

# *Surviving The Aircraft Financial Pandemic*

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**T**here are signs of hope in the aviation marketplace, with the slow return of financing and the apparent bottoming-out of aircraft values. Buying opportunities abound - but so do risks; and no situation is more frustrating than finding yourself "infected" by someone else's bankruptcy. Even if the market has reached nadir, there are many companies that are simply not going to survive much longer in the market as it has been redefined.

There are three major characteristics of bankruptcy that are life- and deal-altering. The first is the automatic stay under Section 362 of the Bankruptcy Code, which prevents creditors and contract parties from exercising remedies against the bankrupt entity. Lenders cannot seize collateral (yet) and contract parties cannot declare breach.

The second is the debtor's ability to accept or reject contracts as part of the reorganization process. Soon(ish) after filing for bankruptcy, the debtor picks through its open contracts, and is able to determine which survive and which do not - and the other parties are just along for the ride. Of course, the power to reject a contract can be used to modify a contract.

Third is the concept of creditor preference, which involves looking backward to the bankrupt party's last actions prior to filing bankruptcy (90 days) to see if any of the deals done were unduly preferential to a creditor to the disadvantage of other creditors.

Any party dealing with a bankrupt entity will also want to avoid having its property (funds or assets) deemed a part of the bankrupt entity's assets (the bankruptcy estate). This could implicate cash deposits or prepayments, leased aircraft or even aircraft parts.



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## CHARTER AND JET CARDS

Traditional, on-demand aircraft charter is the lowest level of financial commitment to private jet usage. Each flight is a completely separate transaction that is independently negotiated. Although there are a few web-based services that attempt to streamline the process, most charters are booked through brokers who seek bids from aircraft operators.

Charter flights are relatively easy to arrange and schedule and flight costs are fixed at an hourly rate with surcharges. Charter customers have a wide array of aircraft choice, departure time, departure location and destination.

Jet cards (also called flight cards, or charter cards) are essentially pre-paid charter flights. Depending upon the card, you can purchase a specific number of hours (e.g., 25 or 50) on a particular aircraft class, or deposit a dollar amount (\$50,000) with a jet card operator, which will then debit your jet card for each trip at the current hourly charter rate for the aircraft.

Jet card programs vary significantly. Some jet card programs are just debit cards, while other jet card programs offer guaranteed aircraft availability with limited notice (four to 12 hours), guaranteed rates and standard catering. >

If your charter operator or jet card provider/broker goes under, you could lose the aircraft service you were expecting, and be at risk to lose whatever money you sent to them, unless the funds are properly characterized as your funds on deposit.

Before getting a jet card or engaging a charter operator, do some research on these companies for signs of economic hardship – SEC filings, lien searches (including tax liens) and news reports. To limit your risk of losing funds, the best prevention is have the money held in escrow by an independent party, or use a bank letter of credit that can be drawn down upon.

With jet cards, you can protect yourself by limiting the card balance and using it quickly. Also, the company issuing the jet card or taking the money for the charter should be the same one providing the transportation service. If that is not possible, ask for direct rights to make a claim against the operator for the service being sold. You will most likely be an unsecured creditor in a bankruptcy proceeding, so your best bet is to argue that your funds are being held in trust or are segregated from the general funds of the bankrupt company.

If you were using your jet card or chartering for business, any non-refunded money should be written off as a tax loss.

### FRACTIONAL AIRCRAFT OWNERSHIP

In a fractional ownership program, you buy “shares” of an aircraft in increments, the smallest fractional share being one-sixteenth. Each 1/16th share generally guarantees you 50 hours of flight-time each year. The aircraft is managed and maintained by the fractional program.

Fractional programs are “turnkey” operations – owners have minimal burdens for scheduling flights and flight activity and the aircraft are professionally managed and maintained. The fractional programs guarantee the availability of your aircraft or another aircraft in the fleet, and will buy back your ownership interest at fair market value (less a remarketing fee). Some options allow for owners to exit early or have shares re-marketed. There can also be tax benefits of ownership (e.g., depreciation).

If one of the other fractional owners of your aircraft has financial problems, such circumstances should not directly impact the other fractional owners. The fractional program operator should take-over the payment of aircraft expenses from the troubled fractional owner, and the operator may end-up purchasing back the fractional interest.

However, if the number of defaulting owners gets large enough, the program sponsor will end up with an overcapacity of aircraft, generating insufficient revenues.



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If the fractional program operator experiences financial trouble, leading to bankruptcy, the fractional owners risk the loss of aircraft services and management, the loss of deposits, and worst yet, the loss of an exit strategy since a bankrupt fractional program operator would not necessarily be required to re-purchase fractional aircraft interest, despite what a fractional repurchase agreement may say.

Accordingly, do your research and pick your fractional aircraft program provider wisely (or be lucky). If the fractional program operator holds some of the fractional interest in your aircraft, a Bankruptcy Court could do some interesting things, such as force the sale of the aircraft on the open market despite what the fractional program documents say, or possibly try to consolidate the fractional owners’ aircraft interests and dispose of the surplus aircraft.

### CO-OWNED AIRCRAFT

Two or more persons or companies can own an aircraft in a “joint ownership” arrangement whereby all of the costs of purchasing, operating and maintaining the aircraft are shared.

This works well when several people or businesses need substantial flight hours each year (e.g. 150+ hours per year), but do not need enough flight hours to justify purchasing a whole aircraft. With a jointly owned aircraft arrangement, the aircraft is generally available, you have hand-picked pilots dedicated to your aircraft, and there are potential chartering revenues and tax benefits to be had.

However, if your partner can no longer afford its interest in the aircraft, this can put you in a difficult position if you have not

planned properly for such contingencies. Your partner may stop paying its share of the financing, or the costs of maintaining and owning the aircraft, and you will probably need to pick-up the defaulting partner’s costs for aircraft maintenance/operation.

In this situation, the governing agreement between you and your partner (i.e., a Joint Ownership Agreement or LLC Operating Agreement), should grant you enhanced rights, such as the right to treat your additional payments as an interest-bearing loan to the owning entity or to your partner, or a contribution to capital with an appropriate increase in ownership interest in the aircraft; or triggering your right to purchase your partner’s interest in the aircraft on favorable terms.

If your governing agreement does not give you such protections, consider paying the vendors directly (instead of contributing more money to the aircraft owning entity) as you may be able to step into the shoes of an unpaid vendor and thereby claim to have lien and secured interest in the aircraft to the extent of the payment made.

Now might be a good time to review and revise joint ownership documents as needed to protect your interests in the event of a co-owner’s financial trouble. If your partner goes into bankruptcy, the Court can force the sale of your partner’s interest in the aircraft, which would require you to have a new partner, or even force the sale of the entire aircraft.

This can be an opportunity for you, however, to purchase your partner’s interest in the aircraft at a discount, particularly if the Court is selling your partner’s LLC interest, which is an intangible asset that many other purchasers may not want for fear of hidden

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liabilities relating to the LLC, such as unpaid vendors, federal excise taxes or sales taxes.

### USED AIRCRAFT

Distressed sales of aircraft are becoming more popular, and they present buying opportunities. However, the party in distress may be the buyer if the seller files for bankruptcy during (or even after) the sale transaction.

It is counter-intuitive, but you would be better off buying from an entity already in bankruptcy than one on the verge of bankruptcy. So, if the filing is coming (and you have some reason to know this) then consider waiting. Transactions undertaken within the bankruptcy proceeding may be a bit slower, but they will be unassailable.

If you feel that the seller is on the cusp of bankruptcy, then speed is your friend. Get to closing as soon as possible because if there is a bankruptcy filing during your transaction, your rights will be subject to the stay (which may expose you to unavoidable delay), and possible rejection of the contract (which could become a modification of the contract).

If you are going to use deposits, make sure they are held by an unrelated escrow agent. You should then be able to get the funds back, although you may have to wait a while as the release of funds from escrow might be prevented by the automatic stay.

### NEW AIRCRAFT

Aircraft manufacturers go bankrupt, and when they do, they leave behind a list of frustrated customers. Some already have possession of their aircraft, and these customers are mostly concerned about warranty rights and aircraft support.

For those customers with signed

contracts, but aircraft in production, the primary concern is whether the aircraft will ever be completed, and whether the manufacturer will honor their contract of sale. Many customers of Eclipse Aviation lost their in-process aircraft and their deposit money. And if Eclipse had reorganized, it could have sold those aircraft to new buyers.

As with the used aircraft purchase, in a perfect world, all the moneys paid before aircraft delivery would be deposits held by an independent escrow agent. In reality, that is rarely possible since the aircraft manufacturer often needs the progress payments to fund the aircraft production. In most cases, the money that has been paid by the purchaser is built into an aircraft, or it is invested in a pile of components.

At some point in the production, the pile of parts becomes an identifiable airframe, and it becomes identified as "your" airframe (meaning it is to be delivered to you). At that point in the construction, some manufacturers will allow you to file a mortgage against the aircraft. However, some manufacturers (including Eclipse) refuse to acknowledge that an aircraft serial number is ever assigned to a specific buyer until delivery (even though they had owner names stenciled on the sides for months!).

Several Eclipse owners lost all progress payments, and were unable to compel delivery (or completion) of aircraft that were literally days away from being completed. In the weeks following the Eclipse bankruptcy there were no less than three owner groups jockeying for enhanced rights: Those that owned aircraft; those that had aircraft near completion; and those holding contracts. In the end, the bankrupt entity is going to do what makes the best economic sense,

without regard to contracts or customer relationships.

### CONCLUSION

If your transaction or ownership structure is mired in a bankruptcy proceeding, the first and most important step is to actively participate in the bankruptcy action. Your level of participation should be based on the size of your claim, and whether or not participation will enhance your outcome.

You can play a role (with legal counsel or on your own) in establishing a special committee if you are in a unique class of creditors, or you can seek to be seated on a committee. While it is not realistic to expect a "special deal" if you are involved at the committee level, you can get an early warning of where the proceeding may be headed, and which direction best serves you.

Even if you play no formal role, you need to make yourself known and educate the creditors and the Court as to the value and importance of your transaction or position, and the need to close a transaction for the good of the bankruptcy. In most cases, the sale of a corporate aircraft is a big shot in the arm to the bankrupt entity, and a step that the creditors will favor. This should allow the transaction to move forward quickly. ■

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