



Charter Management and the FAA: An Update.

BY JOHN CRAIG WELLER

Galland, Kharasch, Greenberg, Fellman & Swirsky, P.C.

Background

In the November 2006 issue of World Aircraft Sales, we wrote about a new FAA initiative concerning “charter management” arrangements between business aircraft owners and charter operators. These arrangements allow a charter operator to offer Part 135 charter flights to the public on business aircraft not owned by the charter operator. These arrangements have worked well for many years and have benefited the charter operator, charter customers, and the business aircraft owner. The charter operator is able to offer a variety of business aircraft for charter without making the capital investment needed for ownership. The charter customer has access to a greater choice of aircraft at a lower cost. Finally, the aircraft owner gets some revenue from charter flights which helps defray aircraft ownership costs, and, with good advice, may enjoy substantial tax benefits as well.

The FAA’s concern about these arrangements arose out of the Challenger crash at Teterboro Airport in February 2005. The accident investigation revealed that, although the airplane was listed on a charter operator’s operations specifications (“Op Specs”), the actual operator of the aircraft had no FAA authority and the charter operator was unaware of the flight. In other words,

the charter operator had not maintained “operational control” of the accident flight. After the accident, the FAA inspected charter operators around the country and found more instances of a loss of operational control. While the FAA took enforcement action in some of these cases, it also decided that more specific oversight and guidance might prevent future problems. To this end, FAA Headquarters began an initiative to significantly expand its standard Op Spec paragraph, A008, to address operational control issues. The FAA also decided to prepare guidance material explaining the new Op Spec paragraph so that its inspectors and the industry would understand the new paragraph. Finally, it conducted a series of “road shows” around the country to explain the new paragraph to the industry and its inspectors, and to obtain input into the specific requirements of the new paragraph. In fact, industry representatives did provide significant input to the FAA on the provisions of the new Op Spec paragraph and the final version reflects that input. However, the FAA chose not to share the draft guidance material at road shows and no industry input was solicited on the guidance. This has proven to be significant.

The New Op Spec and Guidance

While issuance of the final version of the Op Spec and the associated guidance was delayed several times, it was finally issued on December 28, 2006. The FAA notice generally provides 60 days for issuance and compliance with the new Op Spec paragraph, although limited delays in compliance may be authorized. In general, the new Op Spec paragraph contained few surprises, and, with a couple of exceptions, did not impose insurmountable burdens on either the charter operator or the aircraft owner. However, the associated guidance (which only the FAA had seen) contained several big surprises and imposed new requirements that would force substantial changes in most charter management structures. In addition, these new requirements would appear to eliminate several significant tax planning opportunities for the aircraft owner.

First, we will briefly review some of the non-controversial aspects of the new Op Spec and then we will address the more problematic issues.

1. A charter operator always retains sole responsibility for operational control of all flights under its certificate, and is responsible for the actions (or inactions) of its direct employees and agents. However, a charter operator may delegate some authority and duties related to fulfilling these responsibilities.

2. A charter operator cannot “franchise” or share the responsibility for operational control with any other person. It may also not use any “doing business as” (DBA) in a way that makes it appear that an uncertificated person has authority as a charter operator. In general, an operator may not use any

DBA that is in any way related to an entity not holding FAA charter authority. However, the guidance does provide limited exceptions for certain specialized operations such as emergency medical transportation.

3. A charter operator must ensure that there are no restrictions or prohibitions in any documents relating to the aircraft (such as leases, loan documents or insurance policies) that would affect aircraft operations under Part 135 or that would adversely affect the operator’s operational control responsibility.

4. A charter operator must have a system described in the Op Spec that ensures that all pilots who operate Part 135 flights are properly qualified and trained in accordance with Part 135 requirements and the operator’s FAA-approved training program.

5. A charter operator must have a system described in the Op Spec to ensure that all aircraft listed on its certificate are continuously inspected and maintained under the operator’s FAA-approved maintenance program, even when the aircraft is in the aircraft owner’s custody and is flown under Part 91, or it must have a system to ensure that an appropriate airworthiness conformity check is accomplished after flights under Part 91 before the aircraft is again flown under Part 135.

All of the issues listed above were thoroughly discussed between the FAA and industry representatives during the nearly year-long process of developing the new Op Spec. However, the new guidance material that is supposed to explain how the Op Spec requirements work added some surprising and problematic new issues. Most of these

new issues relate to the economic and business relationship between the aircraft owner and the charter operator. For that reason, they do not appear to have any direct affect on safety which should be the FAA's only concern. (The U.S. Department of Transportation (DOT) has jurisdiction over economic issues affecting charter operators.) The FAA provided no evidence that these economic issues had any effect on safety nor did it explain why it chose to, in effect, regulate such economic issues rather than deferring to the DOT.

The most serious economic issue concerns payment of pilots. In several places, the new Op Spec states that pilots must be either direct employees or agents of the charter operator. If the pilots are already employed by the aircraft owner, the Op Spec says that these pilots can be used by the charter operator - provided there is an independent agency agreement between the pilots and the charter operator. However, the FAA guidance inexplicably states that if a pilot receives monetary compensation for flying a Part 135 flight that is paid by the aircraft owner, then the owner is "providing" the pilot to the charter operator and, therefore, the charter operator does not retain operational control of the Part 135 flight.

This guidance, which is accompanied by no explanation, would outlaw the pilot provisions in most current charter management arrangements. Currently, if the charter operator employs the pilots, the owner reimburses the charter operator for the pilots' salaries and benefits. If the owner employs the pilots, the charter operator assumes control of the pilots for all Part 135 flights, even though the pilots get a

paycheck from the owner and not the charter operator. Finally, in some cases, the pilots' employer is an independent aircraft management company that is reimbursed by the owner. It appears that none of these arrangements would pass muster under the FAA's new guidance.

The FAA guidance material also provides that a charter operator must bear the financial accountability for its own operations. Once again, no explanation given for why this issue affects safety, or how it might be applied. Therefore, an arrangement where a charter customer agreed to bear some or all of the financial risk of a particular operation because the charter service was tailored to the customer's unique needs would apparently not be permitted under this guidance. Moreover, all charter operators are required by DOT rules to have specified insurance coverage for their charter flights. Does this insurance shift financial accountability for an accident from the charter operator to the insurance carrier? To the extent of the insurance coverage, yes. Is the FAA seeking to prohibit this risk shifting? The guidance does not say.

Finally, both the new Op Spec and the guidance provide that mechanics (as well as pilots) must be either direct employees or agents of the charter operator. Unfortunately, this will not always work in the business and charter aviation environment. Much of the Part 135 aircraft maintenance is performed by service centers that are FAA-certificated repair stations. While the mechanics employed by these repair stations do the actual work on an aircraft, it is the repair station itself, under the authority of its FAA certificate, that authorizes the aircraft's

return to service. In order to do that, under the FAA's own rules, the repair station must retain control of the mechanics.

What Happens Now?

After reviewing the new Op Spec and guidance, the NBAA convened a meeting of regulatory and tax experts in Washington, DC to analyze the new material and identify problems. On January 12, 2007, NBAA sent a preliminary letter to the FAA Administrator pointing out the fact that there were difficulties with the new Op Spec and guidance. This first letter will

be followed by a detailed analysis of the problems with the Op Spec and the guidance and will suggest possible solutions. It remains to be seen how the FAA will respond.

In any event, what was supposed to be the final play in the charter management game has now gone into extra innings. In the meantime, there are creative regulatory and tax planning solutions that can mitigate the effects of the FAA's action. We will talk more about those strategies and further developments in the charter management game in a future article.

Craig Weller is of counsel to the law firm of Galland, Kharasch, Greenberg, Fellman & Swirsky, P.C. in Washington, D.C. The firm provides a wide range of services in all sectors of worldwide aviation, with an emphasis on business aircraft transactions and related tax and business planning.

Mr. Weller's practice emphasizes the areas of business aircraft transactions and operations. As a founding member and past Chairman of the NBAA Tax Committee, he has extensive experience in negotiating and drafting aircraft purchase, lease, management, and charter agreements, and providing aviation regulatory and planning services to aircraft owners, operators, and managers. Mr. Weller also has substantial experience with aircraft fractional ownership programs. As a participant in the FAA's Fractional Ownership Advisory Rulemaking Committee, he helped to draft the current rules for fractional ownership operations, and then served on the FAA advisory committee that recommended changes to Part 135. He also serves on the Board of Directors of the Professional Aviation Maintenance Association (an affiliate of SAE).

Before entering private practice, Mr. Weller worked as an attorney with the FAA and CAB. He received his law degree in 1977 from the University of Virginia.