

Global Transportation Finance Bulletin

FAA Publishes Proposed Policy Clarification Regarding Non-Citizen Trusts: Permitted, but Conditioned

by Edward K. Gross

Background

On February 9, 2012, the Federal Aviation Administration (the FAA) published its Proposed Policy Clarification (the PPC) regarding the use of non-citizen trusts (NCTs) to effect registration of an aircraft on the FAA registry.¹ The PPC is a draft, prepared and published by the FAA for public comment, which includes its justifications for seeking to impose changes to the NCT registration process, and explanations and descriptions of those proposed changes, including a sample trust agreement revised to reflect the same.² The PPC was issued after being reviewed and approved by officials of the FAA and DOT, as well as the Transportation Secretary.

The PPC includes the FAA's general recognition of NCTs, which is a positive development. However, the PPC imposes new, and not insignificant, conditions on the use of NCTs including the allocation to the trustees of primary responsibility for certain matters as the "owner" of the aircraft. This Bulletin briefly describes the FAA's purpose for publishing this PPC, the matters addressed in the PPC, and its likely implications.

FAA's Compliance Concerns

The PPC repeated the concerns raised by the FAA in previous reviews of NCTs.³ Many of those concerns are not exclusive to the use of NCTs, despite the recent scrutiny. However, the use of NCTs is of particular concern because NCT-registered aircraft are frequently based, operated and maintained outside of the US and, per the FAA, impeding its national and international

responsibilities to monitor, enforce and ensure compliance with the airworthiness and operational standards required of FAA-registered aircraft.⁴

Proposed NCT Requirements

The PPC NCT-related requirements are intended to address the FAA's compliance concerns by requiring NCT trustees to facilitate periodic or urgent efforts by the FAA to find or verify information with respect to the "identity and whereabouts of the actual operators of aircraft and the location and nature of operation." For that purpose, the PPC proposes revisions in the form trust agreement requiring that NCT trustees furnish the following to the FAA upon its demand:

Within 2 business days:

- the identity of the person normally operating, or managing the operations of, the aircraft;
- where that person currently resides or has its principal place of business;
- the location of maintenance and other aircraft records; and
- where the aircraft is normally based and operated.

Within 5 business days:

- information about the operator, crew, and aircraft operations on specific dates;
- maintenance and other aircraft records; and
- the current airworthiness status of the aircraft.

The PPC further provides that the trustees may be required to produce the foregoing information more quickly “in the event of an emergency.”

In addition to the reporting obligations, the FAA has clarified its position regarding documents to be filed with trust agreements, and proposed new requirements related to trustee removal or resignation. In particular, the FAA notes that parties to NCTs often enter into, but do not file with the FAA, an operating agreement, pursuant to which the non-citizen beneficiary or trustor is given significant operational control over the aircraft. The FAA has proposed that these operating agreements must be submitted to the ACC with the trust agreements, but has not specified whether these agreements would be filed in the FAA ancillary files, or recorded with the FAA registry.

The trust agreement attached as an exhibit to the PPC includes suggested revisions by the FAA intended to further limit non-citizens from influencing the trustee’s control over certain aircraft matters, as well as clarifying certain perceived ambiguities in current “market” trust agreement forms. With respect to trustee resignation and removal, the FAA has proposed additional terms to be included in trust agreements. The FAA found that current NCT trust agreements give the non-citizen trustors too much discretion in removing trustees. Consequently, the FAA has proposed new terms that will limit the non-citizen trustors’ ability to remove trustees in the absence of “cause” as well as clarify the grounds that will constitute “cause” for removal. Pursuant to the PPC, trustees will be allowed to resign if the trustor is uncooperative. Parties to transactions involving NCT-registered aircraft, especially financing parties, are likely to further address the impact of any such trustee resignation or removal in the transaction documents.

Industry Reaction

Aviation industry members have so far reacted to the PPC with measured relief as well as disappointment. Clearly, the industry is pleased that NCTs remain a valid mechanism by which a noncitizen may register an aircraft with the FAA registry. However, the PPC also includes numerous worrisome assertions and impositions, including, among others:

- The proposed changes allocate significant, impractical responsibilities, and related costs, risks and other burdens on all parties to transactions involving these trusts. The risk and responsibility allocation related to these changes will engender significant concern and negotiation, and unless revised prior to implementation, inhibit the use of NCTs.
- The PPC’s prefatory justifications and support for the proposed changes also caused a great deal of anxiety among industry members, especially the FAA’s assertions regarding an aircraft owner’s non-delegable responsibilities regarding the condition of its registered aircraft, which extend beyond the transactional risks deemed acceptable to trustees, finance lessors and other passive owners.
- The PPC failed to specify the sanction for non-compliance with these revised trust agreement requirements (*i.e.*, imposing fines, invalidating registration, etc.).⁵

Recommendations

Parties to aircraft transactions (whether NCTs or otherwise) in which the registered owner is not also the operator should consider the FAA’s informational concerns when structuring and documenting the transaction. By way of example, parties to NCT transactions should exercise considerable care when identifying a trustee, drafting the trust agreement, and determining what documents to file with the FAA. Furthermore, parties should carefully consider the FAA’s assertions regarding a passive owner’s compliance responsibilities and be certain that these responsibilities are contractually delegated to a responsible operator.

Conclusion

NCTs are a necessary and FAA-authorized structural accommodation to parties desiring to register aircraft at the FAA, when such parties otherwise are restricted by citizenship requirements for FAA registration. Although the PPC does not invalidate NCTs, its proposed terms could render them impractical.

The FAA has set a deadline of March 31, 2012 for submitting comments to the proposal, and could choose to have another public meeting after receiving such submissions. There is some optimism among industry members that the FAA will ultimately further clarify or be persuaded to reconsider the particularly worrisome assertions and changes in the PPC. The coming weeks will feature much analysis and discussion regarding the PPC among industry members and the FAA.

Vedder Price is among a select group of lawyers, trustees and other industry representatives who have a leadership role in a collaborative effort to respond to the PPC, and to work with the FAA to find more practical solutions to the concerns it has raised, and as these discussions progress, Vedder Price will issue updates as appropriate.⁶

¹ A "Notice of Proposed Policy Clarification for the Registration of Aircraft to US Citizen Trustees in Situations Involving Non-US Citizen Trustors" was published by the FAA in the *Federal Register* on February 9, 2012. A US citizen trustee acting on behalf of a non-US citizen beneficiary can meet the requirement in 49 U.S.C. § 44102 that only "a citizen of the United States" is eligible to register an aircraft by complying with the applicable provisions of 14 C.F.R. § 47.7(c) and certain related interpretive opinions from Aeronautical Center Counsel (the ACC). For a thorough discussion of the history and purposes of NCTs, as well as the FAA's related undertakings and industry collaboration, see the Vedder Price Client Alert, "FAA Scrutinizes Non-Citizen Trusts."

² Since the 1970s, the FAA has permitted non-citizens and other parties to use NCTs to "N" register an aircraft in a circumstance when an owner is unable to certify that it meets the US citizenship test under the Federal Transportation Code (see Title 49 of the US Code and its predecessor, the Federal Aviation Act of 1958, as amended). However, the FAA has taken various actions during the past two years for the purpose of re-establishing the boundaries when using NCT registrations, culminating in the recent publication of the PPC.

³ In 2010, the FAA first tested industry reaction to then-proposed changes by the FAA's Aeronautical Center Counsel regarding NCT-related registration opinions, which changes were subsequently withdrawn. In 2011, the FAA commenced new initiatives with respect to NCT registration requirements, including inviting industry members to make submissions covering their positions regarding various NCT-related concerns raised by the FAA by public notice and at a related public meeting last summer. During this process the FAA finally articulated the concerns giving rise to this recent scrutiny, and (thankfully) reassured industry members that it was not intending to invalidate prospectively or otherwise the use of NCTs, only to impose conditions intended to address these concerns.

⁴ Per the FAA, such impediments could result in dereliction of the FAA's responsibilities under the Convention on International Civil Aviation (Convention on International Civil Aviation, Dec. 7, 1944, 61 Stat. 1180, 15 U.N.T.S. 295, imposing obligations on contracting states to oversee matters pertinent to the airworthiness, licensing and operations of the aircraft registered in those states) regarding the airworthiness of "N" registered aircraft.

⁵ Although parties to NCT-related transactions could contractually allocate certain of the related responsibilities, invalidating registration would be particularly problematic for financing parties, as would any insurance coverage vulnerabilities relating to such noncompliance even if the registration remains valid.

⁶ Edward K. Gross, a Shareholder in Vedder Price's Washington, DC office and author of this Bulletin, continues to participate in the drafting committee of the NCT-AWG Industry Consultative Group. If you have any questions or comments, please contact Mr. Gross at egross@vedderprice.com.

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