THE AVANTAIR FAILURE:
A Cautionary Tale, Part 2

Breaking bad: an inside look at the unraveling of a major fractional ownership program

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In a Nov. 13, 2012, email, Avantair President and founder Steve Santo attempted to reassure the troubled fractional ownership program's 600-plus shareholders that the company was being proactive when it voluntarily grounded its fleet of 56 Piaggio P180 Avanti turboprops the previous month.

Two factors led to the stand-down, Santo claimed, the first being "the loss of an elevator from a plane in late July of this year." The P180 crew had discovered their airplane was missing the left-hand segment of its two-piece elevator during a post-flight inspection at the termination of a two-leg flight. Avantair reported the incident to the FAA and NTSB, Santo wrote, but its own investigation revealed that the elevator piece was lost on the first takeoff, meaning the pilots had failed to perform a mandatory walk-around after that leg, and they were fired as a result. Santo noted Avantair had a "zero tolerance" policy for failing to comply with company rules or the FARs.

The night of the incident, Santo claimed, the entire fleet was briefly grounded and all aircraft inspected, with "no problems discovered." However, the company subsequently grounded the fleet again to replace elevator attachment fittings on all its aircraft.

The "second factor" leading to the voluntary grounding was "an evolution in the FAA's policies" regulating the fractional industry, Santo's email continued, though exactly what he meant was unclear since there had been no policy changes to FAR Part 91, Subpart K, the rule regulating fractionals.

Santo then admitted that Avantair had agreed to a records review and yet another inspection of the P180 fleet, believing that the actions would result in the safest and most reliable fractional program in the industry. To that end, he said some retired FAA executives were helping to put things right and he had made numerous changes in maintenance management to further enhance operational safety

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Santo's email implies that he and his management team were earnestly trying to do the right thing. However, despite his attempts to mollify the feds and reassure the fractional owners who had made his program possible, a culture not of safety and accountability but of incompetence, executive entitlement and subterfuge was playing itself out in the background. Ultimately a climate of chaos and desperation gripped the company as middle managers and employees struggled to keep the operation moving and as many aircraft as possible flying to service both shareowners and charter cardholders.

As *B&CA* reported in "Arrivederci Avantair" (December 2013, page 42), through the late winter and spring of 2013, the program continued to experience difficulties. The company was caught in a vicious cycle of underpriced service contracts, inoperable airplanes due to parts shortages (cut off by Piaggio and suppliers for lack of payment), and runaway charter expenses that were eating up profits to accommodate the fractional program's contractually guaranteed response time and service Avantair's charter card users. The operation was literally hemorrhaging money.

And like a cancerous organism, the company began feeding on itself by cannibalizing parts from some program aircraft to keep others flying. Worse, despite Santo's affirmations that Avantair was cleaning up

Testing the 'Veracity' of the Fractional Ownership Model

William Quinn, president of Aviation Management Systems in Portsmouth, N.H., has long consulted on fractional ownership issues and helped place clients into the Avantair program as shareowners when the program was solvent. When the company brought in retired FAA upper-level managers to help sort out its problems, "we were concerned but didn't know how serious the situation was and where it would end up," Quinn told *B&CA.*

"I was initially optimistic they were being proactive about it when some of my clients [who owned shares] contacted me," Quinn reminisced. But as turmoil continued to rage within the fractional program, "owners complained they were unable to communicate with the Avantair services group and couldn't schedule trips." Not long afterward, the company shut down. And it wasn't an FAA action — they were running out of operating cash and didn't have resources to keep adequate maintenance staff on board to keep the aircraft in airworthy condition.

"We were concerned but **didn't know how serious the situation was** and where it would end up," Quinn told B&CA.

"As I recall," Quinn continued, "there was a lot of concern among my colleagues at the 2012 NBAA Convention after the first grounding that this was something that could test the veracity of the fractional model as a whole. Would this be an implosion? How would they unwrap the shareowner part of it? That portion of the fleet Avantair owned [approximately eight aircraft in addition to the leased core fleet] was not as much a concern as the shareowners' interests, as Avantair did not have a 'put' option in its contracts to buy back the shares."

There was another component of the Avantair failure that had to be considered, as well. "Avantair had gotten heavily into the [charter] card business to exploit excess lift they had, and they'd sold a lot of cards," Quinn pointed out. "After everything imploded the second time around, the people holding prepaid cards were going to be the first to suffer, since the cards at this point were worthless."

Meanwhile, shareowners were hoping they could secure undivided interests in their airplanes. "The only way we saw to do that was that, if you had a group who owned shares in the same aircraft and you could unite them, they might be able to petition the court to secure the aircraft," Quinn speculated.

"Whether this would work was anybody's guess. Assuming they could get control of the shares and put title into a mutually owned entity, they could either reassemble their aircraft [if it had been cannibalized] or sell it for parts and at least get some value out of it. On the other hand, you could throw good money after bad trying to preserve something with little value, which is why some people walked away from their shares."

It's going to be "interesting" to see how the Avantair bankruptcy works out, Quinn said. "There is no operating entity now, and those shares are just sitting out there. Four key managers from the Avantair program have been working to establish some way to salvage the potential for operating former program airplanes, if they can control them."

And "there are liens all over the place, and cleaning that up will be the challenge, because if you do not have a clear title — even if you have converted shares into a whole aircraft — then the referee [Bankruptcy Trustee Beth Ann Sharrer] may have the power and authority to override the liens and clear the title."

So there are two questions that have to be answered for this to happen, Quinn concluded. "Who has the title to these aircraft? Probably a combination of Avantair and shareowners — so that title issues can be cleared up and resolved. Then, how do you address any existing liens? You have to organize ownership into one entity and then clean up the liens so you have a salable commodity."

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What does the Avantair failure mean to the larger fractional ownership concept? "All of us in the industry who worked with fractional were concerned that the demise of Avantair was going to undermine the confidence level of consumers as to how much at risk their investments would be in the other programs," Quinn answered.

"Fortunately, from an industry perspective, the focus was more about bad business management and not so much flaws in the fractional model," he continued. But, he added, "Everything had to be favorable in order for fractional providers to be consistently profitable."

For example, if a fractional program operates in a robust economic period without any downturns and there's lots of discretionary money available, the aircraft are all under warranty, and there are no union issues or other setbacks, then the program will probably thrive. But if it retains older aircraft beyond the warranty period, then the company would have to adjust its service charges to accommodate those increased costs.

"You need to establish in-warranty rates and out-warranty rates, as Netjets learned and did," Quinn explained. "Everything had to come together for the profits to roll in . . . and that's not how the world works all the time." **B&CA**

its maintenance program, records were in disarray, and no one was keeping track of which parts were going onto what aircraft.

By talking with a variety of sources including former Avantair fractional shareowners, attorneys and consultants representing them in the bankruptcy proceedings, ex-employees laid off without pay when the company ceased operations, the court-assigned maintenance records custodian, and others involved in the unwinding of a major fractional program, B&CA was able to piece together this report on what was transpiring inside the company.

Everything came to head in June 2013 when Santo, himself an attorney and former prosecutor, voluntarily grounded the Avanti fleet again when maintenance record discrepancies over life-limited parts tracking could no longer be ignored. This led FAA inspectors to discover that the operator was cannibalizing parts from Avanti airframes, including engines and props, and installing them on other aircraft to keep as many flying as possible. The agency immediately responded by pulling the airworthiness certificates of Avantair's entire P180 fleet. The following month creditors united to force Chapter 7 liquidation on Avantair in the Federal Bankruptcy Court's Middle District of Florida.

Only Five Aircraft Flyable at the End

Only then did it become apparent just how much operations inside the company had deteriorated. An informed source retained to look into the situation by an Avantair creditor that had leased several wholly owned P180s to the program for use as backup transportation in the "core" fleet described it as "a disaster." The source, who asked for anonymity, claimed he learned that when the program shut down last June, only five of the program's original 56 Avantis were operational.

Eight leased core aircraft were pulled out of the program by their owners — five by one, three by the other — either for missed payments on the leases or when they learned Avantair was parting out its fleet, which only exacerbated the company's decline. "This really hurt the program," the source said. Last fall, two of the aircraft turned up in the fleet of charter/management operator Skylimo Inc., at Fort Lauderdale, Fla., Executive Airport.

Contacted by *B&CA,* Skylimo President Steve Markoff said the Avantis were being managed on behalf of their owner and used principally for charter. "We oversaw the FAA airworthiness recertification of these aircraft, and they are the first ones to be put back into charter service. We will add as many of them to our fleet as demand indicates." Markoff said the P180s were in very good condition when Skylimo assumed management of them, "but the horrible maintenance records were the issue, as it took two months per airplane to get them straightened out."

Among other things, the anonymous source was charged with attempting to locate and assay the condition of as many aircraft as he could find. "They were parked all over the country, and I'm convinced Avantair's management was attempting to hide them from creditors and shareowners," he said. "I wouldn't be surprised if some people in the company's management structure were indicted on criminal or conspiracy charges before this is all over." (So far, this hasn't happened.)

The source said he couldn't believe what he saw when he walked into the hangar of one of the MRO facilities Avantair had retained to perform its outsourced maintenance —a handful of gutted Avanti airframes. "They had been reduced to hulks," he said, adding that "if you love airplanes like I do, it would have made you sick."

Engines and props, avionics, major system components, even landing gears had been removed from the aircraft, all of which were sitting on jacks and could not be moved. It was like a tour through the U.S. Air Force's aircraft disposal center at Davis-Monthan AFB, Ariz., the source declared. Meanwhile, elsewhere, overhauled Pratt & Whitney Canada PT6A turboprop engines sitting on loading docks waiting to be shipped to Avantair were being held at shops like Dallas Airmotive for lack of payment, the operator reportedly in arrears as much as $8 million for overhaul and hot-section work for that facility alone.

Another creditor was Teterboro RAMS, a repair station holding four P180s and owed more than $400,000; it petitioned the court on the basis of mechanics' liens to sell two of them and settled with the collective owners of the other two. Among many unpaid creditors are Aero Precision Repair and Overhaul of Deerfield Beach, Fla.; Access Aviation, Sacramento, Calif.; other repair stations holding parted-out airframes; the Signature and Landmark FBO chains; and a number of fuel sellers.

The source continued, "The MRO facility manager told us that someone from Avantair's maintenance department would call and direct him to remove specific parts from one of the airplanes being cannibalized and load them onto an incoming airplane being used as a 'mule' to transport them to the location of an Avanti where they would be installed. At the time we visited, the manager claimed Avantair owed his company more than $700,000 in unpaid invoices for work performed." (Unlike the Avantair maintenance staff, the MRO manager kept scrupulous documentation on all the parts removed from the P180 airframes in his hangar.)

In his desperate search for financing to keep the operation going, Santo actually sent a letter to Avantair shareholders soliciting investment in the company. When things got really bad and owners were being ignored when they attempted to schedule flights from the operator, some simply bailed out of the program and wrote off their losses. Because Avantair had no share buyback clause in its contracts, scaring banks away from lending to purchasers due to the financial risk, shares were purchased essentially with cash.

So, when shareholders defaulted on their service payments to the operator, Avantair was then able to repossess the shares (under the same kind of 'mechanics' liens' the company's creditors were using to impound its airplanes). Theoretically, Avantair could then resell the shares, or if it could aggregate them in specific P180s, it could then sell entire aircraft for operating cash. Unfortunately, the anonymous source pointed out, at this juncture with the fleet grounded and the company clearly in trouble, "no one was buying."

Daniel Herr, an attorney based in Murray Hill, N.J., who specializes in advising clients on factional and whole aircraft ownership and negotiating contracts for clients with fractional providers, had his suspicions about Avantair early in the program's history. "The first time I had a client purchasing an Avantair share, we had lengthy negotiations to revise the contract to give my client more benefits and protections," he told *B&CA*. "At the end of the long and contentious process, we had reached an agreement in form and substance, and it was time for Avantair to send out the final contact version for execution."

But what Avantair sent Herr was very different from the terms he and his client had agreed upon. "The most galling part of the story is that Avantair refused to issue the correct contract version — Avantair insisted on using the new form that was substantively more favorable for Avantair and less favorable to my client. Prior to this transaction, I was skeptical of Avantair from a business perspective. After this transaction, I knew that Avantair had a character deficiency and should not be trusted. After that, I more forcefully steered clients away from Avantair."

Unclear at this juncture is the role of the FAA in this, as it appears the company was grossly noncompliant with FARs governing both maintenance and operations. "The FAA really clamped down on them in response to a whistleblower," the anonymous source said. "The movement of parts all over the fleet was not being documented, so no one seemed to know what airplanes had what parts, so if you did a conformity inspection, all you'd have would be confusion. That's what ultimately shut them down."

Cannibalization as a Parts Strategy and Other Red Flags

Julie Roberts was hired at Avantair in 2006 as a flight coordinator in the company operations control center at Clearwater, Fla. Her duties encompassed flight following and liaison with shareowners. "At first, I really loved it," she told *B&CA*. But six years into the job Roberts began to see red flags.

"The first time I knew we were in bigger trouble than they [the company principals] were letting on was when the manager of warranty and parts told me that he was shut off from buying parts," she recalled. "He immediately quit and wasn't replaced. And that's when they started taking parts from one airplane and putting them on another.

"We had experienced the first shutdown [in October 2012] and were hearing stories from above about the FAA being 'unfair' to us," Roberts continued. "The company then proposed moving the maintenance records, the entire

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maintenance control staff, the chief pilot, the vice president of operations and the operations director — everyone vital to the [operating] certificate — to Orlando International Airport to get them under the purview of a different FSDO, one that really wasn't that familiar with the company, as the one in St. Petersburg was talking about not allowing us to resume operations. They were trying to pull the wool over the FAA's eyes. They actually made this move not too long before the company collapsed."

As things started to unravel in 2013 and fewer P180s were airworthy for lack of parts and required maintenance, Avantair's dispatch rate began to plummet. At that point, with a reduced fleet, charter card holders were in competition with fractional owners for access to aircraft. A new management strategy was to "keep everything from the directors," Roberts claimed, "keeping them in the dark as much as they could — still flying them and canceling the owners to ensure that the board always could fly and not the owners. We were instructed to not let any information get to the directors."

Meanwhile, it was Roberts' responsibility as things declined to call fractional owners when their flights had to be canceled and offer them commercial airfare at company expense or a charter at their own expense. "There were several months when we had only seven to 13 aircraft flying and a 'magic number' of 30 to 40 trips that we could fly in a day. If someone called in over that number we told them we were over capacity." Meanwhile, CEO Santo was co-opting airplanes for personal travel from Clearwater to Telluride, Colo., where he had a home, "and we would have to cancel a shareowner flight."

The reduced number of flyable planes was exerting a huge amount of stress on Roberts and her coworkers — especially pilots. "We would have to double- or triple-crew the airplanes to meet the demand that we had and still remain within [FAA-mandated] duty time requirements. Our chief pilot attempted to keep things as legal as possible. They would start at 5:00 a.m. and run until midnight, running the available airplanes as much as we could. It was a crewing nightmare. The Avanti is a pretty good airplane, but it isn't made for this."

When Avantair finally ceased operations on June 21, 2013, its 330 employees were furloughed without compensation for most of their last month's work. Given the economic climate and scarcity of good aviation jobs, many were forced to foreclose on their homes and relocate to other parts of the country. It was a sad day at Avantair headquarters when an executive came into the operations center and announced that employees were being put into the street, Roberts said.

"When we were furloughed, we couldn't get our 401Ks because we were not formally separated from the company — technically we were still employed," she lamented. It was a "Catch-22" situation. "If you resigned, you couldn't get unemployment, and to get your 401K, you had to resign. Unemployment compensation ceased on Dec. 28, 2013. We just started getting our 401Ks in the last couple weeks [of February] as an attorney for the bankruptcy trustee [Lynn Sherman] was able to get the 401K program terminated. This was our retirement.

"We were also screwed out of three weeks pay," she continued, "and we don't know if we're going to get it. Some employees had their health plan pulled while they were using it, and since the plan wasn't paid up by Avantair, the bills reverted to the employees. The plan was terminated on June 30, 2013. They did everything they could to hurt us."

About 10% of Roberts' co-workers in the operations control center are still out of work. "Some who are employed are working temp jobs," she said. "Avantair paid well, so it's a big step-down. We watched [the unraveling of the company] with great sadness because we liked our jobs, and we wanted to believe that the company could be saved, that their schemes to create money would pan out, that in the end it would all work out." Today, Roberts works for an airline catering company.

Overflying Time-Critical Parts and Pressure to Fudge the Records

"Chuck" (not his real name), a middle manager in the Avantair maintenance department who had signed on with the company originally as an A&P tech, was partially lucky at the end: He was eventually able to secure employment with a Florida-based airline but lost his home in the interim. He agreed to talk with *B&CA* anonymously.

"When they started to lose money and couldn't buy parts, there was a lot of pressure from management to convince my mechanics to do things that were not legal," he said. "I didn't like how they intimidated my people, forcing them to sign off illegal work from minor stuff to really major infractions. I started to stress to my people that it starts small and then goes big, and pretty soon you're sitting and talking to the FAA, which inevitably did happen to one of my guys. They [the managers] were doing anything they could to keep the airplanes in the air."

What kind of things? "They were overflying a lot of time-sensitive items," Chuck said. "They were rash on us at St. Pete because we were too slow getting stuff out. One night we had a scheduled B Check for a Piaggio that was going into another station for the work, and the paperwork was signed off as completed even before the airplane landed. There was so much cannibalization going on — there were times when an airplane would come in, and as a normal procedure the mechanics would do a pre-run of the engines and systems for diagnostic purposes, and management would order us to start removing parts from the airplane while the engines were still running. It got that crazy.

"When you're in maintenance control you get to see everything," he concluded. "They treated the shareowners horribly, putting them on the back burners after they started to sell Edge [charter] cards."

Chuck's contention that Avantair wasn't replacing some time-critical parts and fudging on the hours flown was elaborated on by an Avantair fractional owner who bought one-sixteenth shares in two Piaggios. "Our bankruptcy attorney told us they would take a prop that had flown 300 hr. with 700 hr. left on it out of one airplane and then put it on another and begin counting down from 1,000 hr.," he said. The record would still show that the propeller had 300 hr. on it when it was actually timed out.

"I don't know if this was malfeasance and have assumed that the record-keeping process got sloppy as the money ran out," he continued. "The bankruptcy court required that humpty-dumpty got put together, especially uniting props with engines. On our airplanes, neither has its original engines or propellers. There are 138 time-controlled parts on the airplane that there were no accounting records for. The bankruptcy court has required that props and engines be reunited with their original aircraft."

This fractional owner, who also asked for anonymity — we'll call him Owner A — said that he was attracted to the Avantair program by the cabin size of the P180 turboprop and the buy-in price, "which seemed to be hopelessly low as things played out. I bought into the program in 2005. At one point I had 125 hr. and then took it down to 100. The acquisition was $450,000 for a one-sixteenth, but the operating costs were much less expensive than a jet. A Citation X cabin is not as wide as the Piaggio's. When they would send a light jet, we still preferred the Piaggio."

It was after Avantair's first stand-down in October 2012, the remainder of the fourth quarter of that year, that things started to unravel. "People stopped paying their fees," Owner A said, "and that started the death spiral. They [the program managers] would respond, but they'd say things like, 'For the next three weeks we aren't flying.' It got very inconsistent — they never got back to a place where, when you scheduled a flight, you'd know they'd be there." (The contracted response time was 24 hr., 72 hr. for peak periods.)

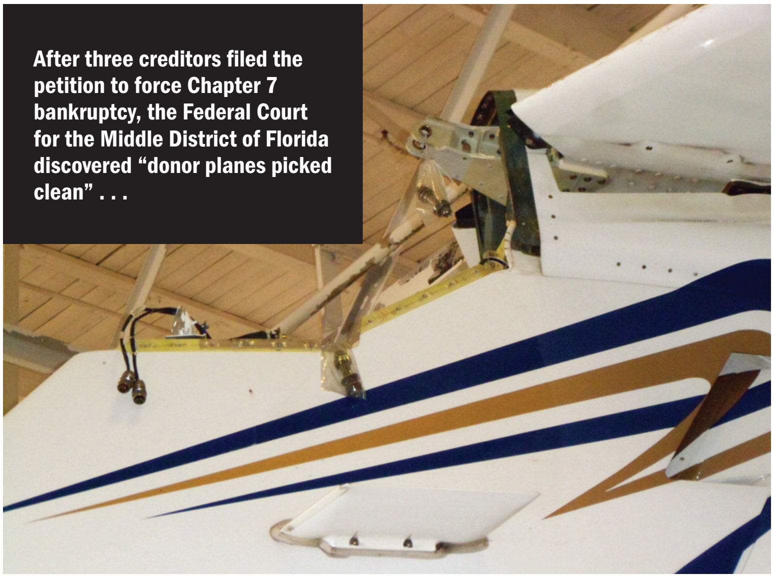
"I had prepaid my fees at the end of 2012 to take advantage of a month's free service," he went on. "It was horrible after the first shutdown — that Christmas, we were traveling back to Colorado from California, the flight was delayed for 5 hr. due to a mechanical, then airplane number two had a midflight mechanical that caused us to divert to Salt Lake, where we spent the night in the FBO, and then they sent a charter the next day to complete the flight in a very inferior older light jet [an early-model Learjet]. After the second grounding, they never came back."

Competing With Cardholders

A second shareowner interviewed by *B&CA* — we'll call him Owner B, as he also did not want to be identified — said he had initially invested in the program through an LLC he formed with a friend, purchasing sixteenth and thirty-second shares on two aircraft (amounting to 75 occupied hours per year) in 2005 and 2006. "We were in it for five years and re-upped for another five years. The first five, it was terrific and everything was flawless."

But problems manifested themselves suddenly in summer 2012 "when they would call you at the last minute and tell you the airplane wasn't available or would reschedule you for the next day or another time. Then they would call and say they couldn't fly you. All of a sudden it became really unreliable, and that was when our antenna went up that something was wrong."

Owner B believes that, sometime late in the last decade, Avantair's board of directors started to pressure CEO Santo for a better return on equity, "and as a result, they started selling the charter cards. As owners, we were then competing with the charter card holders with no benefits falling to us. They ended up running these airplanes ragged and then had to have more maintenance done, and then the airplanes started to go out of service. And that was when they started this ridiculous musical chairs game, ramping up usage and ramping down the availability of the aircraft. It was fewer aircraft available and more hours obligated to use them."



After three creditors filed the petition to force Chapter 7 bankruptcy, the Federal Court for the Middle District of Florida discovered "donor planes picked clean" . . .

At this point, with the program defunct and the provider bankrupt, Owner B and his co-owners want to sell their two aircraft, "and the question is how we go about doing that. One aircraft is a mess with one engine locked up at a service center; the bill on it is $300,000, and they won't release it until paid. The other engine, still with the airframe, is timed out. The only good news is that both the engines are original equipment [i.e., not cannibalized from another aircraft]."

Of something like 44 aircraft originally fractionalized, only two were flying on their original engines when Avantair ceased operations. "The court wants them returned to the original airframes," Owner B said. "That's 84 engines, and you have to find out where yours are, pay to have them removed, then pay to have them shipped and installed on your airframe, and then the engines that were on your airframe have to be dismounted, shipped, and remounted. And the airplanes are scattered all over the country. One of ours is at Greensboro, N.C., and the other is in Sacramento."

The behavior of the Avantair managers was "insidious," Owner B stated, citing a marketing executive who was continuing to sell shares in a parted-out "donor" aircraft at Tampa, Fla., as the program was collapsing. "The other story I heard was there was an airplane in Denver that was damaged in a hailstorm, and Avantair got a million-dollar-plus settlement on it from the insurer and then threw the money into operations and didn't fix the airplane. They didn't have the right to devalue these airplanes by parting them out and removing the engines. If this were a legitimate operation, those engines would be recycled and returned to service immediately."

Avantair reportedly purchased new P180 Avantis from Piaggio for around $6.8 million each, then sold them under the fractional program for $7 million. "Now they are being offered at $900,000," Owner B said. "That is a significant drop. There are some bottom feeders offering $800,000 for them after the liens have been satisfied and the accounts payable brought up to date. Out of that, you have to take the lawyers', trustees' and FBOs' fees. It is a huge mess."

Indeed it is. After three creditors filed the petition to force Chapter 7 bankruptcy, the Federal Court for the Middle District of Florida discovered "donor planes picked clean" for parts to support those few still flying. One airframe, N162SL, was described in the bankruptcy petition as "a cadaver." Maintenance records failed to match parts on a given aircraft when inventoried, and the fractional provider had lost track of hours and cycles and even "zeroed out" some parts. Nothing was sorted out.

The bankruptcy code is in place to prevent a free-for-all in situations like the Avantair failure; as such, it is an injunction that "leaps into place" (as one attorney described it) and keeps parties from attempting to grab "property of the bankruptcy estate" and run with it. After Chapter 7 went into effect, there was a rush by some shareowners to take possession of their property, but because of its knowledge that some engines might be timed out, the FAA was concerned that owners might find their airplanes and attempt to fly them away. However, if owners could coalesce as a group, identify the aircraft in which they owned shares and determine that an airplane was flyable and where it was, they could then petition the court for a stay and, if granted, fly it to a preferred location. A handful did, but the majority of the airplanes were being held by creditors on the basis of mechanics' liens and couldn't be moved.

Breach of Contract

When contracted service in a fractional ownership company declines "and you own the aircraft," attorney Amanda Applegate observed, "you do what a lot of the owners decided, and that was that Avantair was in breach of contract. . . ." The result was that owners simply stopped paying their management fees, which compounded the problems the provider was experiencing. "In the quarterly filings with the SEC, it showed that Avantair's accounts receivable — what they were owed by shareholders — were growing," she said.

A member of the Aerlex Law Group in Santa Monica, Calif., Applegate is especially equipped to represent a third of the Avantair fractional ownership group. "I was associate general counsel and contracts vice president at NetJets for 12 years, so I knew the business from the other side," she told *B&CA* in a telephone interview from her home in Cleveland from where she works now. "I'm currently in private practice, and my firm was contacted by some of the co-owners to represent them, determine their rights and provide counsel."

Following the collapse of the company, "Avantair fractional owners, a sophisticated group, began to try to find one another in order to determine the best course of action going forward," Applegate related. "In the fall of 2012, Avantair management also reached out to the fractional owners and offered them the ability to invest in the company. Avantair raised more than $500,000 during this period. In July 2013 [after the company ceased operations and furloughed its employees but prior to the Chapter 7 petition], the company was also attempting a restructuring into a regional fractional program — the so-called 'NEWCO' plan — speculating a Chapter 11 move and asking for shareholders to each contribute $25,000, which didn't go over too well. So, they were ultimately unable to achieve the financing they needed." (Board member Loren Weil, who owned five of the eight P180 Avantis leased to the company as core fleet, loaned Avantair $2 million, as well, before the bankruptcy was forced.)

After the Chapter 7 bankruptcy went forward, "it was imperative that the owners find one another, and they got no help from Avantair," Applegate explained. Using blogs and a website created by fractional owners and employees, owners resorted to using Amstat and JETNET services to research the FAA records. "We would help them find their co-owners, and once we did, we set up group calls among them. They had to decide collectively what they were going to do with the aircraft. That is how we have been spending all our time since last July."

Applegate continued, "The issuing of the liens attached to the aircraft, revocation of the airworthiness certificates for all former Avantair aircraft and mandatory Service Bulletins [SBs] make it more difficult for the owners. The aircraft have a good number of liens on them so that the airplanes have been devalued by 25 to 50 percent, but we don't know for sure. You also have 630 to 660 owners, and there may be enough buyers out there to support the inventory that will come to market."

What most outsiders don't know, Applegate maintains, "is how much the owners like this aircraft and represent potential purchasers of them. The new aircraft that went into the Avantair fleet were approximately $6.8 million. However, at $2 million, the price point then becomes attractive for whole ownership. Chartering them could make them pay for themselves [*i.e.,* putting them into a charter/management program]."

Toward that end, Owner B has become the lead owner for both of the airplanes in which he owns shares. "We have hired an auction house to sell them," he said. "One is in Dallas and the other is in the Avantair facility in Florida. Fortunately, they are both in good shape, early models, probably the least valuable in the fleet. All the owners hired a records management company to go through the records for the parts.

"We have the maintenance records for our airplanes and have located the engines and props that are supposed to be on them, and the auction house has agreed to either put them back together or at least get them in the same room," he continued. "With everything there, the values should be maximized to the best we can do, and everything will then be auctioned off, but they will not be as valuable as complete, properly managed airplanes. Based on conversations with potential buyers, our attorney has told us we'd be lucky to get $1 million for them, so each one-sixteenth owner will potentially have lost — and have a claim to — [a value] between the Bluebook one for a properly maintained Avanti and what they actually will get. If we get $1 million for an airplane and the real value should be $2.5 million, we will have lost $1.5 million, and each one of us will have lost one-sixteenth of that."

Owner B's claim to any diminution in value of his airplanes is solely as an unsecured creditor in the bankruptcy proceeding. "If considered legitimate, this will be added to the overall pile of claims — and that will far exceed the amount of cash that's available. The other thing the owners add to that pile is fees paid for services not rendered. Also, employees are a priority creditor in the bankruptcy. All the claims will be added up, and the assets of the bankruptcy estate will be used to partially pay those claims. The largest likely asset of the estate will be the proceeds of the company's directors and officers insurance policy."

Despite his experience with Avantair, Owner B is still a fractional user, having purchased shares in the Embraer Phenom 300 and Nextant 400 aircraft in the Flight Options program.

Selling Out, Taking the Loss and Walking Away

A third Avantair one-sixteenth shareowner, Greg Brown, who presides over consultancy GMB Management, said it has never been clear to him what happened to his ownership interest at the end of his contracted five years. "You could re-up for another five years and continue to have access to the aircraft. After the bankruptcy was filed, I got the list of the other owners of my aircraft and contacted most of them, and as a result of all of that, I conveyed GMB's interest in the aircraft to another one of my co-owners for a greatly reduced price."

Under that sales agreement, Brown retained all rights in the bankruptcy and rights to pursue Avantair and possibly its management and directors in a suit. "Our aircraft was N178SL. Every indication that I had, without ever seeing the aircraft, was that it had not been cannibalized and was operable. I really liked the airplane; it had plenty of room inside and was relatively fast. A totally new entity is now sole owner of it, so my co-owners may have sold it or created the new entity."

Brown was attracted to the Avantair fractional ownership plan because of a need to frequently travel between his home in Park City, Utah, and a business interest in Little Rock, Ark. Flying on the airlines, which operated no direct flights between Salt Lake City and Little Rock, he was losing an entire day to travel. "So I needed an economical option," he said. "Avantair looked like the best deal, and I jumped in. It was a million-dollar commitment over a five-year period, and that made sense to me."

He bought into the program in 2008 and was "satisfied, totally," until early 2012 when it was time to renew his management fees, and the operation began to run late meeting scheduled flights. "Previously, I'd prepaid my operations fees for a year, and that got us an extra 2 hr., so we had 52 hr. per annum. But because of their tardiness, I notified them I'd be paying the fees on a monthly basis for the last year of

How Avantair Survived the 2008 Downturn and the Beginning of the Slippery Slope

Daniel Herr, an aviation attorney based in Murray Hill, N.J., advises clients on the advantages and limitations of fractional ownership. (He can be accessed at http://www.FractionalLaw.com) B&CA asked him how Avantair managed to survive the economic downturn of 2008, only to plunge into the financial problems that led to its internal breakdown and ultimately to bankruptcy.

"When the 2008 downturn hit, and new aircraft sales dropped dramatically, Avantair avoided much of the pain experienced by the larger fractional industry . . . not through any business genius, but because its growth had been throttled by Piaggio's limited production capacity.

"So Avantair entered the downturn with a comfortable backlog of demand — and generated further demand by positioning itself as the economically reasonable turboprop option for a post-bubble era. Avantair also touted the lower fuel consumption of its turboprops." This advantage was augmented by the provider positioning itself as the economical alternative to jet programs, and by "deftly expanding into the card market. To the extent that Avantair's owners were flying less due to the downturn, Avantair could take the owner's under-utilized aircraft and generate additional revenue by selling card hours."

And this is where Herr believes "a contractual quirk" really helped Avantair. "Most fractional programs charge a monthly management fee that is a fixed cost every month plus an hourly fee that is assessed on the number of hours flown in the previous month. If a customer does not fly, the customer pays the monthly fee but has no hourly expense. The Avantair business model was different in that every month customers paid the management fee and one month of hours as well."

So if customers owned a 50-hr. share, they would get billed 4.2 hrs. per month regardless of whether they flew or not. When an Avantair customer used this share, the only additional expense to the owner was the fuel surcharge and landing fees. "On the flip side of the coin," Herr continued, "if an Avantair owner stopped flying in an economic downturn, the owner still had to pay the hourly fee — he would save only on the fuel surcharge and landing fees. So when owners didn't fly, Avantair made a killing because the company kept the revenue stream while greatly reducing operational expenses."

At other fractional programs, when owners stopped flying, the hourly revenue stream stopped as well — leaving the program with only the monthly fee revenue.

the contract. In October 2012, they had the first grounding — after I'd paid a fee for the month. I had a trip scheduled, and they called the night before that they were grounding the fleet and were not providing a charter backup. I had to cancel business meetings for the next day, and we stayed home.

"Then we had another trip planned for Thanksgiving," Brown continued, "and they said they had safety issues. So we started taking demos with other providers, and the Thanksgiving trip was covered by those demo flights. Then we had a Christmas trip planned, and they called again the night before and said the scheduled flight would be delayed 4 or 5 hr. At that point I stopped doing anything with them. When they started hectoring me for operational payments, I wrote Santo and told him I considered him in breach of contract and I wasn't paying them anything. By the end of October 2013, my interest in the aircraft was fully depreciated."

Brown believes that "the first time that the company pulled an engine and put it onto a different airframe without informing the respective owners of those two aircraft, they may well have been committing a criminal act. Whether a prosecutor will run with that, I don't know. At some point the statute of limitations will kick in. It is tragic what happened to the employees."

Finished with fractional ownership, Brown now participates in charter card flying with Flexjet and says he likes the Embraer Phenom 100 entry-level jet. "Several providers have come up with deals specifically for former Avantair owners," he said.

In early February this year, a legal action was filed in Pinellas County, Fla., by a group of former shareowners against Santo, Executive Vice President Kevin McKamey and another former Avantair executive alleging "tortuous interference" with contracts and negligence.

No one knows for sure where Santo is, although rumors abound, everything from his leaving the country to operating a pizza parlor in Clearwater. On the Avantair Owners Forum (**www.avantairowners.freeforums.net**) a former Avantair pilot claimed to have seen Santo and McKamey at an Embassy Suites hotel in Miami. "The question is," the poster asked, "what are they doing there and how is that trip to MIA being funded?"

Meanwhile, the bankruptcy process moves ahead, emphasis at this juncture on straightening out the maintenance records of program aircraft and creating as much cash as possible to pay off liens on aircraft and engines by auctioning off whatever of Avantair's assets can be cleared for sale. To that end, the bankruptcy trustee has retained TPE Flight Log Services to address the records situation and Starman Auctions to dispose of assets.

A division of Turboprop East (coincidentally, a Piaggio service center), TPE Flight Log Services is the court-appointed custodian for the Avantair maintenance records. "We are holding maintenance records for the majority of the fleet," COO Amy Smith said. "Only the engines and props are being rationalized to their original airframes, as per the bankruptcy court. All the other parts on an airframe will stay there, whether they are original equipment or cannibalized from other airframes — the court has also decided

Avantair's Dual Revenue Streams

So Avantair got through the bursting of the housing bubble relatively unscathed. If an airplane was idle, the company still made money on it through the fixed monthly and hourly revenue stream. "Additionally," Herr pointed out, "Avantair used idle aircraft to generate additional revenue by selling that excess capacity in the card market. So Avantair could theoretically generate more revenue and profits in a downturn — owner revenue plus card revenue."

Soon the provider came to depend on having the dual revenue streams. "But eventually," Herr said, "owner demand returned or the excess capacity diminished due to new owners replacing owners who under-utilized their shares. This higher owner demand reduced the card revenue that Avantair could generate and may have increased Avantair's expenses of hiring outsourced charter to cover trips. Further, the fleet was getting older and maintenance expenses were increasing. And, of course, the time eventually came that the demand backlog for new aircraft was satisfied and there were no longer profits from the sale of shares in new Piaggios."

Whereas owners in other fractional programs benefited from buyback clauses (or "puts") in their contracts, Avantair was unique in that it wrote its contracts without an obligation to repurchase owner's shares. "In the downturn," Herr explained, "the best Avantair's shareholders could ask for was 'please find another buyer for my share.' If Avantair couldn't find a buyer, the owner was stuck. Owners were on the hook to continue to pay the monthly management fee and the hourly fees even if they weren't flying."

Somewhere along the line when cash got tight due to the return of owner demand for flights and the additional maintenance requirements for an aging fleet, Avantair began offering owners incentives to pay their monthly and hourly fees for one year in advance. "The incentives were either a percentage discount or additional hours on account," Herr said. "Those premiums offered by Avantair were significantly above what a capable borrower would have had to pay in the commercial market. A customer on the receiving end of those offers would rightly have wondered why Avantair could not borrow elsewhere at a more reasonable rate.

"Retrospectively," he continued, "we know that the cash flow problems led Avantair to move parts around between aircraft. It's hard to know whether there was malice in that practice, or if it was just a business practice taken to extreme. Here's where the slippery slope starts — from the reasonable exchange of a nav light to the extreme of exchanging engines and props. Whether it's criminal depends on the intent." B&CA

After the Chapter 7 bankruptcy went forward, it was imperative that the owners find one another, and they got no help from Avantair," Applegate explained.

this. We do traceability research to locate the proper documentation that belongs with the part, and we are involved in that as customers [i.e., co-owners] come to us for assistance. Reviewing, organizing and copying logbooks and records for approximately 50 aircraft will take time, as we are meticulous about our work."

The records and logbooks were transferred to TPE from the Van Allen Group in December 2013, an Atlanta-based consultancy that had been holding them, by bankruptcy court order. According to the court, the transfer was made in light of the Avantair parts cannibalization, inaccuracies in its maintenance records and the necessity of consolidating the records "under the supervision of a qualified custodian" toward the goal of preserving the values of the Avantair fractionally owned aircraft and restoring their airworthiness certificates. The court also allowed TPE to be retained by shareowner groups and assist them in rationalizing the records of their aircraft so that their airworthiness certificates could be reissued.

Auctioning Off the 'Cadaver'

Starman Auctions, headquartered in Omaha, specializes in aviation, arranging auctions in the U.S. and Canada for everything from light planes to airliners and business jets, engines, parts and support equipment. At an auction in January at Avantair's base in Clearwater, Starman sold N162SL, a virtual hulk that had been stripped of every removable part, including its entire cabin and cockpit interior. The "cadaver" described in the bankruptcy petition was picked up by an operator in Florida. Meanwhile, the PT6A engines, which had been removed from the airframe, were sold separately to Davis Aviation, a repair station and parts supplier in Brandon, Miss. Additionally, Starman auctioned off Avantair's ground support equipment, including tugs, and shop and office equipment. Proceeds from the sale will be distributed among fractional owners by the bankruptcy trustee.

"The court has allowed owners to have parts for their aircraft returned if they know their numbers and can locate them," Steve Starman, president of the auction house, said. "We have combed our inventory for part numbers that owners have provided us and found some and returned them." Starman may conduct auctions for other aircraft and parts in the near future.

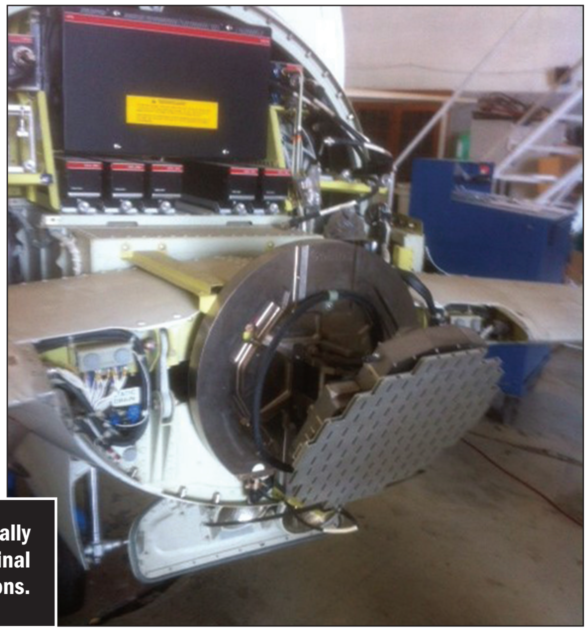
Avantair had a Socata TBM 700 and a pair of Pilatus PC-6 single-engine turboprops that were used for executive transport and to support the maintenance operation, moving parts and mechanics to locations of disabled Piaggios. This winter, the court sold the TBM, paid off liens against it, and had $80,000 left over to pay creditors. An employee class action suit has been filed against Avantair directors and officers — who are ostensibly protected by a $15 million liability insurance (or "wasting") policy — for back wages and failure to comply with the "Warn Act." Responding to the employee suit, the bankruptcy trustee filed a motion with the court to enjoin, or halt, the suit on the grounds that the potential payout in the directors' policy can be "preserved" to pay the employee judgment.

"I spend my days talking to lien holders, potential buyers, the appointed counsel for the trustee, the records custodian," attorney Applegate said. "Some groups are in the process of recertification of their aircraft. Each owner group has to do a cost/benefit analysis to determine whether or not to put the money into [an aircraft] to bring it back to certification. A small number of the aircraft may wind up like N162SL — that is, sold as a hulk or for salvage value." Asked how this story will end, Applegate responded, "It is when the aircraft are sold, and I'm hopeful that most of the airplanes will be before Memorial Day."

Avantair was the only fractional ownership program to be publicly traded. At this juncture, there is no indication that the Securities and Exchange Commission is considering an investigation or any legal action against Santo, his executive group or the Avantair directors for possible fraud.

As one source told *B&CA,* "The Justice Department looks at this as a bunch of rich white guys screwing another bunch of rich white guys, so nothing is going to happen." While there may be some truth in this cynical observation, if there was financial malfeasance or improprieties in Avantair's representation of itself in stock transactions, the perpetrators should be accountable for their misdeeds. And it's obvious from the tales told by the brave people willing to testify for this report that accountability wasn't the Avantair management group's long suit.

"How the company managed to screw this up is mind boggling," one of the anonymous shareowners stated. "It was unnecessary — there had to be a way they could have salvaged this. At the end of the day, everyone loved the airplane and the service and the pilots and administrative employees. I thank God that no one was killed on these badly maintained airplanes." **B&CA**



Of something like 44 aircraft originally fractionalized, only two were flying on their original engines when Avantair ceased operations.