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Lessons that May be Learned from Failed Transactions and a Proposal for Owners of Aircraft and Yachts on the OFAC SDN List

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While it is possible to buy a grounded Russian owned aircraft if the owner and the aircraft are not on the OFAC SDN List (the U.S. Office of Foreign Asset Control Specifically Designated National list), "All the easy transactions are done. All that remain now are the hard cases, the aircraft that have sanctions issues that need to be solved, if they can be solved." This summary of the market for grounded Russian-owned aircraft located outside of the Russian Federation by an aircraft broker aligns with the author's experience in 2024 with purchases of grounded Russian-owned aircraft.

A couple of transactions that the author was involved in during 2024 on behalf of Western buyers failed to proceed to closing due to a number of factors. First, the sanctions have been broadened to apply to additional Russian companies and specifically designated nationals (SDNs). This factor is out of the control of sellers and buyers.

Second, in some transactions there has been a discovery, during legal due diligence investigations, of issues caused by prior transactions with an aircraft or a legal entity that owns an aircraft after February 24, 2022, the date of the commencement of the conflict in Ukraine. The prior transaction was legally flawed, for example, the original equipment manufacturer ("OEM") concludes that the consideration was not actually paid in the prior transaction which leads the OEM to view it as a sham transaction. The prior transaction must be fixed in some manner before the history of ownership of the aircraft is presentable and would withstand a review by the OEM. The OEM may require proof that consideration paid now to the intended seller of an aircraft or a legal entity that owns an aircraft would not end up being transferred to the former owner of an aircraft who is an SDN.

Third, the technical condition of grounded aircraft is continually worsening. The cost of returning grounded aircraft to service is continually growing, and by very large amounts. Engine overhauls, if required, may cost $4 million per engine. In some cases, owners are facing the consequences of their own negligence and unwillingness to preserve a grounded aircraft. In some cases, elementary steps such as placing engine covers over the engines on aircraft parked in a desert environment have not been taken. The result is a widening gap between the price a seller wants for his aircraft and the price a potential buyer is willing to pay. Further, most inspections that would be a routine part of a transaction are not permitted because the provisioning of services to a Russian owner is prohibited. These aircraft have to be purchased as-is, where-is, and the cost of inspections and returning an aircraft to service has to be paid for by a purchaser who will negotiate for price low enough to offset this cost and risk. Certain inspections might be permitted by outside inspectors who are not maintenance facility ("MRO") personnel.

Fourth, the OEMs should be assumed to have complete knowledge about past transactions and know the details of past transactions that were undertaken to move the ownership of aircraft away from SDNs to neutral third parties. Information about past transactions that failed may be known by the OEMs because of disclosures made in past, failed attempts to buy an aircraft.

Fifth, the OEMs know about past movements of aircraft and which aircraft were in Russia after sanctions became applicable. Due diligence investigations by buyers will include a request to see aircraft flight and maintenance logbooks since January 1, 2022. The inquiries are to determine whether an aircraft has been operated in Russia since February 24, 2022. No OEM or broker may provide services for, or buy an aircraft that has completed an unlicensed flight to Russia after February 24, 2022. A legal due diligence investigation will sometimes result in a potential buyer discovering that a potential seller is not being transparent with the potential buyer. Meanwhile, the OEM has a greater amount of information about an aircraft, and past transactions, and past movements of the aircraft than is disclosed by the seller to a buyer.

The unwillingness of sellers to be transparent with buyers, born out of a habit of secrecy, results in failed transactions. Sellers attempt to tie the hands of, and to blind buyers with confidentiality agreements and non-disclosure agreements, followed by an incomplete disclosure of information. The seller's representative attempt to hide facts that, it sometimes turns out, are known to the OEMs. Such nondisclosure results in failed transactions after a lot of effort has been expended and costs incurred by a buyer. Moreover, such action could be considered by governments as acts directed towards evasion of sanctions and put sanctioned property in danger of forfeiture proceedings.

Looked at objectively, of course a buyer must become aware, through a legal due diligence investigation of an aircraft and its ownership, of what an OEM already knows about an aircraft and past attempts by others to buy an aircraft that ended in failure. The fact is that an OEM knows what it already knows and cannot disregard that information, and the OEM must agree to resume providing parts and services for a previously grounded aircraft once it has been acquired by a new owner. A potential buyer cannot have less information than the OEM already has, or a transaction may be doomed to failure. A buyer cannot go to closing and pay for an aircraft and then discover that the OEM would reject the transaction and refuse to provide parts and services because an issue known to the OEM was not identified by the buyer and has not been resolved, while the buyer has paid for an aircraft that may not be returned to service.

Sixth, aircraft brokers are not willing to spend large amounts on legal due diligence investigations to find facts that the broker comes to believe are being hidden and intentionally not disclosed by the seller. Even a broker who is willing to invest in trying to solve legal issues uncovered during a legal due diligence investigation will become frustrated, give up and refuse to pay for more work at some point. He will then refuse to fund the necessary work to solve problems that a seller is not willing to admit exist.

To address one due diligence issue, there is an incorrect view held by some operators that a flight may be conducted to Russia for less than 8 days that does not transport Russians who are SDNs. Such a flight would in fact violate the U.S. sanctions on Russia. If the U.S. Bureau of Industry Security ("BIS") found out about such a flight, it would be considered a violation of U.S. sanctions and criminal law and substantial monetary penalties would be imposed on whatever company conducted the flight.

If an OEM, service provider or broker learned about such a flight by, for example, reviewing the aircraft flight logs, that manufacturer or service provider would have to discontinue providing parts and services for the aircraft, and no potential broker or buyer of the aircraft who learned about such a flight could buy the aircraft until the BIS approved a voluntary self-disclosure by the current owner of the aircraft that such a flight had been conducted.

Effective February 24, 2022, BIS imposed expansive and stringent controls on aviation-related items destined for Russia, including a new license requirement for specified aircraft or aircraft parts. As a result, any aircraft manufactured in the United States, or that is manufactured in a foreign country and includes more than 25% U.S.-origin controlled content, is subject to a license requirement if such aircraft is destined for Russia. See: https://www.bis.doc.gov/index.php/documents/about-bis/newsroom/press-releases/2942-2022-03-30-bis-list-of-aircraft-violating-the-ear-press-release-final/file and https://www.bis.doc.gov/index.php/documents/about-bis/newsroom/press-releases/2914-2022-02-24-bis-russia-rule-press-release-and-tweets-final/file

Effective March 3, 2022, BIS added that no license would be issued for a flight of an aircraft destined for Russia for any aircraft registered in, owned, or controlled by, or under charter or lease by Russia or a national of Russia. See Section 15 CFR Section 746.8(c)(5) and https://www.federalregister.gov/documents/2022/03/08/2022-04819/imposition-of-sanctions-against-belarus-under-the-export-administration-regulations-ear.

So, if there is to be a flight to Russia of an aircraft with more than 25% U.S.-origin controlled content, a license is required. But, a license would not be issued for such a flight if the aircraft is registered in, owned, or controlled by, or under charter or lease by a national of Russia. It is not required that the Russian national be a person under sanctions. It would be sufficient to prevent a license ever being issued that a person owning, controlling, chartering or leasing the aircraft holds a Russian passport.

Also, there is no exemption from the licensing requirement if an aircraft is to be in Russia for not more than seven days. There is a reference to a period of seven days in the context of a license issued by BIS for an aircraft on a temporary sojourn. See 15 CFR Section 740.15(a)(4). The note following this subsection provides: "Note to paragraph (a): An aircraft exported or reexported to a country pursuant to this paragraph (a) may not remain in that country for more than seven consecutive days before it departs for a country to which it may be exported without a license or the United States."

However, there is no exemption from the generally applicable requirement for a license to be obtained for a flight to Russia of any aircraft for any period of time if the aircraft includes more than 25% U.S.-origin controlled content. And, no license would be issued for a flight under the control of a Russian national.

There could be a flight to Russia of an aircraft for not more than 7 days if a license were obtained and the flight was not under the control of a Russian national. For example, a license could be applied for an obtained for a non-Russian corporation to conduct a flight to Russia of one or more non-Russian nationals.

If an owner or operator wants to apply for such a license, the process appears to be that the operator of the flight would apply for a license via this website: https://www.bis.doc.gov/index.php/licensing/simplified-network-application-process-redesign-snap-r/cin-request. The first step is for the operator to obtain a Company Identification Number (CIN) and an active user account to access SNAP R. The system will then verify the email address entered; once verified, further instructions to set up the operator's user account will be delivered by e-mail.

No operation of an aircraft into Russia that includes more than 25% U.S.-origin controlled content would be permitted without a license for any such flight first being applied for and issued by BIS. Anyone interested in this topic should see a Press Release and BIS Order and Settlement Agreement concerning a penalty imposed on Sapphire Havacilik, a Turkish operator of a Gulfstream aircraft, for flying the Gulfstream into Russia on two occasions without a license issued by BIS, and those flights were, further, controlled by or under charter or lease by a Russian national. See: https://www.bis.gov/press-release/bis-imposes-285000-penalty-against-sapphire-havacilik-san-ltd-sti-resolve-alleged and https://www.bis.gov/sites/default/files/E2941%20Sapphire%20Final%20Order%206-13-2024.pdf

A Proposal for Owners of Aircraft and Yachts on the OFAC SDN List

There are many yachts and aircraft on the OFAC SDN List. The question of what should be done with all the yachts and aircraft detained around the world because they or their owners are on the OFAC SDN List is a problem that requires a solution. Some wealthy Russians and their advisers have been under the impression that Trump would win the upcoming U.S. Presidential election, and all sanctions would go away in 2025. It appears more likely now, based on U.S. election polling in September 2024, that the problem of what to do with yachts and aircraft detained due to U.S. sanctions is not likely to go away with the results of the U.S. Presidential election. Even if Trump were to win, given his transactional nature, it is unlikely that he would lift sanctions without significant and unpalatable concessions or other consideration from Russia and or SDNs.

Yet, the status quo of parking yachts and aircraft cannot continue indefinitely without degrading their value, both monetarily and as political leverage. The MROs and ports where assets are located want these assets removed because there are substantial unpaid costs and accumulating debts being incurred. The space occupied by these parked assets is needed for other aircraft and yachts. The Owners are incurring substantial costs and loss in the value of blocked assets. The OEMs want to see the blocked assets placed back into service. Moreover, the leverage that governments imposing the sanctions decreases in proportion to the depreciation of the seized assets. A solution must be commercially, politically and legally viable. A license from OFAC is required for any transaction. In any solution, a blocked asset must be removed from the SDN List. European sanctions authorities are likely to follow the lead of OFAC in permitting a transaction.

What transaction might OFAC license to allow the sale of a yacht or aircraft on the OFAC SDN List? There are precedents of the use of auctions conducted pursuant to OFAC licenses in order to pay off a bank loan. The author worked on the consequences of one such transaction and obtained the removal of an aircraft from the OFAC SDN List after it was purchased in an auction.

Owners of Aircraft and Yachts on the OFAC SDN List might consider the possibility of allowing a newly organized private equity fund (the "Fund") to purchase a yacht or an aircraft that is a sanctioned asset (an "Asset"), subject to the terms of, and contingent on the prior receipt by the buyer of an OFAC license for the envisioned transactions, and a license from any other jurisdiction that has imposed a parallel sanction on an Asset.

The organization of the Fund would be financed by the investor interested in purchasing a yacht and/or an aircraft from the Fund (the "Investor"). Lawyers working for the Investor (the "Law Firm") would hire a firm that specializes in organizing investment funds to organize the Fund. The Fund could be a Delaware Limited Partnership with a General Partner and a professional Manager, or could be a Delaware Limited Liability Company. Most interests in funds are offered in reliance on Rule 506(b) of SEC Regulation D (or Section 4-2 of the Securities Act of 1933) which permits an offering of interests to a number of "accredited investors."

The legal entity that currently owns an Asset to be sold to the Fund ("Former Asset Owner" or "SDN") could become a Limited Partner in the Fund and would have an interest in the Fund and an account with the Fund. Assets could be sold to the Fund by a Former Asset Owner for a nominal price, for example one United States Dollar (the "Initial Transaction Price"). Then, an amount determined upon completion of an auction of an Asset owned by the Fund, reduced by the Initial Transaction Price for the Asset, and all transaction expenses incurred by the Fund with regard to sale of the Asset, including all investments into the Aircraft to restore it to an airworthy condition and make it marketable, and all legacy expenses incurred by the Fund to pay debts owed by the Former Asset Owner for storage and maintenance of the Asset prior to its sale to the Fund (the "Net Proceeds of Resale of an Asset") could then be credited to the account of the Former Asset Owner in the Fund.

The Fund would promptly resell each Asset via a transparently conducted auction for the highest price offered, pursuant to rules for auctions developed by the Fund and approved by Former Asset Owners(s) and OFAC (the "Resale Price"). Either 100% or 90% of the Net Proceeds of Resale of an Asset would be credited to the account of the Former Asset Owner in the Fund. Perhaps 10% of the Net Proceeds of Resale of an Asset would be paid to the General Partner of the Fund, that may be a charity, to make the proposal acceptable to OFAC. It may be that OFAC would object to interest being accumulated for sanctioned persons, and that interest may be required to be paid to a government agency. But the principal amount of the Net Proceeds of Resale of an Asset should be secure. The balance of the account of the Former Asset Owner in the Fund would be invested by the Fund only into investment grade securities such as U.S. government treasury bonds bearing interest at prevailing rates, or other securities.

As a result, the Assets would be converted from being blocked physical assets incurring expenses and declining in value prior to the envisioned transactions into interest-earning investment grade securities (the "Securities"). The account of a Former Asset Owner that has become a Limited Partner in the Fund would be frozen and blocked in the same manner as the Assets are currently blocked, subject to removal of the blocking of the account at a future time when applicable sanctions are removed. The proposed transaction would appear to be an improvement as compared to the current situation for the Former Asset Owner as well as for the government because depreciating, cost-incurring Assets would be converted into an investment into an interest-bearing monetary asset for a currently indeterminable period of time, invested into U.S. government treasury bonds.

The Law Firm would have to persuade OFAC to grant a license for the above transactions because the realizable value of the Assets, determined by a transparent auction, and the account of a Former Asset Owner in the Fund, would remain blocked and not available to an SDN. Yet, the realized value of the Asset(s) would be converted into cash invested for a currently indeterminable period of time into U.S. government treasury bonds.

Assets currently owned by the Former Asset Owner that are not the subject of US government forfeiture proceedings should remain not subject to forfeiture proceedings. In the case of Assets with regard to which forfeiture proceedings have commenced, further research would be required to see whether the U.S. Department of Justice ("DOJ") would agree to stop forfeiture proceedings and not to seek forfeiture of the proceeds of the sale of an Asset held by the Fund. It appears that DOJ and OFAC could agree not to seek forfeiture, and to allow an Asset to be purchased and sold by the Fund in order for government agencies to stop accumulating expenses for maintenance, parking, insurance and crew, and to avoid having to expend resources to proceed with forfeiture proceedings, by allowing an asset to be bought and sold by the Fund.

Not all blocked assets are subject to forfeiture proceedings. The DOJ has sought forfeiture where it has alleged that illegal payments were made to acquire or maintain an asset. The owner of an Asset should refrain from any payments or activities that could be considered to be illegal sanctions evasion. There is one example in which the DOJ sought the forfeiture of one asset allegedly owned indirectly by a wealthy Russian national, and did not seek the forfeiture of another asset owned by that same Russian national. For example, the DOJ has sought forfeiture of a yacht, but OFAC allowed an aircraft beneficially owned by the same Russian national to be sold through an auction.

In the envisioned transaction to obtain a license from OFAC that would allow a blocked asset to be converted into a blocked account in a Fund, the Law Firm would seek to add to a license from OFAC to the Fund that limited share interests and the principal amount of an account balance held by a Former Asset Owner would not be subject to forfeiture, though they would remain blocked. This point would need to be specifically addressed in a license because, otherwise, if the DOJ were to intend to allege that the Asset had been acquired through criminal activity or money laundering, the limited share interests and the principal amount of an account balance might be considered to be "proceeds" which is defined as "property of any kind obtained directly or indirectly, as the result of the commission of [an] offense giving rise to forfeiture, and any property traceable thereto…" within the meaning of 18 U.S.C. § 981(a)(2)(A)

The proposal is that the balance of the account of a Former Asset Owner in the Fund would be unblocked at a future time when the sanctions are removed pursuant to a process similar to the unblocking of bank and brokerage account balances. In the interim, the Fund would be professionally managed and administered. The Chairman would be a highly reputable retired law firm partner who would defend the interests of the Limited Partners in the Fund.

Without doubt, work will continue in 2024 and beyond on the need to find a resolution and return to service of all aircraft and yachts that are currently parked and declining in value.

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Ultimately, all wars and conflicts come to an end, and the current one will certainly end in some sort of settlement. Such a settlement, by necessity, will have to address how seized assets are to be unfrozen and claims settled. The Former Asset Owners' accounts in the Fund would undoubtably be addressed in such a settlement. There is ample precedent for this, including how the US and Iran agreed to form the Iran US Claims Tribunal in 1981 to settle claims arising from assets seizures connected to taking US diplomats hostage in Tehran in 1979.