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Fractional Aircraft Ownership Programs: *Avoiding Turbulence in the Marketplace.*

Recent developments in the marketplace for fractional aircraft programs make it imperative that Board Members understand risks faced by a company that owns – or is considering the purchase of – a fractional interest in an aircraft, cautions attorney Chris Younger.

The purchase of a fractional aircraft interest is typically perceived as a less risky alternative to owning and operating an aircraft. However, an issue that Board Members must evaluate is the viability, strength and reputation of the fractional program provider.

As reviewed in David Wyndham's articles on Fractional Ownership (July and August editions), the fractional program provider normally sells the fractional aircraft interest to its customer, manages the customer's aircraft operations for a fee and, at the end of the program term, re-purchases that interest. It is therefore imperative that Directors choose a fractional program provider with a proven track record of successfully honoring its commitments during the life of the fractional contract, and having the financial wherewithal to repurchase that interest at contract conclusion.

There are several ways that a Board may mitigate the risks of an unsatisfactory fractional experience, as outlined here.

DUE DILIGENCE

First, the Board should obtain as much information as possible concerning the fractional program provider's business operations and financial condition. Fractional providers are known for carefully guarding such information. What is available to a prospective owner is typically only those data that are published by the fractional program provider in its marketing materials or is provided to regulatory bodies as required by law (e.g., SEC filings). It is therefore imperative that the ›

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What the Boardroom needs to know about Business Aviation

Board request as much information as it believes is needed. The best time to request additional information is prior to purchasing a fractional interest or renewing the program. This is the point at which the Board will have the most leverage to obtain the information it needs to make an informed decision.

Secondly, the Board must ensure that the agreements between it and the fractional program provider contain maximum protection for the company. These provisions include terms that will allow the company as early as possible to liquidate its investment if a fractional program provider's solvency is questionable or if it fails to perform completely its obligations to its customers.

An example of such a provision is a requirement that the fractional program provider operate all flights in accordance with the terms and conditions of the program documents and that the program provider will be in default if it fails to do so, thus giving a fractional owner the opportunity to "pull the plug" at an early stage.

Many provisions can be built into program documents to provide protections to an owner, such as financial covenants, representations and warranties concerning the program provider. Each of these terms is intended to give a fractional owner advance notice of issues that could affect its interests.

Despite the Board's best efforts, however, a fractional provider may without advance warning cease operations or be forced into receivership or involuntary bankruptcy proceedings. In such an event, the Board will need to make itself aware of the potential outcome of such a situation so that it can chart the best course of action.

THINGS HAPPEN

If an untoward event occurs, the owner will need to work with other fractional owners of the same aircraft to ensure that it is properly maintained and insured on a going-forward basis so that the value of the aircraft can be maintained for purposes of selling the asset at the earliest possible time.

If the fractional program provider owns an interest in the same aircraft, the process of liquidating the fractional owners' investment in that aircraft will be more difficult because creditors of the fractional program provider may seek to assert liens against the aircraft or to repossess it. Even if the fractional program provider does not own such an interest, it is likely that vendors that provided services with respect to the aircraft may seek to assert mechanics' and similar liens against the aircraft for amounts owed to those vendors.

Ultimately, the Board's thorough evaluation of the financial health and reputation of a fractional program provider is of paramount importance. All of the risks that may be eliminated or lessened through the purchase of such an interest in lieu of direct aircraft ownership and operation are worthless if the fractional program provider is not able to fulfill all of its commitments during the entire term of the program and at its end.

Adding legal protections for a fractional owner offers only limited protection to the owner. However, those protections can be designed to provide early notice to an owner of a program provider's financial (or other) difficulties, and may allow the owner to liquidate its investment before the fractional provider's business implodes.

Note: This article should not be construed as legal advice or legal opinion on any specific facts or circumstances. The reader is urged to consult legal counsel or other advisors concerning his/her own situation and specific legal questions.

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