THE COMING OF AGE OF FRACTIONAL AIRCRAFT OWNERSHIP PROGRAMS

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Introduction

In introducing its NetJets program to the corporate aviation market more than a decade ago, Executive Jet Aviation, Inc. dubbed its concept "fractional aircraft ownership" because each participant in the program was required to purchase a fraction of the ownership interests in a single aircraft. The original NetJets program, now considered to be the traditional fractional ownership model, requires that each owner of a fractional interest in a particular aircraft agree to place the aircraft into a pool of aircraft, all of which are fractionally owned. The aircraft in the pool are then made available to all participants in the program, with the total number of flight hours available to each participant each year limited to a number that corresponds to the participant's ownership fraction.

As with any successful new idea, the traditional fractional concept has been emulated by numerous competitors. However, as the earliest fractional ownership programs achieved national name recognition, later entrants found it necessary to incorporate innovative ideas into their programs to attract customers. In some cases, the innovative ideas involve a shift away from the requirement that the customer actually purchase a fractional interest in an aircraft. Thus, some programs offered today under the general rubric of a "fractional" program do not necessarily require fractional ownership of aircraft.

The primary purpose of this article is to outline the elements of traditional fractional ownership. Along the way, this article will point out some critical issues that may arise in planning for and negotiating a purchase of a fractional interest in an aircraft. In the sections that follow, this article will briefly discuss the regulatory background that led to the development of fractional aircraft ownership, the elements of a traditional fractional ownership program, a few of the innovative new business concepts that are being marketed today under the "fractional" label, and the future of the fractional industry.

Traditional Fractional Concept

Operations of U.S.-registered aircraft of the types typically used by corporations, executives, and individuals must be conducted under one of two sets of rules: flight operations conducted by a person or entity for the purpose of providing air transportation services to another person or entity for compensation or hire must be conducted in accordance with the commercial charter regulations of FAR Part 135; and non-commercial flight operations conducted by an individual to meet his or her own transportation needs and that of his or her guests, or by a corporation to transport its employees, property, and guests, may be conducted in accordance with the noncommercial regulations of FAR Part 91. The traditional fractional concept is designed to provide fractional customers some of the benefits of typical FAR Part 135 commercial charter operations, while maintaining the ability to operate under the less restrictive rules of FAR Part 91. Perhaps the most advantageous benefits of fractional aircraft ownership, from the individual fractional customer's point of view, are price consistency, the potential for reduced overall costs of operations, and the ability to obtain use of an aircraft on relatively short notice without regard to whether or not the customer's own aircraft is available or unavailable due to maintenance, repair work, or other scheduled use.

The potential for the realization of reduced overall

costs for individual customers arises from the ability of the fractional program manager to spread the fixed overhead costs of operations of each aircraft among several customers. Before the advent of fractional ownership, corporate aircraft operators often found it necessary to purchase a whole aircraft even if their air transportation requirements would not result in full utilization of the lift capability afforded by the aircraft. This situation causes the total cost of ownership and operations to be spread out over a fewer-than-optimal number of flight hours, with the result that average cost per flight hour experienced by the operator of under-utilized aircraft may be significantly higher than the average cost per flight hour experienced by the operator of a fully utilized aircraft. Fractionally owned aircraft are more likely to be fully utilized than other aircraft. Thus, while fractional programs often price their products and services at a level that results in average costs per flight hour being higher than those of fully-utilized aircraft in the non-fractional context, they may nevertheless provide a more cost-effective method of aircraft ownership to customers who could not otherwise benefit from the cost efficiencies of a fully utilized aircraft.

In order to obtain the desired benefits of fractional aircraft ownership while maintaining the ability to operate under FAR Part 91, it was necessary for the developers of the traditional fractional concept to devise a means of providing their customers with both an aircraft and all the pilot and management services necessary for the operation of the aircraft, while simultaneously ensuring that operational control of the aircraft during any given flight was vested in the fractional customer for whom the flight was operated. Operational control is the exercise of authority over initiating, conducting, or terminating a flight and is typically exercised by the person who has the legal right to possess the aircraft. This objective was accomplished by a combination of passing title to undivided fractional interests in each individual aircraft to one or more fractional customers, providing for the leasing of aircraft by and among the various fractional customers, and providing that each aircraft will be managed by the fractional program manager under an agreement similar to a typical turn-key aircraft management agreement. Thus, for each flight by a fractional customer, the fractional customer will either have title to the aircraft, or will be leasing it from another fractional customer, and in either case will be acquiring only aircraft management services, not transportation, from the fractional program manager. The theoretical and intended regulatory result of structuring operations in such a manner is that the fractional customer should be considered the operator of the aircraft.

Fractional Ownership Program Governing Documents

Acquiring an ownership interest in a fractionally owned aircraft usually requires the execution of four contracts commonly referred to collectively as Governing Documents. The Governing Documents include a Purchase Agreement, a Management Agreement, an Owners Agreement, and an Interchange Agreement. In some fractional programs, execution of a Deposit Agreement will precede execution of the Governing Documents.

The Purchase Agreement

The Purchase Agreement sets forth the terms and conditions of the sale of an undivided ownership interest in an aircraft, including the purchase price, closing date, and delivery conditions, and representations and warranties. The agreement should specify that the customer is acquiring a specific percentage or fraction of the ownership interests in the aircraft, and that the customer will hold its interest as a tenant-in-common with all other persons possessing ownership interests in the aircraft. Unlike most other aircraft purchase contracts, a fractional program Purchase Agreement will likely include provisions to require and facilitate the repurchase of the aircraft ownership interest by the fractional program at some later date, as well as substantial restrictions on the customer's right to sell or otherwise transfer the ownership interest to any party other than the fractional program. Such provisions usually take the form of put and/or call options. These provisions should receive special scrutiny as they will likely have a significant impact on the price and time at which the ownership interest will ultimately be sold back to the fractional program. It is not uncommon for a fractional program to claim that it will repurchase the ownership interest at its fair market value as of the date of the repurchase. Close

scrutiny of the Purchase Agreement may, however, reveal that the fair market value is only the starting point in determining how much cash the customer will actually receive. Certain provisions contained in the agreement will likely affect the amount the customer will ultimately realize on the transaction. A few of these provisions include caps on the repurchase price, "remarketing" fees, and the methods and assumptions used to determine the fair market values of program aircraft.

Caps on the repurchase price. Purchase Agreements usually cap the repurchase price at the original purchase price, or at a fixed percentage of the original purchase price that decreases over time (e.g., 96 percent of original purchase price after one year, 92 percent after 2 years). Such caps will not affect the repurchase price if the fair market value of the aircraft declines at a rate equal to or faster than the rate of the cap. Aircraft do not, however, always depreciate in value, let alone at a rate equal to or faster than the rate of the cap. In fact, the values of many corporate jets actually rose during the 1990's. Whether such appreciation will continue into the 21st century is unknown. A cap on the repurchase price that declines over time will, in any event, ensure that the value of the customer's fractional interest will fall regardless of whether the value of the underlying aircraft falls, stays the same, or rises. Few fractional programs will negotiate an elimination of the cap. It may be possible, however, to negotiate a more favorable cap in some circumstances.

While most fractional programs cap the repurchase price, some will also protect customers against excessive downside risk. Such protection most likely will take the form of a minimum repurchase price that the fractional program will pay to repurchase the fractional interest. In most fractional programs that offer such protection, the customer will only qualify for the protection when trading in its ownership interest for an equal or greater percentage interest in a newer aircraft of equal or greater value.

Remarketing fees. When a fractional program repurchases an ownership interest from a customer, the fractional program usually does so with the intention of reselling the ownership interest to a third party. In the case of an older aircraft that is to be phased out of the program and replaced with a newer aircraft, the fractional program may time its repurchase of all fractional interests in the aircraft to occur nearly simultaneously and will subsequently sell the entire aircraft out of the program to a third party. Like all retailers, fractional programs earn revenue by buying at wholesale and selling at retail. In order to repurchase an ownership interest in a fractional program aircraft at wholesale, the fractional program will deduct from the aircraft's fair market valuation a "remarketing" fee. These fees tend to range from 4 to 20 percent or more depending on a number of factors, including: the length of time the customer has participated in the fractional program; whether the customer is terminating participation in the fractional program; and the reason the customer is terminating participation on the program. Purchase Agreements generally require higher remarketing fees for customers that terminate participation in the fractional program pursuant to an early-out provision than for those who participate throughout the entire term of the Governing Documents, and for customers who terminate participation in the program at the end of the term of the Governing Documents than for those who trade in their old ownership interest for a new ownership interest. The remarketing fee also will likely be higher as a form of liquidated damages payable by those whose participation in the program is terminated due to a default under the Governing Documents.

Methods and assumptions used in determining the fair market value. The Purchase Agreement may specify certain methods or assumptions for determining the fair market value of an ownership interest in an aircraft. In most fractional programs, the fair market value of an ownership interest in an aircraft will be the fair market value of the aircraft in which the customer owns an interest, multiplied by the percentage of the customer's ownership interest. In some fractional programs, however, the fair market value of an interest may instead be based on the average fair market value of all or a specified number of aircraft of a particular make and model within the fractional program. The former method leaves each customer vulnerable to factors that may adversely affect a particular aircraft, while the latter method spreads risk among all customers in the program. Factors that may affect the fair market value of an aircraft include a history of damage,

deferred maintenance, and excessive flight hours and cycles on the airframe and engines resulting from use of the aircraft in commercial charter operations at times when the aircraft is not being used by a fractional customer. Regardless of whether the fleet average or individual aircraft method is used, it may be possible to limit the risk of comparatively low market valuations by negotiating provisions in the agreement specifying that aircraft values will be based on certain presumptions notwithstanding the actual condition of the aircraft. Commonly negotiated provisions in this area include presumptions that the aircraft will have no damage history, that the airframe and engines will be at the mid-point between major inspections and overhauls, and that the total number of flight hours and/or cycles on the aircraft will not exceed a certain limit.

The Management Agreement

The Management Agreement typically is the most comprehensive of the Governing Documents and deserves the greatest attention. The agreement sets forth the terms and conditions of the management of the customer's ownership interest, the rights of the customer to use of program aircraft, and all charges payable by the customer for flight services. The agreement will cover a wide variety of issues. Among these are general management and administration of the aircraft and aircraft records, the fractional program's obligations to inspect and maintain the aircraft and to furnish trained and qualified pilots for all flights, the level of catering services that will be provided, the geographical service areas in which program aircraft may be operated, scheduling of program aircraft, ferrying and miscellaneous charges, minimum charges for use of program aircraft, upgrade-downgrade rights, monthly and hourly fees, excise taxes, the number of hours of use of program aircraft to which the customer is entitled, operational control of program aircraft, substitution of ownership interests, and the types and amounts of insurance coverages that the fractional program will provide. A few of the more important topics covered in the Management Agreement are discussed below.

Operational control of fractional program aircraft. Perhaps no provision of the Governing Documents is more confounding to the prospective fractional customer than the provision that addresses operational control. As stated above, in order to design a fractional program that would be permitted to operate under FAR Part 91, it was necessary for the developers of the traditional fractional concept to devise a means of providing their customers with both an aircraft and all the pilot and management services necessary for the operation of the aircraft, while simultaneously ensuring that operational control of the aircraft during any given flight was vested in the fractional customer for whom the flight was operated. Most fractional Management Agreements will, therefore, contain at least one provision specifying that operational control of program aircraft will be vested in the customer. The importance of a clear understanding of the consequences of this provision cannot be overstated. A simple reading of the regulatory definition of operational control as being the "exercise of authority over initiating, conducting, or terminating a flight" often does not convey to prospective fractional customers the full meaning and importance of the term. In short, the person or company that has operational control is legally the operator of the aircraft, and hence may bear ultimate responsibility for all operations of the aircraft. Although many fractional customers view their purchase of an aircraft ownership interest and membership in the program as little more than the purchase of a specified number of chartered flight hours, fractional customers in fact are not on the same legal footing as customers of traditional on-demand charter operators. Customers of on-demand charter operators are passengers, have no responsibility whatsoever for the condition or operation of the aircraft, and are entitled to the benefits of the increased level of safety afforded by FAR Part 135. In contrast, customers of traditional fractional programs are considered aircraft operators, not passive passengers, and the fractional program in this context is not an aircraft operator, but rather a contractor employed for the purpose of assisting the customer in the operation of the aircraft. Thus, unlike the passive customer of an on-demand charter operator, the fractional customer potentially could be held liable for any violation of any law or regulation that occurs during the customer's flight, or be subjected to claims for damages following an accident or an incident involving either the aircraft in which the customer owns an interest, or an accident or incident

involving another aircraft while the aircraft is being used by the customer pursuant to an interchange agreement.

Monthly and hourly fees. Virtually every fractional program charges both monthly and hourly fees for use of program aircraft. Typically, the monthly fee is intended to reimburse the fractional program for fixed monthly operating expenses such as hangar space, insurance, pilot salaries, and administration overhead, and the hourly fee is intended to reimburse the fractional program for direct operating expenses incurred in connection with flight operations, such as fuel costs and maintenance reserves.

Most multiyear fractional Management Agreements provide for annual increases in monthly and hourly fees. Often such increases are tied to a specific consumer price index, but many Management Agreements permit the fractional program to increase its fees by a certain minimum percentage each year even if the increase in the specified consumer price index does not reach the set minimum percentage. A minimum annual increase of 3 to 4 percent is not uncommon.

In addition to annual increases, most fractional Management Agreements provide for fluctuations in the hourly fees that are tied to fluctuations in fuel costs. In some cases the agreement allows for both increases and decreases in the hourly fees, thus passing on both the benefits of fuel cost reductions, and the burdens of fuel cost increases, to the customer. In other cases, however, the agreement provides only for possible increases in the hourly fees.

Excise taxes. Most fractional program Management Agreements require the fractional program to collect from the customer and remit to the Internal Revenue Service (IRS) an excise tax on amounts paid for the transportation of persons and property by air. This tax, commonly referred to as the "FET", is currently imposed on domestic flights at the rate of 7.5 percent of the total amount paid for the transportation, plus $2.75 per person per flight segment. A variety of special rules not discussed in this article apply to international flights and flights to or from Alaska and Hawaii.

The FET is generally considered to be a tax on commercial transportation. As traditional fractional programs are structured to be operated in accordance with the noncommercial regulations of FAR Part 91, many fractional programs believed, prior to 1997, that operations of aircraft in fractional programs would be treated as noncommercial for excise tax purposes as well. The U.S. Court of Appeals for the Federal Circuit disabused the fractional industry of that notion when it sided with the Internal Revenue Service and held in Executive Jet Aviation, Inc., that operations of aircraft in fractional programs were commercial operations and subject to the FET.
The Executive Jet Aviation decision addressed only the application of the FET to hourly fees; the issue of whether the FET may also apply to monthly fees was not before the court. While neither the Executive Jet Aviation decision nor any published guidance from the IRS appears to require fractional programs to collect FET taxes on monthly fees, neither does the Executive Jet Aviation decision nor any published guidance from the IRS provide to the contrary.

Although the law is not clear as to the issue of whether the FET applies to monthly fees paid by fractional program customers, the law is clear that any person who has a duty to collect and remit any FET taxes and fails to do so may be held liable for payment of the uncollected taxes. In order to avoid a potentially devastating liability for failure to collect such taxes in the event the IRS asserts applicability of the FET to fractional program monthly fees, some fractional programs have begun to collect and remit such taxes voluntarily. Customers in these programs consequently bear a greater excise tax burden than customers of other fractional programs for similar service. Customers in fractional programs that do not collect FET taxes on monthly fees could, however, eventually be held liable for such taxes should the IRS eventually assert applicability of the FET to monthly fees. Such liability may result from claims by the IRS for unpaid taxes. It is more likely, however, that the IRS would assert any such claim against the fractional program, in which case any claim against the fractional customer would likely be brought pursuant to a tax indemnification clause in the Management Agreement.

Hours of use of program aircraft to which the customer is entitled. Virtually all-fractional Management Agreements restrict the number of hours that a customer may use aircraft within the program. This

is necessary to ensure that each customer in the fractional program has a fair opportunity to use program aircraft, and that customer demand will not, on average, exceed supply. The total number of flight hours available to each fractional owner each year usually is limited to a number that corresponds to such fractional owner's ownership fraction (e.g., 100 hours per year for a 1/8 interest, 200 hours per year for a 1/4 interest). In most fractional programs, a customer who does not use all the flight hours available to the customer during a year will be permitted to use some or all of the unused hours in the succeeding year. In some fractional programs, extra flight hours may be obtained in any given year by paying a surcharge in addition to the hourly rate. Surcharges as much as 100 to 200 percent of the hourly rate are not uncommon. In other fractional programs, customers may be able to obtain extra flight hours in a given year by accelerating use of a portion of the hours that would otherwise be available to the customer in the succeeding year. This, of course, reduces the number of hours that will be available to the customer in the succeeding year. Some fractional programs that permit their customers to accelerate the use of hours also charge a surcharge in addition to the hourly rate for each flight hour that is accelerated. Customers in such programs are not able to obtain a higher total number of flight hours over the course of a multiyear contract, but will end up paying a higher total cost over the course of the multiyear contract if they avail themselves of their rights to accelerated use of flight hours.

Substitution of ownership interests. Most fractional program Management Agreements contain a provision permitting the fractional program to substitute an ownership interest in one aircraft for an equivalent ownership interest in another aircraft under either of two conditions. One condition is an event of the destruction, theft, or other total loss of the aircraft in which the customer owns an interest. A typical fractional Management Agreement will grant the fractional program the option of either giving the customer an equivalent ownership interest in another program aircraft, in which case the fractional program would be entitled to retain any insurance or other proceeds that may be recovered, or paying out all insurance or other proceeds that may be recovered to the customer and terminating all Governing Documents.

Another condition under which a fractional Management Agreement may permit a substitution is a determination by the fractional program itself that it is in the best interests of the fractional program to do so. This provision facilitates the simultaneous re-purchase by the fractional program of all the outstanding ownership interests in a particular aircraft when the fractional program determines that a particular aircraft has reached the end of its useful life and should be rotated out of the program and replaced with a newer aircraft. Most fractional Management Agreements specify that any substituted interest will be in an aircraft of the same make and model, and of equal or greater market value, as the original interest, and that the substitution will be made at no cost to the customer.

The Owners Agreement

The Owners Agreement, also known as the Interest Holders Agreement, is an agreement by and among the various owners of a particular aircraft. Typically, the fractional program provides the form of the agreement, but will not be a party to the agreement. The Owners Agreement usually specifies the nature of the relationship among the owners, which typically is that of tenants in common, and contains an agreement by the owners that the aircraft will be enrolled in the fractional ownership program managed by the fractional program. The Owners Agreement should specify that each party will be severally, but not jointly, responsible for its pro rata share of the costs of operating the aircraft, and be entitled to its pro rata share of all tax depreciation benefits, if any, arising from its ownership interest in the aircraft.

Prospective fractional customers often attempt to negotiate changes to the fractional program's form Governing Documents, including the Owners Agreement, and virtually all fractional programs are willing, to varying degrees, to accept proposed changes. It is doubtful, however, whether negotiated changes to the form Owners Agreement would be given effect in a court of law or other legal forum. In fact, in such a setting negotiated changes may serve only to confuse whatever issue may be at bar. The reason for this is that the parties against whom a complaining party would be required to enforce any negotiated change to the Owners Agreement likely would not have agreed to the negotiated changes, nor to

have been a party to, or even to have been aware of, the negotiations that resulted in the changes. As stated above, the fractional program typically is not a party to the Owners Agreement. Rather, the Owners Agreement is an agreement by and among the various owners of a particular aircraft. Each owner typically becomes a party to the agreement by executing a signature counterpart when it acquires its ownership interest in the aircraft, which may or may not coincide with the time any other owner becomes a party to the agreement. Furthermore, the Owners Agreement presented to any prospective fractional customer for signature may or may not list the identities of persons who have previously executed signature counterparts. In fact, some fractional programs will neither disclose to a prospective fractional customer the identities of the existing parties to an Owners Agreement, nor disclose to the existing parties the identity of any person who subsequently becomes a party to the agreement. The result of this procedure is that several unreconciled versions of an Owners Agreement affecting a single aircraft may exist because each party to the agreement may have negotiated changes to the agreement. However, in each case the changes likely may never have been approved, or even presented to, any other party to the agreement, and hence may not be enforceable against any other party to the agreement.

The Interchange Agreement

The Interchange Agreement, also known as a Master Cross-Leasing Agreement, is an agreement by and among all of the customers in a fractional program. The agreement facilitates the sharing of all aircraft managed by the fractional program by and among all of the fractional program's customers. The agreement serves as a lease pursuant to which each owner of a fractional interest in an aircraft agrees to lease its interest in the aircraft, from time to time and on an as needed basis, to each other owner of a fractional interest in an aircraft managed by the fractional program. Typically no monetary rent is charged for use of an aircraft pursuant to an Interchange Agreement. Rather, consideration for use of an aircraft under the agreement by one party is in the form of a grant to each other party of the right to use the fractional ownership interest owned by the first party. The fractional program itself may or may not be a party to a fractional Interchange Agreement. In fractional programs in which the fractional program is a party to the fractional Interchange Agreement, the fractional program likely will be a party solely for the purpose of being delegated responsibility and authority for coordinating the interchange of aircraft among the remaining parties.

Most fractional Interchange Agreements are structured as "dry" leases. In industry parlance, a lease is usually considered dry if the lessor provides only the aircraft itself to the lessee, and does not provide a flight crew or substantial additional services. Thus, a typical fractional Interchange Agreement should not be confused with an Interchange Agreement of the kind defined in 14 C.F.R. § 91.501(c)(2). An Interchange Agreement within the meaning of 14 C.F.R. § 91.501(c)(2) is usually considered a "wet" lease in aviation circles as the regulation contemplates reciprocal leasing of aircraft between two persons with each party providing a fully crewed, fueled, and insured aircraft to the other party for any given flight. In contrast to the regulatory variety of Interchange Agreements, each party using an aircraft pursuant to a fractional Interchange Agreement obtains all flight crew and other services necessary to operate the aircraft pursuant to its own Management Agreement with the fractional program.

Negotiated changes to fractional Interchange Agreements are subject to the same problems as negotiated changes to Owners Agreements. As stated above, the Interchange Agreement is an agreement by and among each of the customers in a fractional program, and it is highly unlikely that any negotiations or purported agreements concerning proposed changes to Interchange Agreements will occur among all the parties involved.

Recent Innovations in the Fractional Market

One current trend in the industry is to reduce barriers to entry into the market by reducing the up-front costs of entering a fractional program. The purchase price for even a relatively small fraction of some aircraft types can run into the millions of dollars. To some would-be business aircraft users, an initial investment of such magnitude may be a significant barrier to entry. Some fractional programs have attempted to address this problem by developing close relationships with finance and leasing companies

that understand the fractional industry and that will finance the purchase of fractional aircraft interests for customers. Financing may be in the form of a traditional purchase money loan secured by a chattel mortgage, or the finance company may purchase the fractional interest and lease it to the customer on an operating lease or financing lease basis.

Another method of reducing up-front costs is for the fractional program to lease a fractional interest in an aircraft, or sell use of an aircraft for a specific number of flight hours, directly to the customer. Often referred to as "block charter" arrangements, this type of program is indistinguishable from traditional charter operations from a regulatory perspective, and, in fact, probably will be operated under the commercial charter provisions of FAR Part 135 rather than the general operating rules of FAR Part 91 that apply to most other fractional programs. The advantage of a block-charter fractional is that it is essentially a traditional on-demand charter, but with the increased reliability and guaranteed service offered by traditional fractional companies.

Other innovations in the market today include the development of programs operated exclusively in accordance with FAR Part 135, and the ability and willingness of fractional programs to offer a greater degree of customization of business terms and conditions to meet the needs of specific clients than was possible just a few years ago. Customized terms and conditions may include shorter overall terms and early out provisions, flexible structuring of deals to satisfy individual customers' tax planning objectives, and the customer's ability to authorize the fractional program to use any of the customer's unused allocated flight hours to charter the aircraft to third parties on the customer's behalf with a portion of the charter proceeds being payable to the customer.

The Future of Fractional Ownership: Proposed Subpart K

Despite the fact that fractional ownership programs have existed and operated ostensibly under FAR Part 91 for a decade and a half, policy makers at the Federal Aviation Administration (FAA) have yet to formally declare that such programs do not fall within the scope of FAR Part 135. In order to address the regulatory issues surrounding fractional programs, in October 1999, the FAA established a Fractional Ownership Aviation Rulemaking Committee consisting of 27 members selected from government and the business aviation industry. The committee, known as "FOARC", studied the relevant issues and determined that a new subpart under FAR Part 91 should be adopted to regulate fractional ownership programs. The FOARC presented its proposal to the FAA on February 23, 2000, in the form of a draft Notice of Proposed Rulemaking. The draft proposes to add a subpart K to FAR Part 91 that would define and govern fractional ownership operations. The draft also proposes to amend certain portions of FAR Parts 119, 125, 135, and subpart F of FAR Part 91.

Subpart K, if adopted as proposed, would codify many elements of the traditional fractional concept, and would establish a variety of safety-related regulatory requirements similar to those that apply to operations under FAR Part 135. It is unclear what effect, if any, the adoption of subpart K would have on existing programs that share some of the elements of a traditional fractional program. Section 91.1001 of proposed subpart K specifically defines what constitutes a fractional ownership program. However nothing in subpart K appears to prohibit a program that has some of the characteristics of a fractional program from operating under FAR Part 91 outside of the bounds of subpart K in much the same manner as they do now. In this respect, subpart K appears to be optional. There is tremendous variation in the structures of fractional ownership and other types of shared aircraft programs in existence today, and nothing in proposed subpart K appears to indicate that structures that are somewhere on the continuum between traditional joint ownership and subpart K fractional will suddenly become illegal. Consequently, if proposed subpart K is ultimately adopted in its present form, the FAA may have to take the further step of affirmatively banning certain types of operating structures in order to force operators into subpart K.

The administrator of the FAA is reported to have recently signed off on the draft proposal for subpart K. The draft has since been forwarded to the Department of Transportation Office of Management and Budget for review.

Conclusion

Fractional aircraft ownership programs are here to stay. How the programs will evolve and what they will look like in ten years remains to be seen. Over the next several years, the business aviation sector will likely see more innovation as newer and smaller fractional programs search for ways to differentiate themselves from the larger, more established fractional programs. Implementation of proposed subpart K could effectively restrict further innovation, or even require some programs to abandon certain innovations in order to fit within proposed subpart K's definition of a fractional ownership program. On the other hand, it may be just as possible that implementation of subpart K may have little or no impact on the ability of fractional programs to continue introducing new and innovative twists to fractional programs, except perhaps to require such companies to drop the word "fractional" from their marketing literature in order to avoid coming within the scope of subpart K. All that is certain at this point is that the introduction and development of fractional ownership programs have already substantially reduced barriers to entry into the business aviation marketplace and permitted hundreds, and perhaps thousands, of businesses and individuals who previously were excluded from the market to realize the benefits of businesses aviation, and in doing so has been the catalyst for the greatest expansion in business aircraft manufacturing in decades. As barriers to entry fall further, it is likely that an even greater number of businesses and individuals who previously could not afford to participate in the business aviation marketplace will enter the market.

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