

Clients & Friends Memo

FAA Policy Clarification on Non-Citizen Trusts

August 12, 2013

On June 18, 2013, the Federal Aviation Authority (“FAA”) published a Notice of Policy Clarification (“Notice”) that aims to resolve what the FAA considered uncertainties about the regulatory responsibilities of trustees of United States registered aircraft beneficially owned by non-U.S. citizens.¹ The FAA observed that it had struggled on occasion to obtain operational and maintenance information about aircraft registered in such non-citizen trust arrangements, in particular while the aircraft operated outside the United States. According to the FAA, the problems in obtaining such information in turn affected the FAA’s ability to conduct fully effective oversight of such aircraft when operated outside the United States, and to provide foreign civil aviation authorities with information on those operations in support of those authorities’ safety oversight activities, in accordance with international law. The Notice also describes the FAA’s responses to commenters, including the Aviation Working Group (“AWG”). The Notice goes into effect on September 16, 2013.² However, AWG has requested that it be rescinded, postponed, or modified.³

This memorandum explains how the Notice clarifies trustees’ responsibilities in the FAA’s regulation of aircraft. The FAA reaffirms that it reviews, alongside trust agreements, other agreements between a trustee and trustor. The FAA requires that such agreements limit the trustor’s power to remove the trustee. The FAA also sets forth general standards for promptness in requirements that the trustee provide it with information about the aircraft’s operation when requested.

¹ Notice of Policy Clarification for the Registration of Aircraft to U.S. Citizen Trustees in Situations Involving Non-U.S. Citizen Trustors and Beneficiaries, 78 Fed. Reg. 36,412 (June 18, 2013) (to be codified at 14 C.F.R. ch. 1) [hereinafter Non-Citizen Trusts], available at http://www.faa.gov/about/office_org/headquarters_offices/agg/special/AircraftRegistration/ (follow the “Federal Register Notice” hyperlink).

² *Id.* at *36,424.

³ AWG objects to provisions of the Notice that it says “adversely affect the aircraft leasing and financing markets” without adequate justification and “could impair the vital and free flow of capital to the commercial and business aviation communities of the U.S., and cause an exit from the market of banks and other reputable trustees who serve as registered owners.” “[T]he NCT Final Policy blurs the longstanding distinction between regulatory obligations requiring compliance by ‘owners or operators,’ a phrase long understood as imposing regulatory requirements on owner-operators or (if the owner is not also the operator) on the operator.” Letter from Kenneth P. Quinn, Counsel for the Aviation Working Group, to The Honorable Michael P. Huerta, Administrator, Federal Aviation Administration, 1, 3 (August 5, 2013) (on file with Cadwalader); see *infra* note 12.

Trustees as Owners

The Notice clarifies that trustees are equivalent to owners for regulatory purposes. Trustees cannot, for instance, avoid regulatory obligations through private contracts with aircraft operators (or with anyone else). Nor do they avoid regulatory obligations if they participate in fractional ownership programs. Although some commenters expressed concern about the possible expansion of trustee's tort liability through what were perceived as new duties placed on trustees by the Notice, the FAA states that it does not take a position on the Notice's effects on trustees' tort liability.⁴

Registering an Aircraft

The Notice addresses the concern that trustors may exercise undue control over trustees through private agreements outside the trust. The FAA will require trustees to submit all operating agreements and similar side agreements when they register an aircraft, pursuant to 14 C.F.R. § 47.7.⁵ The FAA's review of side agreements found that such agreements could significantly modify the trust, often expanding non-U.S. citizens' control over trustees. Thus, the FAA will not register aircraft without reviewing all side agreements. If none exist, the trustee must give "adequate assurance" that this is the case, in, for instance, an affidavit.⁶

Some commenters were concerned that retaining agreements in the FAA's files would threaten the agreements' confidentiality. In response, the FAA agreed to return side agreements after reviewing them at the trustee's or trustor's request if the registration is accepted. It will instead retain a "brief summary" of the review. However, if the application is rejected, the FAA will retain the agreements in case they are needed for litigation.⁷

⁴ *Id.* at *36,414.

⁵ "The applicant must submit with the Aircraft Registration Application [a] copy of each document legally affecting a relationship under the trust" 14 C.F.R. § 47.7(c)(2)(i).

⁶ Non-Citizen Trusts, 78 Fed. Reg. at *36,415-16. The Department of Transportation Office of the Inspector General ("**OIG**") recently criticized these provisions and others for not meeting the FAA's need for information. The FAA must provide information on U.S.-registered aircraft to foreign authorities upon request, under the Convention on International Civil Aviation. The OIG says that in order to do this, the FAA will need to collect this information about the owners and operators of aircraft when they are registered, so that it is available ahead of time. This may suggest that the FAA should require a registration application to provide information about the aircraft operator and aircraft records. Office of the Inspector General, Department of Transportation, FAA's Civil Aviation Registry Lacks Information Needed for Aviation Safety and Security Measures (2013) [hereinafter OIG]; see Convention on International Civil Aviation art. 21, Dec. 7, 1944, 61 Stat. 1180, 15 U.N.T.S. 295; *infra* text accompanying note 11.

⁷ Non-Citizen Trusts, 78 Fed. Reg. at *36,416.

Removing a Trustee

The FAA likewise addresses trustors' power to remove trustees. Non-U.S. citizens may have no more than 25% of the power to direct or remove a trustee, pursuant to 14 C.F.R. § 47.7, though trustors may still retain more than 25% of the beneficial interest in the trust.⁸ The Notice says that this rule does not permit agreements allowing a foreign body to adjudicate disputes between the trustor and trustee.⁹

This rule also means that agreements providing for the removal of the trustee for cause must specifically define "cause." The Notice states that "[a]s a minimum, the FAA will expect ... examples of specific causes for removal" such as "gross negligence and willful misconduct." One definition of a trustor's power to remove a trustee for cause may be found in the FAA's Standard Trust Agreement.¹⁰

Providing Information to the FAA

The Notice sets out a flexible timeline for trustees to respond to the FAA's requests for information. Within two business days of a request, a trustee should provide information about:

- the aircraft's usual operator or manager and that person's residence or place of business; and
- the place where "maintenance and other aircraft records" are kept.¹¹

Within five business days of a request, a trustee should provide information about:

- the operator, crew, and aircraft operations on specific dates;
- "maintenance and other aircraft records"; and
- the current airworthiness of the aircraft.¹²

⁸ "If persons who are neither U.S. citizens nor resident aliens have the power to direct or remove a trustee, either directly or indirectly through the control of another person, the trust instrument must provide that those persons together may not have more than 25 percent of the aggregate power to direct or remove a trustee. Nothing in this paragraph prevents those persons from having more than 25 percent of the beneficial interest in the trust." 14 C.F.R. § 47.7(c)(3).

⁹ Non-Citizen Trusts, 78 Fed. Reg. at *36,416.

¹⁰ *Id.* at *36,417. The FAA's Standard Trust Agreement (see *infra* text accompanying note 15) defines cause: "[F]or cause', may include willful misconduct or gross negligence, but 'for cause' will not include the refusal of Owner Trustee to act or refrain from acting in a manner that (1) would violate the laws, regulations, court orders, or lawful directions of a government agency; (2) is outside the scope of Owner Trustee's authority; (3) is contrary to its obligations under the Trust Agreement; or (4) is the subject of a mere disagreement between Owner Trustee and Trustor." *Id.* at *36,418 (Trust Agreement, at § 3.02). The FAA also suggests consulting the Restatement (Third) of Trusts § 3 (2003). *Id.* at *36,417.

¹¹ *Id.* at *36,414. The OIG seems to suggest that this information should be required at registration, not simply upon request. See OIG, *supra* note 6.

The Notice emphasizes that this timeline is a guide, not a strict rule. When a delay occurs, however, the FAA expects the trustee to explain the nature of the delay and the trustee's attempts to overcome it. In an emergency, the FAA may ask for information to be sent more quickly.

Many trustees and operators have undertaken private agreements that require operators to report directly to the FAA. Alone, these agreements do not, as AWG has suggested, fulfill the trustee's responsibilities, though trustees may find them useful. Of cases in which the operator or trustee does not give information as asked, the FAA says only that this "may dictate further action."¹³

Although the FAA reserves the right to seek information from the trustee, the FAA observes that in most cases it instead goes directly to the air carrier or operator where their identity is known. Commenters say this practice is more efficient. However, for aircraft used mainly outside the U.S., the FAA has struggled to obtain information and is therefore now more likely to seek it directly from the trustee.¹⁴

Finally, the FAA appends to the Notice a revised Standard Trust Agreement, incorporating suggestions by AWG. A version showing the changes suggested by AWG that the FAA incorporated is available on the FAA's website.¹⁵

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¹² *Id.* AWG urges the FAA to require that operators, rather than non-operating owners, provide this information. Letter from Kenneth P. Quinn, *supra* note 3, at 2-3.

¹³ *Id.* at *36,415.

¹⁴ *Id.*

¹⁵ Trust Agreement (Feb. 10, 2012) www.faa.gov/about/office_org/headquarters_offices/agc/special/Aircraft%20Registration%20-%20Proposed%20Policy%20Clarification/media/Sample%20NCT%20Agreement%20021012%20redline.pdf (showing the incorporation AWG's changes to Standard Trust Agreement in Notice of Proposed Policy Clarification for the Registration of Aircraft to U.S. Citizen Trustees in Situations Involving Non-U.S. Citizen Trustors and Beneficiaries 77 Fed. Reg. 6,694 (Feb. 9, 2013)).