

Fraud Accusations Fly: Family Airlines Investors Fight Beleaguered Owner for Control of Company

By JESUS SANCHEZ
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TIMES STAFF WRITER

After taking out personal loans and cashing out his credit cards, Stillman Sprague raised \$50,000 last September and became an investor and pilot in Family Airlines.

Created by a former Los Angeles businessman who promised cheap coast-to-coast flights, Family attracted Sprague with the excitement of an airline start-up as well as a generous salary and the potential profit of ownership. But eight months later, the 41-year-old Orange County resident has yet to fly a plane or reap a profit.

Family Airlines' only plane--a 747 jumbo jet painted in bright red, white and blue--has never carried a paying passenger and remains grounded at a San Bernardino airport. Meanwhile, about 100 pilot-investors and founder Barry Michaels remain locked in a bitter feud for control of the nascent airline.

Attorneys for about 50 Family pilots said they will try to oust Michaels today when they ask a federal judge in Las Vegas, where the company is headquartered, to put the airline into receivership.

In a lawsuit filed earlier this month in federal court in Las Vegas, several Family pilots claim that Michaels violated securities laws, misrepresented himself about the use of the start-up funds and failed to disclose previous lawsuits alleging that he engaged in fraudulent practices with previous businesses. The suit claims that Michaels used Family Airline funds for personal reasons and borrowed \$50,000 from the company.

The pilots fear that Family and their investment will disappear if Michaels is not removed quickly.

"I still think that we got a shot," said Sprague, a cargo jet pilot. "But I think we have done ourselves damage in the eyes of the public."

Michaels, in turn, has filed his own suit, claiming that several of the pilots and investors have misled the Department of Transportation in an attempt to get the agency to oust him as head of the airline.

"I built a legitimate airline," Michaels said. Even if the pilots do win control of the carrier, Michaels said they face an uphill fight without him.

"I don't think they have anybody who has the entrepreneurial skills that I do," he said.

Michaels--who had never worked at an airline before--has been sued several times, filed for bankruptcy protection and was jailed once over his business practices in Southern California. But the ambitious and

determined entrepreneur nevertheless raised nearly \$3 million from veteran pilots--many of whom were unemployed and eager to fly again--and nearly won the approval of federal transportation regulators.

While the pilots and Michaels battle each other, the Department of Transportation earlier this month ordered Michaels and his wife, Holly, to relinquish control and ownership of Family Airlines as a condition of agency approval of the carrier. Michaels had until last Friday to respond to the order, but had not done so as of Monday, according to agency officials.

The DOT issued the order after being informed of at least a dozen lawsuits and judgments filed against Michaels and his companies in Los Angeles and Orange County courts during the last decade. Suppliers and landlords have sued Michaels for fraud and breach of contract for failing to make payments, according to court documents.

In 1982, Michaels filed to liquidate his holdings under Chapter 7 of the federal bankruptcy code, and he also served four months at the Federal Correctional Institution in Safford, Ariz., on a mail fraud charge, according to the Federal Bureau of Prisons.

The 52-year New York native and his former Encino hair and skin care products firm were charged again with fraud in lawsuits filed last summer as he organized Family Airlines.

Michaels, while admitting previous legal and business difficulties, said they are irrelevant to his current efforts. He publicly defended himself in a letter to President Clinton in an advertisement last week in the Washington Post.

“The Department of Transportation, it would appear, seems more interested in my irrelevant past than in the future of Family Airlines and the traveling public,” Michaels wrote.

Michaels’ business practices were an unwelcome surprise to federal regulators and Family’s investors.

“I can understand that entrepreneurial people are sued,” said one Family employee and a former airline pilot. “But there are unsavory things (in Michaels’ past) and I would not have invested if I had known.”

Many of the pilots were former Pan Am employees who found themselves jobless after the carrier stopped flying in December, 1991. Trapped in a deep industry slump, most of the pilots are in their fifties and would have to start at the bottom of the pay scale at the few jobs that were available.

“They were a vulnerable group in that they were just laid off from Pan Am,” a pilot said. “The guys are buddies of mine. A start-up airline is a very high-risk venture. But we were willing to face that risk and put in hard work.”

Family offered top pay for the three-member crews needed to fly its proposed fleet of 747 jumbo jets. Before sitting in the cockpit, however, Michaels required an upfront investment first: a minimum of \$30,000 for flight engineers, \$35,000 for co-pilots and \$50,000 for captains.

“I didn’t have a choice,” said one laid-off pilot who invested \$65,000 and is worried that he will not see his money again. “There are not many jobs around for 747 pilots.”

Many pilots grew increasingly worried with every delay--Family had initially planned to begin service last December--and finally many revolted when they learned about Michaels’ past.

The DOT also grew alarmed after receiving an anonymous tip about Michaels’ legal and business problems, which had escaped an initial review. In Family’s application to the DOT last September, Michaels denied having been charged with deceptive and unfair business practices within the last 10 years or being subject to outstanding judgments.

“We looked again into their application,” said Kathy Cooperstein, the DOT analyst in charge of the Family Airlines case. “They lied.”

Before moving to Las Vegas from Los Angeles late last year, Michaels had run companies involved in printing, chemicals, shampoos and skin care.

Cindy Martin, a longtime acquaintance of Michaels, worked for him as a bookkeeper at Level Care, a fast-growing Huntington Beach-based shampoo company Michaels headed in the mid-1980s. Despite nationwide sales of \$350,000 a month, many of Level Care’s suppliers often went unpaid, according to employees, lawsuits and company documents, said Martin, who claims that Michaels owes her \$13,000 in unpaid wages.

Michaels kept turning to his investors for more cash.

“He kept needing more money and more money,” said one Los Angeles real estate broker who invested more than \$50,000 in Level Care but received only a single \$48 dividend check. “He kept telling us how great it was doing. We all just wanted to believe. He seemed to be very convincing.”

Investors finally forced Michaels out and put the company into receivership in July, 1988, and it later went out of business.