
In re Avantair: Is My Airplane Now Yours?

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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). The ruling helps to clarify uncertainties regarding the legal status of fractional ownership arrangements.

Brief Overview

Avantair, Inc. 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, fractional-share participants 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 certain planes in the fleet by removing parts from those 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, which issued an emergency order grounding Avantair’s fleet, forcing the company to cease operations and eventually to enter bankruptcy. Upon ceasing operations, Avantair left its fleet of aircraft grounded at various airports throughout the United States.

Immediately after the company filed 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 Corp. 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. 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 an unsecured 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 Eleventh Circuit decision has provided some welcome clarity to the legal status of fractional ownership programs, which are now common in the United States. By reaffirming 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 my airplane now your airplane after your airplane’s parts have been installed on mine?” 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 until suitable replacement parts are installed on the aircraft. While in fractional-ownership arrangements these provisions are often non-negotiable due to the need for operational flexibility, they are the norm in commercial aircraft financing and leasing. Prospective owners and financiers should certainly take note that in the absence of these contractual protections, the creditworthiness of their counterparty becomes all the more important.

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