrowers personally, since they were guarantees on the loan. Borrowers counter-sued, claiming the aircraft was not commercially reasonable.
Ways to Mitigate Risks

- Perform comprehensive due diligence on Borrower
  - Confirm operating profile (private, charter, management, dry/wet leasing, where will the aircraft be operated?)
  - Check the public records & Internet, KYC due diligence
  - Check applicable export control “watch lists”
  - Verify countries of operation are permissible under the loan documents and insurance policy
Ways to Mitigate Risks

• Prepare the comprehensive agreements, thoroughly review associated subleases, operating agreements and management agreements
  • Guarantees
  • Maintenance and return conditions
  • Indemnifications
  • Securities and other assets as collateral
  • Aircraft registration considerations: What is the best registry if “X” happens?
  • Tax implications: Be sure borrower has performed tax planning, otherwise liens and government seizure are possible
Ways to Mitigate Risks

Agreement language matters:

TERRITORIAL LIMITS: LESSEE AGREES NOT TO OPERATE OR LOCATE THE AIRCRAFT, OR ALLOW THE AIRCRAFT TO BE OPERATED OR LOCATED DURING THE TERM, IN OR OVER ANY GEOGRAPHIC AREA WHICH IS NOT COVERED BY THE INSURANCE POLICIES REQUIRED BY THE LEASE, OR ANY COUNTRY OR JURISDICTION FOR WHICH EXPORTS OR TRANSACTIONS ARE SUBJECT TO SPECIFIC RESTRICTIONS UNDER ANY UNITED STATES EXPORT OR OTHER LAW OR UNITED NATIONS SECURITY COUNSEL DIRECTIVE, INCLUDING WITHOUT LIMITATION, THE TRADING WITH THE ENEMY ACT, 50 U.S.C. APP. SECTIONS 1710 ET. SEQ., AND THE EXPORT ADMINISTRATION ACT, 50 U.S.C. APP. SECTIONS 2401 ET. SEQ. OR TO OTHERWISE VIOLATE, OR PERMIT THE VIOLATION OF, SUCH LAWS OR DIRECTIVES.
Ways to Mitigate Risks
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Democratic Republic of Congo

Potentially Hostile Situation below 15,000 ft.

Aircraft operating below 15,000 ft. AGL in the Congo may come within weapons range as the country’s civil war continues. “An October 1998 incident in Eastern Zaire, where a civilian Boeing 727 was shot down by a Manpads, demonstrates that rebel forces in the Congo can and will shoot down civilian aircraft they believe to be carrying government soldiers and weaponry,” says the FAA. “Operators considering flights within the Congo should familiarize themselves with the current situation.”
Ways to Mitigate Risks

Northern Ethiopia

Special Federal Aviation Regulation 87 – All altitudes
U.S. carriers and commercial operators prohibited from operating in territory and airspace of Ethiopia north of 12 deg. N. Lat. No reason is provided.
Ways to Mitigate Risks

• Arrange for and retain local counsel
• Perform annual due diligence and document requests; loan documents should specifically include updates
• High-risk operators may require on-site audits of the borrower and operators
• Review the flight logs, maintenance records and flight crew training frequency
• Have a Crisis Management Plan, prepare for the unexpected
Ways to Mitigate Risks

• Evaluate the risks
  • Litigation
  • Cape Town Convention (Is it irrelevant?)
  • Rights under the Country of Registration
  • Self-help & onsite repossession
  • Loan document remedies, “Event of Loss” & “Event of Default”
  • Political pressure & seizure and sale of the Aircraft

• Finally, agreements, warranties, representations and *their word* are only as good as the person’s character
Thank You & Questions

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