In re Avantair: Is your airplane now my airplane because my airplane's parts have been installed in yours?

By Mark N. Lessard, Dominic Pearson and William DeCotiis

This alert also was published as a bylined article on Law360 on March 21, 2016.

Last month, the United States Court of Appeals for the Eleventh Circuit upheld the Bankruptcy Court and United States District Court for the Middle District of Florida determination that the authorized swapping of parts among aircraft to maximize efficiency "did not and could not commingle the participants' ownership interests." In re Avantair, Inc., No. 15-10303, slip op (Eleventh Circuit, February 3, 2016).

Brief Overview

Avantair, Inc. ("Avantair"), ran a fractional-owner aircraft operation of approximately 40 Piaggio twin engine turboprop airplanes under Part 91 of the Federal Aviation Regulations, 14 C.F.R. §§ 91.1001 – 91.1443 ("FAA Fractional Ownership Regulations"). Avantair was one of many operators of aircraft in the United States using a fractional-owner business model.

To participate in Avantair's program, participants (each, a "Fractional-Share Participant") purchased shares of at least one sixteenth multiples in specific aircraft via an Aircraft Interest Purchase Agreement ("AIPA"). Then, through a Management and Dry Lease Agreement ("MDLA"), each of the Fractional-Share Participants leased their fractional ownership interests in the aircraft to Avantair. In return, Avantair was responsible for scheduling flights at the owners' request and maintaining the planes in airworthy condition. Pursuant to FAA Fractional Ownership Regulations, the rights of the fractional share participants in aircraft are expressly limited.

Subsequently, Avantair began experiencing financial troubles. To keep as many aircraft as possible in operation, Avantair cannibalized parts from other planes in the fleet by removing parts from some aircraft to keep other aircraft operating without repairing or replacing the removed parts. This practice and the condition of the aircraft came to the attention of the Federal Aviation Administration who issued an

emergency order grounding Avantair's fleet, forcing the company to cease operations and eventually to enter bankruptcy. Upon ceasing operations, Avantair's fleet of aircraft was left grounded at various airports throughout the United States.

Immediately after filing for bankruptcy, the Bankruptcy Court appointed a trustee to secure the property used by Avantair. Most Fractional-Share Participants of the various aircraft recognized the common benefit that could be achieved through the powers of Bankruptcy Court, including the sale of their respective aircraft with good title, free and clear of all liens, and the distribution to the Fractional-Share Participants of the funds realized from the sale.

To maximize the value of the estate, the Bankruptcy Trustee developed a plan to sell the aircraft. First, the sales proceeds of each aircraft would be distributed to various categories of creditors, and any funds left over would then be distributed to the corresponding Fractional-Share Participants.

Corrections Corporation of America ("CCA"), a Fractional-Share Participant in Avantair's program, objected to the distribution of proceeds from the sale of a specific aircraft to the Fractional-Share Participants of that aircraft alone. First, CCA argued that Fractional-Share Participants did not actually buy ownership interests in any aircraft, but rather just purchased flight time. Second, CCA argued that even if each Fractional-Share Participant owned a share of the corresponding aircraft, Avantair's pervasive parts-swapping practice essentially gave each such Fractional-Share Participant an ownership interest in every other aircraft in the program. Thus, CCA demanded a "pooling" approach to the distribution of sales proceeds in which proceeds would be held until every aircraft was sold, and then the entire fund would be distributed among the Fractional-Share Participants, such that all Fractional-Share Participants would "share and share alike" rather than receive only a pro-rata share of the funds received for aircraft in which such Fractional-Share Participant had a direct fractional-share interest.

The Court's Decision

The Bankruptcy Court overruled CCA's objections and the District Court affirmed that determination. In overruling CCA's objections, the Bankruptcy Court concluded that the program documents unambiguously designed a fractional-ownership program, with each Fractional-Share Participant necessarily owning a share of its corresponding aircraft. The AIPA, which conveyed a fractional ownership interest in that aircraft, specifically stated that the interests held by the Fractional-Share Participants in that aircraft were held jointly on a tenancy-in-common basis and the arrangement was not intended to create any "Time Sharing Agreement or Joint Ownership Agreement" as defined in FAA Fractional Ownership Regulations. Further, the MDLA provided for a broad grant of authority to Avantair including the authorization to swap (or "pool") parts between aircraft to maximize program efficiency. Thus, the Bankruptcy Court concluded that regardless of the "essence of the transaction", absent ambiguity in the purchase agreement (which it did not find), the actual transaction was "a purchase of tangible personal property coupled with a contract controlling how the property could be used…" and the mere "fact that plaintiff [CCA] ha[d] contracted away some (or even most) of its practical control over its airplane [did] not preclude the plaintiff from having purchased it." In other words, given the express language in the MDLA granting broad authority to Avantair, the court held that any interest a Fractional-Share Participant had in parts previously installed on its aircraft—whether original or not—expired when the parts were permanently removed and installed on another aircraft.

The Court of Appeals for the Eleventh Circuit affirmed the findings of the Bankruptcy and District Court holding that while Fractional-Share Participants, as owners of the relevant aircraft, would have a claim against Avantair (or the estate) to the extent that Avantair failed to replace parts or maintain the donor

planes, “the authorized swapping of parts did not and could not commingle the [Fractional-Share Participants’] ownership interests” because, in accordance with the broad language in the program documentation, each such Fractional-Share Participants title to such parts had been extinguished upon removal from its aircraft.

What the Decision Means

The decision of the United States Court of Appeals for the Eleventh Circuit has provided some welcome clarity to the legal status of fractional ownership programs which are now common in the United States. The court has also confirmed that, despite comprehensive FAA regulation in this area, common law principles of ownership such as tenancy-in-common as a means of joint ownership of personal property, may be validly applied and continue to be upheld in respect of aircraft. By re-affirming the property rights of fractional-share participants of such programs in their aircraft, it has provided some comfort that such rights will be respected as such in a bankruptcy of the operator–manager of the program, but only insofar as the program documentation governing such rights does not provide to the contrary. In so doing, the Court has answered the question, “is your airplane now my airplane after my airplane’s parts have been installed on yours?” with a resounding “no, if your contract so provides”.

There are also other, broader lessons to be learned from the Avantair case. Firstly, it highlights more generally the risks associated with permitting the pooling of parts among other aircraft in an operator’s fleet or rather, the installation of parts belonging to a third party on an owner’s aircraft. In particular, as the court in this case has held, broad provisions authorizing pooling of parts will very likely result in the owner’s title to such parts being lost, unless careful drafting is employed to expressly provide that the owner of the aircraft from which such parts were removed is to retain title, Those participating in, or considering participating in, fractional ownership schemes should carefully review the rights of lessees to pool parts among aircraft which are not all owned by the same aircraft owner. In fractional-ownership schemes (or indeed under many other management agreements), these provisions are probably non-negotiable, but at least if prospective owners are warned of such risks when entering into such management agreements by their legal advisors, they will be more fully apprised of these sorts of issues when embarking on aircraft ownership.

If you have any questions about the content of this alert please contact the Pillsbury attorney with whom you regularly work, or the authors below.

Mark N. Lessard (bio)
New York
+1.212.858.1564
mark.lessard@pillsburylaw.com

Dominic Pearson (bio)
San Francisco
+1.415.983.1008
dominic.pearson@pillsburylaw.com

William DeCotiis (bio)
New York
+1.212.858.1239
william.decotiis@pillsburylaw.com

Pillsbury Winthrop Shaw Pittman LLP is a leading international law firm with 18 offices around the world and a particular focus on the energy & natural resources, financial services, real estate & construction, and technology sectors. Recognized by *Financial Times* as one of the most innovative law firms, Pillsbury and its lawyers are highly regarded for their forward-thinking approach, their enthusiasm for collaborating across disciplines and their unsurpassed commercial awareness.