How to Structure “Charter- Management” Arrangements to Comply with FAA Requirements

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What are the Key Considerations in Setting up a Charter-Management Arrangement?

• Who is the aircraft owner and what are its needs?
  – turnkey versus more limited arrangements
  – charter-management versus pure management?
• FAA Regulatory issues affecting operations by aircraft owners and managers
• Other considerations:
  – Limiting liability exposure
  – State & Federal tax planning
  – Use by affiliated companies
  – Personal use by executives (tax and securities law implications)
  – Operational restrictions on FAR 135 flights
Structuring to Limit Owner Liability Exposure

Options and considerations:

• Have Charter-Manager operate all flights under FAR Part 135

• Have Owner operations in entity with limited assets – but face:
  – “Flight Department Company trap”
  – limitations of cost-sharing even within a corporate family

• Insurance coverage issues
Key FAA Regulation (FAR) Issues

- **FAR Part 91 - Private Operations**
  - Company/individual operating for own business/personal purposes
    - fewer operational restrictions
    - tax considerations

- **FAR Part 135 – Commercial Operations**
  - Air transportation for compensation or hire
  - Generally requires the operator to be certificated to operate under FAR Part 135 (on demand/air taxi)
Pure Management Arrangement

Widgets, Inc.
owns Aircraft and
is in operational control
of all flights of Aircraft
under FAR Part 91

Aircraft Management, Inc.
provides pilots, insurance,
maintenance, hangar, etc. to
Owner for Owner’s FAR
Part 91 flights

Management Agreement

Pure Charter Arrangement

Widgets, Inc.
owns Aircraft

Aircraft Charter, Inc.
provides pilots, insurance,
maintenance, hangar, etc.;
is in operational control for
all flights for Owner and
for 3rd Party charter
customers under FAR Part
135

Exclusive Dry Lease Agreement
Widgets, Inc. owns Aircraft and is in operational control of all flights of Aircraft under FAR Part 91.

Operational control shifts from Owner to Charter-Manager depending on purpose of the flight.

Aircraft Charter-Management, Inc.
1) provides pilots, insurance, maintenance, hangar, etc. to Owner for Owner’s FAR Part 91 flights
2) dry leases Aircraft and is in operational control for FAR Part 135 flights or 3rd party charter customers.

Aircraft Services / Management Agreement

Non Exclusive Dry Lease Agreement
FAA Concerns about “Operational Control” and Charter-Management

• Operational Control: The “exercise of authority over initiating, conducting or terminating a flight” [FAR 1.1]

• The party having operational control is responsible for the safety of the flight and liable for the actions and inactions of the pilots (whether employees or agents)

• The party who actually has operational control depends on the facts and circumstances surrounding the flight operation of the aircraft
Part 91 vs. Part 135

- Air transportation for compensation requires an Operating Certificate or Air Carrier Certificate to operate under Parts 135, 121 or 125
- "Compensation" according to the FAA
  - Reimbursement of operating expenses (fuel, landing fees)
  - Money does not need to change hands
  - “Compensation” can occur in the absence of profit
  - Monetary losses can still result in “Compensation”
Part 91 vs. Part 135 (cont.)

- Good will can be "compensation"
- Expectation of future economic benefits can be "compensation"
- Acquisition of pilot time can be “compensation”
- With a few exceptions, Part 91 requires owning/operating the aircraft by a company with a business purpose other than providing air transportation
  - FAR 91.501(c)
  - Dry Lease with separately contracted pilots
The “Flight Department Company Trap”

• “Flight Department” or “Sole Purpose” companies that are established solely to own and operate an aircraft that will provide transportation are not permitted under FAR Part 91

Widget Inc.
(large public company manufactures widgets)

Widget Inc. funds aircraft operator through periodic capital contributions

Widget Aviation LLC
(owns aircraft, employs pilots flies for Widget Inc. business, no other business)

Widget Aviation providing air transportation For compensation to Widget Inc.
The 134 ½ Structure
FAA Chief Counsel Memorandum of Feb. 20, 2013

A1, Inc. (owns aircraft, has no other business)

- Each investor enters into shareholder/participation Agreement
- buys $1000 in stock in A1
- is made a member of board of A1

A2, Inc. Provides management services to A1; employs pilots; does not hold 135 certificate

Management Agreement

A1 & A2 same officers, Same address; affiliated entities

Each investor can then lease an aircraft from A1 and pay monthly management fee; pay hourly fee for use of aircraft

Note: Unclear whether there was a separate pilot services agreement between owners & A2; and whether pilot fees were paid to A1 or A2?
Can the Owner Employ the Pilots?

• FAR Part 135 Operations – Qualified Yes
  – FAA has endorsed “agency agreements between pilot individually and charter-manager”
    • Oct. 24, 2012 FAA Chief Counsel Opinion
  – Pilots are subject to all training control requirements of Charter-Manager

• FAR Part 91 Operations - Yes
  – However issues related to affiliated company usage

• Charter-Manager hires Owner pilots as direct employees (pro/con)
John Widget III
(CEO of Widget, Inc)

JW Holding, LLC
(owns aircraft, has no other assets or operations)

100%

JW hires pilots from manager pays direct operating costs
For flights

Aircraft Charter-Management, Inc.

Third Party Charter Operations

Widget, Inc.

Widget, Inc. charters for JW business flights for Widget, Inc.
Insurance Issues

• Potential benefits of being on Charter-Manager’s policy
• Charter-Manager’s concerns with Owner policies
• Solution: Need to ensure that all parties are covered for their operations:
  – If owner/affiliate will be in operational control, it needs to be covered for its own negligent operations – not just for “operations of the named insured”
  – Waiver of subrogation, breach of warranty, etc.
  – Who is loss payee?
Federal & State Tax Considerations

• State Sales/Use tax
  – Base of operations
  – Air carrier exception in some states

• Federal Tax Issues
  – 7.5% Federal Excise Tax on air transportation
  – Effect on depreciation method/schedule
  – Current Issues on whether management fees are taxable air transportation
  – Personal/entertainment use by executives
FAR 91 Use by Affiliates and Executives

• Owner may want to charge affiliated entities for their use
  – FAR 91.501(b)(5) Intra-company reimbursement is limited to reimbursements for flights incidental to the business of the company operating the aircraft.
  – Executive personal use has tax/SEC implications if they don’t reimburse, but reimbursement limited:
    • Timesharing Agreement under FAR 91.501(b)(5)
    • Charter often is useful alternative
Operational Restrictions on FAR 135 Flights

• Flight and Duty Time
• Balanced Field Length
• Look-See Privilege
• International Flight Authorizations
• International Pilot Age Restrictions
• Cabotage
Charter-Management Agreements

• Charter-Management Agreement between Owner and Charter-Manager with non-exclusive dry lease language, OR

• Part 91 Management Agreement between Owner and Charter-Manager AND separate Non-Exclusive Dry Lease Agreement between Owner and Charter-Manager
Charter-Management Agreements (cont.)

• Charter-Manager provides pilots to Owner
  – Owner funds full-time dedicated pilots as part of fee; or
  – Owner pays day rate for any of a pool of pilots

• Agreement should clearly state that pilots are being provided to Owner for its Part 91 flights

• Agreement should address compensation, qualifications and training of pilots

• Agreement should address prohibition or permission for Owner to hire pilots post-agreement
Charter-Management Agreements (cont.)

• Charter-Manager manages maintenance for Owner
  – Agreement should clearly address compensation and qualifications of mechanics
  – Agreement should address parts markup/service fees (potential conflict of interest)
  – Agreement should address any hidden costs

• Agreement should clearly state that aircraft is being dry-leased to Charter-Manager for charter operations on a non-exclusive basis
Charter-Management Agreements (cont.)

• Agreement should clearly state that Charter-Manager must obtain/provide its own pilots meeting certain objective criteria for charter operations and that charter flights are flown by employees or agents of Charter-Manager.

• Agreement should address need for aircraft to be maintained under Part 135.

• Agreement clearly state who has operational control (Charter-Manager for Part 135 flights and Owner for Part 91 flights).
Charter-Management Agreements (cont.)

• Compensation
  – Charter-Manager customarily pays Owner a percentage of the charter revenue in lease payments
  – Owner pays monthly fee to Charter-Manager
  – Agreement should address how expenses incurred in connection with charter flights are divided between the two parties

• Agreement should address Owner’s potential sales tax liability on the lease payments and Charter-Manager’s Federal Excise Tax liability
Charter-Management Agreements (cont.)

- Agreement should address insurance, maintenance, fuel, hangar and liability issues
- Agreement should address exchange of aircraft/records and final payment when Agreement expires or is canceled
Conclusion

• There is no “one size fits all” when it comes to charter-management
  – Numerous factors go into structuring
  – Advance planning and up-front discussions with charter-manager are critical

– QUESTIONS?