

**Written Submission of William G. Sutton, CAE
President and CEO of the Equipment Leasing and Finance Association
before the United States International Trade Commission
Business Jet Aircraft Industry: Structure and Factors Affecting Competitiveness
October 18, 2011**

Introduction

Chairwoman Okun, Vice Chairman Williamson, and members of the Commission, I am pleased to submit the views of the Equipment Leasing and Finance Association (ELFA) and its member companies in connection with the ITC's investigation on Business Jet Aircraft Industry: Structure and Factors Affecting Competitiveness (Investigation No. 332-526). This submission focuses on the key role of the equipment finance industry in providing financing for business jet aircraft and other aviation equipment. We have also provided an overview of the key policy issues affecting the availability of financing and its corresponding impact on the competitiveness of the business jet aircraft industry in the United States.

Background on ELFA

ELFA is the trade association that represents financial services companies and manufacturers in the U.S. equipment finance sector. In 2010, this industry's equipment finance volume was \$559 billion and its financing volume is projected to be \$628 billion in 2011. ELFA has more than 500 members including most of the major financing providers to the business jet industry. These financing providers facilitate the growth and expansion of business jet aviation in the U.S. by providing financing for these aircraft and other aviation equipment. They have a unique understanding of business jets and the business purposes and circumstances of business jet owners and operators and as a result make capital investment more efficient in the business jet market. Please refer to Annex A of this Submission for more information regarding ELFA and its member companies.

Executive Summary

As vital stakeholders in the financing of business jet aircraft in the U.S., ELFA's members are concerned about the risks and burdens resulting from certain existing and prospective laws, regulations, rules, interpretive opinions and other applicable legal requirements pertinent to US registered aircraft.¹ On the behalf of ELFA member financing providers, we suggest that the Commission consider the implications of existing and prospective legal requirements on aircraft financing providers, and work with our industry on measures that enhance and invigorate this marketplace. The legal requirements and other matters we are asking the Commission to consider include:

- Preserving or creating favorable tax considerations by preserving existing depreciation schedules and continuing "bonus depreciation" and other capital formation tax incentives available to this industry.
- Implementing a statutory or other "safe harbor" preserving the priority rights and interests of financing parties in a financed aircraft notwithstanding breaches by a customer or other third party of legal requirements which otherwise could cause de-registration or invalidation of the registration of that aircraft.
- Maintaining the validity and practical availability of non-citizen trusts as a structural mechanism for use in financing and other transactions involving parties who are not U.S. citizens for purposes of registering an aircraft with the FAA registry.

¹ Any and all of such laws, regulations, rules, interpretive opinions and other applicable legal requirements are generally referred to in this Submission as "legal requirements".

- Amending 49 U.S.C. §44112 so as to clarify the scope of its protections afforded secured parties and lessors financing aircraft by preempting state vicarious liability laws with respect to harms suffered by persons or property whether inside or outside of the aircraft, and while in the air, or on land or water.

Role of the Financing Parties in Aviation

Business jets are often financed by banks, equipment finance companies or investors based in the U.S., or based elsewhere but with significant operations in the U.S. This financing may be extended by secured loans or leases, some of which are structured and priced to take into account the various state taxes, federal income tax and accounting characterization of the transaction. Financing parties to the business jet market are often the originators of the transaction with an existing relationship with the customer, or a desire to establish a relationship with that customer. Certain financing parties participate in these transactions by taking assignment of a funded loan or lease between the originating financing party and the customer. For current data on the worldwide business aircraft market including business jets financed and or leased please refer to Annex B of this Submission (Source AMSTAT).

The financing providers participating in this market typically have a sophisticated understanding of the business jet market, including the various business jet capabilities and values, customer profiles, manufacturers, maintenance providers, charter operators, and related tax and accounting implications. As the market slid into the recession, and even as it slowly emerges, the number of financing providers participating in this market and the risk appetite for business jet financing by the remaining participants has declined. The remaining participants have increased their due diligence and generally refocused on the various credit, collateral and other approval processes. Many of these financing providers now take a more deliberate approach to opportunities to enter into large dollar, long term business jet financings, especially with those borrowers or lessees without a preexisting relationship with the financing provider. The current trend for financing providers in this market is an emphasis on the likely ongoing credit strength of the ultimate obligor. Despite this greater emphasis on the customer's credit, financing providers still require meaningful collateral protection, and the related financing documents typically include closing and ongoing requirements relating to the value of the financed aircraft and protecting the financing provider's rights as a secured party or lessor, as the case may be, with respect to the aircraft.

Certain financing providers have become less willing to rely solely on the aircraft as collateral for the loan or lease obligations and are requiring non-aircraft collateral including deposits, pledged accounts or liens against other aircraft owned by the customer. In some cases, manufacturers might provide support for the financing provider's collection risk by agreeing to assist with the disposition of an aircraft in connection with an enforcement action or at lease expiration, or provide other support intended to optimize the collateral or residual value of the financed aircraft. During the recession, the U.S. Export-Import Bank has played an increasingly important role in providing credit support for customers acquiring U.S. manufactured business jets.

Key Issues Affecting the Competitiveness of the U.S. Business Jet Aircraft Industry

Tax Policy

ELFA has consistently supported the use of capital formation tax incentives that focus on the need to invest in plants and equipment, including business jet aircraft, as a key component of economic growth, competitiveness and productivity. This includes tax provisions that provide for bonus depreciation and 100 percent expensing. Congress has periodically utilized these economic drivers as a means of stimulating capital investment and the economy. This was done most recently as a component of the "Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010," that was enacted into law in December of last year. Notably, in advancing these provisions, Congress has consistently included special rules for the equipment finance industry regarding sale-leasebacks, syndications, fractional interests, and like kind exchanges that have provided necessary liquidity to the general aviation aircraft market. In addition, in applying these tax incentives, Congress has recognized the unique nature of aircraft production, and consistently provided an extended placed in service date for such longer-lived

assets, that specifically included certain transportation property and business aircraft. These tax provisions have had a major positive impact on the competitiveness of the business jet aircraft industry in the United States.

Availability of lease financing may be adversely affected by extending the depreciation period from five years to seven years for general aviation aircraft. Assuming that such a change in the depreciation schedule would also create a disincentive for a customer from replacing an aircraft, this would further depress the used aircraft market, and decrease the demand for newly manufactured aircraft. Should the new or used market stall, aircraft values will decline further, lessen available liquidity and could trigger defaults under existing financings containing loan to value default triggers.

Title and Lien Risks

Title and Lien Priority Required by Financing Parties

The FAA Civil Aviation Registry (Registry) is the agency designated by law to maintain and exercise oversight over all records pertaining to US-registration of aircraft. The Registry also maintains the official records with respect to recordable interests related to such aircraft including leases, mortgages, security interests and other liens. Many of the business jets manufactured or sold in the US and financed by a US financing provider are registered at the Registry. These registrations can be made in the name of an aircraft owner who is typically the borrower or its affiliate (if the aircraft is financed by a loan), the financing party/lessor (if the aircraft is financed by a lease), a trustee or other related party involved in the financing.

In order to protect its rights under applicable commercial and bankruptcy law, the financing party is likely to record with the FAA security agreements or leases evidencing the financing party's security interest or other rights relating to the aircraft or related collateral. A leased aircraft will be registered in the name of the financing party if the transaction is characterized as a "true lease" for commercial law purposes, and not as a "conditional sale" as determined by the FAA's Aeronautical Center Counsel. The financing provider's rights are often further evidenced by registrations made with the International Registry pursuant to the Cape Town Convention (because the United States is a signatory)², but only if the correlative filings are first made at the Registry.

In business jet financings, financing providers allocate to the customer all responsibility for aviation-related and other legal compliance, including the operation, maintenance and registration of the aircraft. The "first priority" of the financing providers' security interest as a secured lender, or title as a lessor as the case may be, with respect to the financed aircraft is essential to the financing provider's willingness to finance the customer's acquisition of that aircraft. Borrowers and lessees in these financings agree to take all necessary actions to cause the financing provider's security interest or title to continue to remain valid and have first priority. The failure to do so often results in an immediate default under the financing. This is because the consequence of its failing to do so could be the financing provider's loss of its bargained for collateral protection.

Micro and Macro Consequences of Breach-Related Loss of Registration

Imposing new legal requirements or modifying existing requirements often create a risk of breach by customers whether by negligence or other misconduct, or by mistake of customer or financing parties. In many circumstances a breach of a requirement could result in a loss of registration, and consequently the following "**micro**" concerns:

² The Cape Town Convention on International Interests in Mobile Equipment and the related Protocol on Matters Specific to Aircraft Equipment were finalized at a Diplomatic Conference held in Cape Town, South Africa in November 2001.

- i. create uncertainty regarding the validity and first priority of the financing provider's security interest or title to the aircraft (*i.e.*, no predictable effect on commercial and bankruptcy law issues);
- ii. require financing parties to assume much more burdensome and costly responsibilities with respect to managing existing or future transactions, especially leases (as registered owners of leased aircraft would have more significant compliance requirements);
- iii. expose financing lessors to much greater risk of civil and criminal penalties for unintentional non-compliance with the registration requirements;
- iv. expose financing parties to loss of collateral and liability protection if customer's insurance coverage is vulnerable due to possible policy breaches relating to unlawful operation;
- v. undermine the soundness of existing customers and prospective customers; and
- vi. involve financing parties in disputes with customers, third parties, insurers, governmental agencies, others, resolvable only through expensive and time-consuming litigation.

Introducing additional costs, harms and other risks and uncertainty in the business jet financing market will undoubtedly create an additional unexpected burden for an already pressured financial industry and worsen the current liquidity crisis. Any significant risk of a questionable registration status could result in any of the following “**macro**” concerns:

- i. undermine the reliability of existing financings;
- ii. increase cost of managing existing and future transactions requiring technical and human resources unavailable to financing parties or requiring reallocation of resources from other necessary functions;
- iii. discourage new financing to the business jet market;
- iv. result in portfolio “dumping” or exiting market – further depressing business jet values; and
- v. materially increase the financing, leasing, and insurance costs for business jet owners and operators (some of which are likely to be reflected in cost of services to their customers).

Need for Title and Lien Protection

Business jet finance providers make loans and leases to many business organizations and individual operators that will not have administrative processes to address significant unanticipated changes in legal requirements. It is a certainty that, irrespective of the good intentions of most business jet owners and operators, administrative compliance errors will occur in light of the many legal requirements relating to aircraft ownership, operation and maintenance. Any such non-compliance will result in defaults by customers under their loans and leases. Significant errors in compliance with changes in legal requirements are inevitable because such requirements are new, impose tight deadlines or require payments, and particularly in the absence of a governmental warning received by financing parties well in advance of the scheduled deadline.

Suggested Protections.

As a consequence of non-compliance with certain legal requirements related to owning, registering, and operating aircraft, the cancellation or invalidation of the aircraft registration could occur. Override provisions therefore are essential to preserving a financing party's title or lien status in that aircraft. Financing providers would take significant comfort from such an override or other protective devices that serve the government's intended purpose without causing the harms referenced above. The applicable requirements could simply suspend the Certificate of Registration as a result of such non-compliance, and such suspension would mean that the aircraft could not be legally operated with the suspended Certificate of Registration, but the actual registration with the FAA in the name of the registered owner would not be affected without further administrative action. Legal requirements which, if breached, could cause de-registration or invalidation of registration of an aircraft subject to a recorded security interest or lease should provide for notice to any such recorded interest holder and a reasonable grace period before such de-registration or invalidation, or the proposed suspension of registration, becomes legally effective. Although these protections would not address all of the financing parties' concerns (*e.g.*, insurance vulnerability if the aircraft is operated without a valid Certificate of Registration onboard), they would

protect the lien status and afford the financing parties an opportunity to avoid certain of the other harsh consequences that might result from the breach.

Non Citizen Trusts (NCTs)

U.S. aviation law establishes certain conditions under which an aircraft may be registered on the FAA registry, including that the registered owner must meet certain citizenship requirements.³ If a non-U.S. citizen registers its ownership of an aircraft at the FAA Registry, it will be subject to impractical operational restrictions under the Transportation Code.

For more than 30 years individuals and business entities who desired to “N” register an aircraft with the FAA but could not certify that they met the U.S. citizenship test under the Federal Transportation Code have relied on non-citizen trusts (NCTs) to effect this registration. NCTs are discretionary trusts established by one or more beneficiaries who are not U.S. citizens for purposes of registering an aircraft with the FAA registry. NCT agreements must contain provisions complying with the pertinent regulations including restrictions on any non-citizen beneficiary’s power to influence or limit the trustee’s authority.

Non-U.S. citizen operating or financing lessors often use NCTs when FAA registering an aircraft, especially when the lessee or other essential party is situated in the United States, or the beneficiary is a financing source, operating lessor or passive investor with U.S. operations. U.S. financing parties providing secured financing to non-citizen owners often require that the aircraft be U.S. registered, necessitating the use of an NCT. U.S. registration is preferred by these financiers for various reasons including: (i) collateral value benefits if the aircraft is FAA registered and maintained under the Federal Aviation Regulations; (ii) a diminished risk of unrecorded liens; and (iii) more favorable repossession, de-registration and disposition remedies, especially if available under the Cape Town Convention. Moreover, non-U.S. citizen lenders who repossess an aircraft might use an NCT to register the aircraft while it is being stored or marketed to facilitate its disposition if it is likely that the new purchaser or lessee is situated in the United States.

In the spring of 2010, the FAA raised doubts about the validity of future and existing NCT-registered aircraft. A public hearing was held in June 2011, and as of the date of this Submission, the FAA has not yet issued regulations or opinions addressing the matters covered in the hearing and related submissions by the industry. Should the FAA elect to take steps to render all NCT arrangements invalid, it would be disastrous for those many financing providers with existing NCT-structured transactions. Invalidating NCTs or other changes to the related procedures and documents which would have the effect of rendering them impractical as structural devices and would create a significant barrier to new business jet financings requiring that structure.

Various submissions were made by interested parties both prior to and after the June 2011 meeting among industry members and the FAA. We support the suggestions made by the AWG Industry Consultative Group in their submissions to the FAA on May 26, 2011 and July 1, 2011. Specifically, their suggestion that any related changes be limited to revising the standard form NCT agreement, including with respect to the trustee’s unfettered control of essential aircraft-related matters. We also support their suggestion that the NCT process be changed so that trustees could better serve as an additional resource to the FAA for information about trustors/beneficiaries, operators and operations of an aircraft.

Liability

Section 44112 of the Federal Aviation Act, as recodified in 1994,⁴ states that a “lessor, owner, or secured party is liable for personal injury, death, or property loss or damage on land or water only *when* a civil aircraft, aircraft engine, or propeller is in the actual possession or control of the lessor, owner, or secured party. . .”⁵ This statute applies only to U.S. registered civil (non-governmental or non-military) aircraft.⁶

³ 49 U.S.C. § 44102, providing the conditions under which an aircraft may be registered on the U.S. Civil Aircraft Registry under 49 U.S.C. § 44103.

⁴ 49 U.S.C. §44112.

⁵ 49 U.S.C. §44112(b) (emphasis added). Before the recodification, the statute was found at 49 U.S.C. §1404.

The intention of §44112 was to protect from civil liability “owners of aircraft for security purposes only, or who are lessors of aircraft,” so as to “remove one of the obstacles to the financing of purchases of aircraft.”⁷ The majority of courts considering §44112 have held that it preempts state law tort claims, thereby shielding defendants from liability.

The preemptive nature of this statutory protection has been challenged on a number of occasions, including recently. By a very narrow reading of 49 U.S.C. §44112 (“Section 44112”), the Supreme Court of Florida determined that Section 44112 did not preempt a wrongful death action against an aircraft lessor (Aerolease) filed by the administrator of the decedent’s estate (Vreeland).⁸ Changes to Section 44112 should be considered so as to clarify its scope, and the extent to which it covers secured parties and lessors by preempting state vicarious liability laws with respect to any harms suffered by persons or property whether inside or outside of the aircraft, and while in the air, or on land or water.

Conclusion

With business jet buyers experiencing a tighter credit market, the ability to provide aircraft financing could be materially and negatively affected by changes in laws, rules and other legal requirements. Certain changes in legal requirements could (at best) significantly increase the cost of providing business jet financing, and (at worst) undermine essential collateral and liability protections. Financing parties that remain willing to provide business jet financing would likely pass the related costs on to its customers, and impose stricter financing terms on business jet finance customers. Additionally, the administrative burdens that are sometimes associated with changes in legal requirements, together with any related uncertainties regarding the financing party’s lien status and insurance protections, could result in a diminution in the availability of business jet financing.

By including the financing parties in the rulemaking process, the federal government will gain a very useful ally in its efforts to better ensure compliance with applicable legal requirements. Financing parties will work to assure that their business jet borrowers and lessees comply fully and in a timely manner with any existing or proposed requirements since any failure by those customers would cause a default under the related financing transaction, entitling the financing party to accelerate the payment obligations and recover possession of the aircraft. When engaged in rulemaking, the government must consider the implications to financing providers, both micro (*e.g.*, especially costs, burdens, risks regarding existing financings), and macro (*e.g.*, creating more “toxic assets” on books of banks and other financing providers; and exacerbating liquidity crisis in this marketplace).

For all of the reasons stated above, ELFA respectfully requests that the USITC consider the impact of existing and proposed legal requirements which could serve as a disincentive to financing providers who might otherwise be willing to provide liquidity in this market and by doing so facilitate the purchase, ownership and operation of business jets. We appreciate your consideration of our views in this matter. We are prepared to meet with you to discuss ELFA’s concerns and answer any questions that you may have regarding our comments.

⁶ *Id.*

⁷ See H.R. REP. NO. 802091 (1948) (“Provisions of present Federal and State law might be construed to impose upon persons who are owners of aircraft for security purposes only, or who are lessors of aircraft, liability for damage caused by the operation of such aircraft. This bill would remove this doubt by providing clearly that such persons have no liability under such circumstances. . . . It is the conviction of this committee that the bill should be passed to remove one of the obstacles to the financing of purchases of aircraft”).

⁸ *Vreeland v. Ferrer*, No. SC10-694, 2011 WL 2652187 (Fla. July 8, 2011).

ANNEX A
To ELFA Submission Regarding
Business Jet Aircraft Industry: Structure and Factors Affecting Competitiveness

Background on ELFA

ELFA is the trade association that represents financial services companies and manufacturers in the U.S. equipment finance sector. In 2010, the equipment leasing and finance industry finance volume was \$559 billion and financing volume is projected to be \$628 billion in 2011.

ELFA has more than 500 members including (i) independent leasing and finance companies, (ii) captive finance companies, (iii) commercial banks, (iv) diversified financial services companies, (v) investment banks and (vi) service providers including law firms, accounting firms, trustees, servicers, custodians and others who assist in the financing of equipment leases and loans. ELFA members include (a) many of the nation's largest financial services companies and manufacturers, (b) national, regional and community banks and (c) independent medium and small finance companies throughout the country. ELFA members' clients range from Fortune 100 companies to states and large urban governments to small and medium sized business enterprises to cities, counties, school districts and other governmental units nationwide and healthcare, education and other non-profit corporations that serve the public interest.

Equipment finance provides a significant source of funding for both small and large commercial enterprises (including those serving the equipment needs of the Federal government) and federally tax-exempt, taxable and tax credit funding for state and local governments in the United States and is a significant contributor to capital formation in the U.S. and abroad. Overall, business investment in equipment and software accounts for 8.0 percent of the U.S. Gross Domestic Product (GDP) and the commercial equipment finance sector contributes about 4.5 percent to the GDP.

ELFA members are the driving force behind the commercial and state and local government equipment finance market providing credit every business day to nearly every business and State and local government sector in the country. ELFA members finance the acquisition of all types of capital equipment, including commercial and business aircraft, rail cars and rolling stock, trucks and transportation equipment, vessels and containers, construction, agriculture and off road equipment, medical technology and equipment, IT hardware, software and capitalizable services, emergency communications, public transit, police and emergency vehicles, school buses, energy management and conservation equipment and virtually every other type of equipment.

ANNEX B
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Worldwide Business Aircraft Market - Select Data

Source: AMSTAT / Date: 10/18/2011

Table 1: Worldwide New Deliveries of US OEM Built Business Jets

Financing Status <i>(for activities that got the aircraft to the first operator)</i>	2008			2010			2011 YTD (Jan - Sep)		
	Total	US	Non US*	Total	US	Non US*	Total	US	Non US*
Financed	161	159	2	49	49	0	41	41	0
Financed, then Leased	38	28	10	10	7	3	8	4	4
Not Financed, then Leased	181	44	137	83	22	61	44	15	29
Not Financed, Not leased	524	286	238	204	95	109	132	60	72
Total New Deliveries	904	517	387	346	173	173	225	120	105

Table 2: Worldwide New Deliveries of Learjet Business Jets

Financing Status <i>(for activities that got the aircraft to the first operator)</i>	2008			2010			2011 YTD (Jan - Sep)		
	Total	US	Non US*	Total	US	Non US*	Total	US	Non US*
Financed	13	13	0	0	0	0	0	0	0
Financed, then Leased	1	0	1	2	1	1	2	0	2
Not Financed, then Leased	26	8	18	4	1	3	7	4	3
Not Financed, Not leased	42	21	21	18	11	7	16	11	5
Total New Deliveries	82	42	40	24	13	11	25	15	10

Table 3: Worldwide New Deliveries of US OEM Built Business Jets PLUS Learjet

Financing Status <i>(for activities that got the aircraft to the first operator)</i>	2008			2010			2011 YTD (Jan - Sep)		
	Total	US	Non US*	Total	US	Non US*	Total	US	Non US*
Financed	174	172	2	49	49	0	41	41	0
Financed, then Leased	39	28	11	12	8	4	10	4	6
Not Financed, then Leased	207	52	155	87	23	64	51	19	32
Not Financed, Not leased	566	307	259	222	106	116	148	71	77
Total New Deliveries	986	559	427	370	186	184	250	135	115

Important Comments

- >> Data in Table 1 is for US OEMs ONLY (Adam, Boeing, Cessna, Eclipse, Gulfstream, Hawker Beechcraft).
- >> Data in Table 2 is for Lear ONLY. Lear is provided separately as it is headquartered in Wichita, USA but owned by Bombardier, a Canadian company
- >> Data in Table 3 incorporates data from Tables 1 and 2
- >> Data is for makes and models covered by AMSTAT research only

>> Data for US TOTAL New Deliveries and FINANCING is considered accurate

>> *Data for Non US TOTAL New Deliveries is considered accurate

>> *Data for Non US FINANCING and LEASING is limited and likely incomplete due to lower civil registry reporting standards. The data provided here (in gray) should be used for year on year comparison ONLY.

>> US non US delineation is based on where aircraft ends up, for example, if sold to US finance company and leased outside of the US then this would be counted as Non US