



Leasing Structures and Associated Risks

Avoiding Illegal Charter Operations

By Jeff Whalen, Todd Dixon, and Mary Comazzi

In recent years, the Federal Aviation Administration (FAA) has progressively increased its scrutiny of the operation of aircraft conducted under 14 CFR 91, which is Part 91 of the Federal Aviation Regulations (FARs) pertaining to flights that are not operated for compensation or hire.¹ The FAA's objective is protecting consumers and ensuring that commercial flights are operated in a safe manner.

An informational letter circulated by the FAA in May 2020 reminds pilots of common operational pitfalls that could unwittingly cause an ordinary personal or business flight to be considered an illegal charter; that is, a flight for compensation

or hire without proper authority from the FAA.² These pitfalls include common business arrangements or liability-structuring methods that are perfectly acceptable in many other business settings, such as placing and operating the aircraft in a single-purpose limited liability company, allowing passengers to reimburse for fuel or other flight costs, and providing a pilot with the aircraft through a lease agreement. At a glance, these pitfalls might seem benign, but the underlying regulations are directly related to the safety and certification requirements in the FARs, and the FAA takes an unwavering position prohibiting such activities. If a flight is considered an illegal charter,

At a Glance

Common operational pitfalls could unwittingly cause an ordinary personal or business flight to be considered an illegal charter — a flight for compensation or hire without proper authority from the FAA. These pitfalls might seem benign, but if a flight is considered an illegal charter, the FAA may pursue significant monetary penalties against aircraft owners or operators, take certificate actions against pilots, and invalidate insurance coverage.

the FAA may pursue significant monetary penalties against aircraft owners or operators, take certificate actions against pilots, and invalidate insurance coverage.

Under the FARs, flights operated for “compensation or hire” are subject to strict regulatory standards. A typical flight by a major air carrier such as American Airlines or Delta Airlines is operated under Part 121 of the FARs,³ which requires certification by the FAA and the Department of Transportation, and operators are subject to a high level of oversight and scrutiny. Charter flights are typically operated under Part 135 of the FARs,⁴ which also requires the operator to be certified by the FAA and comply with strict maintenance and operational standards.

Part 91 applies to flights which are not operated for “compensation or hire.”⁵ Operations under Part 91 offer more flexibility, particularly in areas such as required personnel and policies, pilot duty days, aircraft maintenance, operation during various weather conditions, and runway length. Though it is more flexible, operators conducting flights under Part 91 must be cautious and avoid activities that may be considered operations for compensation or hire or otherwise requiring certification by the FAA, including those identified below.

Is the flight a commercial operation for compensation or hire?

As previously noted, commercial operations require appropriate FAA certification. Commercial operations, as viewed by the FAA, are those in which the operator of the aircraft is carrying persons or property for compensation or hire. A key question regarding any flight is, “Who is the operator?” The FAA presumes the registered owner of the aircraft is the operator and has “operational control” of the aircraft.⁶ Operational control can be transferred to another operator by leasing the aircraft to another person.⁷ Accordingly, unless there is a lease in place, the FAA will start with the presumption that the aircraft’s registered owner is the operator.

Once the operator is identified, we can determine if a flight is operated for compensation or hire. The FAA construes “compensation” very broadly; it considers any value in any amount across any boundaries paid for the flight to be compensation. A profit motive is not required, and compensation can simply include the sharing of costs. The test to determine whether an entity is operating a flight for compensation or hire is whether the carriage by air is merely incidental to the person’s other business or is, in itself, a major enterprise for profit. When determining whether a person is operating for hire, the FAA will consider whether the operator is “holding out” or is a “common carrier” based on the operator’s conduct, such as providing air transportation to the public, advertising online, or providing flight crews through a related entity.⁸

The flight department company trap

As lawyers, we are trained to reduce our client’s exposure to potential liability, such as liability arising from an aircraft accident. When our client purchases an aircraft, our first instinct is to shield the client’s other assets or businesses from the potential liabilities arising from aircraft operations and ownership by placing the aircraft in a separate, sole purpose, limited liability company. Often, such a limited liability company with no other assets or ongoing business holds title to and operates the aircraft. This is illegal. The FAA does not recognize the concept of a disregarded entity, and this type of structure implicates the FAA’s so-called “flight department company trap.”⁹

With the ownership and operation of a corporate aircraft, liability protection cannot be viewed in isolation. FARs must also be considered in order to avoid violations and limit or mitigate liability. Placing aircraft operations in a separate entity whose primary or sole purpose is to operate the aircraft would not comply with the FARs. In such a structure, FAR 91.501 clearly indicates that Part 91 (non-commercial) aircraft operations by a company are limited to those in which “the carriage is within the scope of, and incidental to, the business of the company (other than transportation by air).”¹⁰ Since the business of the sole-purpose entity would be transportation by air, it does not meet the requirements for Part 91 operations. The FAA refers to such operations as flight department companies,¹¹ and the flight department company structure should be avoided at all costs.

One way to avoid the flight department company trap is to dry-lease the aircraft to an operating company with an ongoing business that is not transportation by air. (Dry-leasing, discussed in greater detail below, involves a lease that transfers possession and use of only the aircraft itself.) If the goal is mitigating liability, a better (legal) way to achieve that goal is maintaining as much aviation liability insurance as possible.

The flight department company trap is particularly confounding because, at first glance, it does not seem like the single purpose entity will receive any compensation. The

operation of an aircraft involves significant capital requirements, however. If the single-purpose owner does not have a trade or business outside of owning and operating the aircraft, it is probably funded by capital contributions, which the FAA views as compensation.¹²

By way of demonstration, consider the following hypothetical situation. The registered owner of an aircraft is a limited liability company created solely for the purpose of owning the aircraft (Title Holding LLC). Title Holding LLC is a subsidiary of a business with multiple affiliated entities. Title Holding LLC hires pilots and is funded through the capital contributions of its parent company. In this scenario, the FAA considers Title Holding LLC a flight department company. In the event of an incident or a ramp check (a pre- or post-flight inspection of the aircraft by an FAA inspector), the FAA would likely charge the flight department company with a violation for operating a charter flight without the required charter air carrier certificate.

The FAA's broad definition of compensation also creates other pitfalls. If an operator invites passengers onto the aircraft, the passengers may want to reimburse the operator or trade time on each other's aircraft. Additionally, a business with multiple affiliates — like Title Holding LLC in our hypothetical situation — may want reimbursement from its affiliates for use of the company aircraft. Except in the limited situations discussed below, these actions are considered compensation and render a Part 91 flight an illegal charter.

Permissible cost-sharing structures under 14 CFR 91.501

There are limited circumstances where cost sharing is permitted in connection with a Part 91 flight. The permitted arrangements are enumerated in 14 CFR 91.501 and include time-sharing agreements, interchange agreements, and joint ownership agreements.

Under a time-sharing agreement, a company may lease its aircraft, with flight crew, to another individual or company for carriage of company officials, employees, and guests and receive reimbursement for the items listed in 14 CFR 91.501(d). An interchange agreement allows a person to lease an airplane to another person in exchange for equal time on the other person's airplane.¹³ A joint ownership agreement enables one of the registered joint owners of an airplane to furnish the flight crew and receive reimbursement for a share of those charges.¹⁴ 14 CFR 91.501(b)(5) also includes an affiliated-group exemption, which allows a company to charge for the

carriage of officials, employees, guests, and property of a company on an airplane operated by that company, or the parent or a subsidiary of the company or a subsidiary of the parent, when the carriage is within the scope of, and incidental to, the business of the company (other than transportation by air) and no charge, assessment or fee is made for the carriage in excess of the cost of owning, operating, and maintaining

the airplane, except that no charge of any kind may be made for the carriage of a guest of a company, when the carriage is not within the scope of, and incidental to, the business of that company.

The exceptions enumerated in 14 CFR 91.501 are narrow and unique because in certain situations, they allow the operator to provide both the aircraft and crew and receive compensation. In these situations, the lessor retains operational control and liability related to the flights. If the registered owner wants another person to operate the aircraft, it must dry-lease the aircraft.

Leasing an aircraft

The FAA separates leases for aircraft into two types: wet leases and dry leases. A wet lease is the lease of an aircraft plus any one crew member. Generally, the FAA does not permit wet leases absent the use of an exemption (such as those included in 14 CFR 91.501) or other authorization from the FAA (such as operating authority under Part 121 or Part 135).

A dry lease is a lease that transfers possession and use of only the aircraft itself and does not include crew members. Under current FAA guidance, the lease should indicate that the lessee is responsible for maintenance of the aircraft and specifically state who is responsible for operational control.¹⁵ Accordingly, under a dry lease, the lessee would need to provide its own crew members or contract for crew members separately. Leases of aircraft with a maximum takeoff weight of more than 12,500 pounds must comply with 14 CFR 91.23 which requires, among other things, that the lease be in writing and include a truth-in-leasing statement as the concluding paragraph, that a copy of the lease be provided to the FAA, and that the nearest FAA Flight Standards District Office be notified of the first flight.¹⁶

Under a dry lease, operational control, including liability for flight operations, is transferred to the lessee of the aircraft. The FAA scrutinizes dry leases to determine whether operational control has been transferred and meets the agency's requirements for a dry lease. The FAA may scrutinize the sourcing of flight crew members, including whether the aircraft and flight crew are furnished by separate, unrelated persons.¹⁷ Further, the FAA has taken the position that when the aircraft and crew are furnished by persons "acting in concert," operational control is placed with the lessor of the aircraft, the person furnishing the crew, or both.¹⁸

Recently, the FAA issued new guidance for inspectors in its Flight Standards Information Management System, setting forth other indicia of operational control that aviation safety inspectors can consider in determining whether a lease meets FAA requirements for a dry lease, such as who maintains the aircraft; who pays for insurance, the hangar, and other costs; and who bears regulatory and civil liability.¹⁹

Aircraft lessors and lessees should ensure that the requirements of 14 CFR 91.23 are met and lease agreements are

followed so the FAA considers any flight under the leases to be a Part 91 flight. Aircraft owners should avoid a proliferation of dry leases, which can be construed as holding out by the FAA.²⁰

Consequences of violating Part 91

The potential consequences of violating Part 91 can be severe. Aircraft operators and pilots could be subject to fines of more than \$14,000 per flight, and pilots could be subject to sanctions affecting their certification.²¹ More importantly, it is possible that an aviation insurance company would refuse to honor the claim because the flight department company did not have appropriate insurance coverage for a charter operation. Further, a resourceful plaintiff's attorney could pierce the corporate veil of a flight department company set up for an inappropriate purpose and seek to impose liability on the owning entity or individuals. The entity owning an aircraft should avoid these consequences by using appropriate cost-sharing and leasing methods. ■



Jeff Whalen dedicates his practice to assisting clients with aviation transactions. He has represented clients in the acquisition, financing, and operation of general aviation aircraft ranging from Boeing business jets to single-engine prop planes. Whalen also has experience with a wide variety of commercial aircraft transactions including aircraft and engine leasing, part outs, wet leases, and long-term charters.



Todd Dixon focuses his practice on aviation law. A retired military officer and pilot, he has structured aviation transactions including domestic and foreign-based aircraft purchases and sales, timeshare agreements, interchange agreements, joint and fractional ownership agreements, personal and executive use policies, state and local tax considerations, FAA registrations,

FAA enforcement actions, Cape Town Convention and International Registry matters, and aircraft leasing transactions.



Mary Comazzi assists clients with aviation transactions and issues. She has extensive experience structuring domestic and foreign-based aircraft purchases and sales, aircraft leasing agreements, tax considerations, timeshare and interchange agreements, joint and fractional ownership agreements, personal and executive use policies, FAA registrations, and Cape Town

Convention and International Registry matters. She also assists clients with aviation-related mergers, acquisitions, reorganizations, joint ventures, and other complex commercial transactions.

ENDNOTES

1. For a listing of the regulations, see Federal Aviation Admin, FAA Regulations <https://www.faa.gov/regulations_policies/faq_regulations/> [<https://perma.cc/2GTY-KCT6>]. All websites cited in this article were accessed July 4, 2021.
2. Informational Letter to Pilots (May 22, 2020), available at <https://www.faa.gov/about/initiatives/safe_charter_operations/media/Letter_to_Pilots.pdf> [<https://perma.cc/9DA7-KHWB>].
3. 14 CFR 121.
4. 14 CFR 135.
5. 14 CFR 91.
6. FAA Advisory Circular No. 91-37B, Truth in Leasing (February 10, 2016), available at <https://www.faa.gov/documentLibrary/media/Advisory_Circular/AC_91-37B.pdf> [<https://perma.cc/ZR55-B6C9>].
7. See Legal Interpretation to Eric L. Johnson from Rebecca B. MacPherson, Assistant Chief Counsel for Regulations, Federal Aviation Admin (August 11, 2011), available at <[https://www.faa.gov/about/office_org/headquarters_offices/agc/practice_areas/regulations/interpretations/data/interps/2011/johnson-johnson%20-%20\(2011\)%20legal%20interpretation.pdf](https://www.faa.gov/about/office_org/headquarters_offices/agc/practice_areas/regulations/interpretations/data/interps/2011/johnson-johnson%20-%20(2011)%20legal%20interpretation.pdf)> [<https://perma.cc/4K9U-GQXX>].
8. FAA Advisory Circular No. 120-12A, Private Carriage Versus Common Carriage of Persons or Property (April 24, 1986), available at <https://www.faa.gov/documentLibrary/media/Advisory_Circular/AC%20120-12A.pdf> [<https://perma.cc/R7VN-BMWWE>].
9. See Legal Interpretation to James E. Cooling from Lorelei Peter, Assistant Chief Counsel for Regulations, Federal Aviation Admin (August 22, 2017), available at <[https://www.faa.gov/about/office_org/headquarters_offices/agc/practice_areas/regulations/interpretations/data/interps/2017/cooling%20-%20\(2017\)%20legal%20interpretation.pdf](https://www.faa.gov/about/office_org/headquarters_offices/agc/practice_areas/regulations/interpretations/data/interps/2017/cooling%20-%20(2017)%20legal%20interpretation.pdf)> [<https://perma.cc/MX2D-U7AS>].
10. 14 CFR 91.501(b)(5).
11. See Legal Interpretation to Lawrence Williams from Lorelei Peter, Assistant Chief Counsel for Regulations, Federal Aviation Admin (December 4, 2017), available at <[https://www.faa.gov/about/office_org/headquarters_offices/agc/practice_areas/regulations/interpretations/data/interps/2017/Williams%20-%20\(2017\)%20legal%20interpretation.pdf](https://www.faa.gov/about/office_org/headquarters_offices/agc/practice_areas/regulations/interpretations/data/interps/2017/Williams%20-%20(2017)%20legal%20interpretation.pdf)> [<https://perma.cc/74WJ-68JM>].
12. See Legal Interpretation to James E. Cooling, n 9 *supra*.
13. 14 CFR 91.501(c)(2).
14. 14 CFR 91.501(c)(3).
15. FAA Advisory Circular No. 91-37B.
16. *Id.*
17. See Legal Interpretation to Eric L. Johnson, n 7 *supra*; FAA Advisory Circular No. 120-12A.
18. See Legal Interpretation to Jerry Eichenberger from Rebecca MacPherson, Assistant Counsel for Regulations, Federal Aviation Admin (August 26, 2011), available at <[https://www.faa.gov/about/office_org/headquarters_offices/agc/practice_areas/regulations/interpretations/Data/interps/2011/Eichenberger-EichenbergerBuckley%20-%20\(2011\)%20Legal%20Interpretation.pdf](https://www.faa.gov/about/office_org/headquarters_offices/agc/practice_areas/regulations/interpretations/Data/interps/2011/Eichenberger-EichenbergerBuckley%20-%20(2011)%20Legal%20Interpretation.pdf)> [<https://perma.cc/W3RH-FBWB8>].
19. FAA Order 8900.1 CHG 703, vol 3, ch 13, § 6, *Evaluate an Aircraft Lease Agreement for Regulatory Compliance Under § 91.23* (April 8, 2020), available at <<https://fsims.faa.gov/PICDetail.aspx?docId=8900.1,Vol.3,Ch13,Sec6>> [<https://perma.cc/SCF7-597X>].
20. FAA Advisory Circular No. 120-12A.
21. 14 CFR 13.14 and 14 CFR 13.18.