



## GENERAL AVIATION DRY LEASING GUIDE



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# General Aviation Guidance and Frequently Asked Questions About Aircraft “Dry” Leasing

This guide is published to provide information on basic concepts and requirements, and to assist and encourage owners and operators to remain compliant with current applicable laws, regulations and policies. As such, it is intended to serve as general guidance rather than an authoritative reference, and is no substitute for fact-specific advice from a business aviation consultant or attorney.

## Part One: Overview

### Importance of Leasing to Commercial, Business and General Aviation

With the Federal Aviation Administration’s (“FAA”) recent significant emphasis on illegal charter in the form of increased legal enforcement, personnel training, and updated inspector guidance, aircraft leasing has become a hot topic in the commercial, business and general aviation industry. Although this issue stems from some using improper leasing arrangements in order to disguise illegal charter operations, legitimate aircraft leasing is an important and appropriate tool for, among other things:

- aircraft owners to obtain financing;
- individuals and companies to possess and control the aircraft they use for various business, risk management<sup>1</sup> and tax planning purposes;
- private pilots to train, fly and enjoy their aircraft for leisure; and
- properly certificated air charter operators to gain access to additional aircraft for their fleets.

There are different requirements depending on the size of your aircraft but whether you are flying a two-seat piston powered aircraft or a long-range business jet, you should be familiar with leasing concerns that apply to the aircraft you own or fly. It is critically important for each segment of the industry to understand the rules that govern aircraft leasing in the U.S., to the end that:

- individual and business users can optimize the ownership and operations of their aircraft under the FAA’s non-commercial rules;
- that properly certificated air charter operators are protected from unfair competition arising from illegal leasing operations that have not met those stringent requirements, and most importantly; and
- that the flying public is appropriately protected in the safe use of those aircraft.

### Purpose of the Applicable Regulations

In order to fully understand what aircraft leasing is and what kind of leasing is appropriate, it is fundamental to first understand the policy goals that underpin the FAA’s regulations regarding leasing. One of the FAA’s highest mandates under the Federal Aviation Act of 1958<sup>2</sup> is to afford an appropriate level of safety and regulatory oversight to the type of air transportation that is being conducted, looking at this issue primarily from the viewpoint of a knowledgeable and reasonable passenger.

- The baseline set of operational rules under the FAA’s Federal Aviation Regulations<sup>3</sup> (“FAR”) are found at 14 C.F.R. Part 91 – (General Operating and Flight Rules, or commonly simply referred to as the non-commercial rules). Part 91 generally mandates that the aircraft being operated must be in an airworthy condition, that the pilots flying the aircraft are properly qualified to do so, that the operations are being conducted within the confines of the technical performance requirements of that aircraft, and that the pilots are obeying the appropriate rules and instructions regarding air traffic control. Beyond this, there are no further certification requirements or authorizations (other than special authorizations that are required for specific types of flight operations, such as overwater navigation) to be a Part 91 operator. This frequently results in very little to no interaction between a Part 91 operator and the FAA on a routine basis. Flying under Part 91 therefore assumes, in part, that: (i) the aircraft is being properly maintained; (ii) the pilots are qualified; (iii) reasonably knowledgeable passengers have some basic understanding of who is operating the flight; (iv) the passengers are not being asked to contribute to the cost of the flight; and (v) the passengers will have some form of redress if those obligations are not being followed.
- Conversely, when passengers are unclear who is operating the aircraft, whether the aircraft is properly maintained, whether the pilots are properly trained, and if there may be some ownership structuring in place that would shield the operator from regulatory or civil liability with respect to the conduct of that flight – especially when they are being asked to contribute in

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<sup>1</sup> 49 U.S.C. § 44112.

<sup>2</sup> 49 USC §§ 40101, *et seq.*

<sup>3</sup> 14 CFR Parts 1-199.

some form or fashion to the cost of the flight – then the FAA’s mandate to protect the passenger triggers the requirement for the person operating the aircraft to comply with additional rules to ensure that safe operations are being conducted. This means the operator must now obtain additional certification under the applicable FAR – Part 135 (Operating Requirements: Commuter and On Demand Operations and Rules Governing Persons on Board Such Aircraft) – before they can begin to operate such flights. It also means that the operator will face additional maintenance, pilot training and operational requirements in order to conduct those flights, and that a team of FAA safety inspectors will be specifically assigned to monitor the performance of those operators on a regular basis and take enforcement action if performance is deemed to fall short.

### **Types of Leases**

With these underlying policy goals in mind, a party can then begin to understand and assess whether the leasing they are contemplating fits within the guidelines established by the FAA. In general, a lease is any agreement by a person to furnish an aircraft to another person for compensation, regardless of the size or type of aircraft. This excludes a contract of conditional sale.<sup>4</sup> Once an aircraft lease has been created, the FAA will then characterize that lease as either a “wet” lease or a “dry” lease. Fundamentally, a “wet lease” is specifically defined in the FAR as a lease of an aircraft with at least one crewmember. The prototypical example of an appropriate wet lease is the charter of an aircraft to a passenger by a properly certificated charter operator under FAR Part 135. Examples of wet leases permitted under the non-commercial rules of Part 91 of the FAR include time sharing and interchange agreements. Under a wet lease, compensation paid for the lease is the payment for an air transportation service, similar to riding in a taxicab.

Conversely, a “dry lease” is therefore the lease of an aircraft without any crewmembers. Types of dry leases include rental agreements and, in aircraft trust arrangements, operating agreements. Under a dry lease, the compensation being paid is typically in the form of a rental payment in exchange for the lessee’s own use (whether the lessee is a pilot or a passenger who has hired a pilot) of the equipment being rented, analogous to obtaining a rental car for one’s ground transportation needs. The key distinction is that, generally speaking, wet leases must be operated under FAR Part 135, whereas a properly constructed dry lease may allow a user of the aircraft other than the registered owner to conduct its own flights of the aircraft under FAR Part 91.

### **Determination of Operational Control Under a Lease**

The critical component in determining whether an aircraft lease is a wet lease or a dry lease is to identify the party in “operational control” of the aircraft under the arrangement. FAR § 1.1 states: “Operational control, with respect to a flight, means the exercise of authority over initiating, conducting or terminating a flight.” Many years of rulemaking and various forms of FAA guidance, such as FAA orders, advisory circulars and chief counsel interpretation letters, have established that operational control requires a clear allocation between the parties of responsibility for the elements that make the flight of the aircraft possible (pilots, insurance, scheduling, maintenance, fueling, flight following, and so forth). The party in operational control is the party that bears the ultimate responsibility for the safe conduct and regulatory compliance of the flight. The determination of the party with operational control of a particular flight will ultimately depend on the totality of facts and circumstances surrounding such flight.

### **Means of Achieving Operational Control**

FAR § 1.1 defines: “Operate, with respect to aircraft, means use, cause to use or authorize to use aircraft, for the purposes ... of air navigation including the piloting of aircraft, with or without the right of legal control (as owner, lessee, or otherwise).”<sup>5</sup> As recognized in the preamble to Subpart K of FAR Part 91 (68 FR 54520) and in FAR § 91.1011, a party in operational control is not required to manipulate the aircraft controls personally or perform the other functions of an operator directly but may delegate to another individual or company with aviation expertise such as a management company<sup>6</sup> to assist the operator in performing such functions. However, the party in operational control remains ultimately responsible for these functions even if delegated.

### **Truth in Leasing Requirements**

Another key tool the FAA uses to monitor the conduct of appropriate dry leasing (because such leases do not typically fall under the scrutiny that is applied to Part 135 certificate holders) is the truth-in-leasing requirements found in FAR § 91.23 that apply to contracts for the leasing or the conditional sale of large aircraft (i.e., aircraft with over 12,500 lbs. MTOW). In accordance with FAR § 91.23:

- the lease must be in writing;
- the lease must contain certain specific truth-in-leasing language spelled out in this section;

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<sup>4</sup> AC 91-37B defines “Lease” as “For the purpose of part 91, § 91.23, a lease means any agreement by a person to furnish an aircraft to another person for compensation or hire, with or without flight crewmembers, that is not a contract of conditional sale. The person furnishing the aircraft is referred to as the lessor and the person to whom it is furnished is referred to as the lessee.”

<sup>5</sup> See also 49 USC § 40102(a)(35).

<sup>6</sup> This guide uses the industry terms “management company” and “manager” to mean a company or person who provides assistance or services to the operator but who is not assuming operational control of the aircraft.

- the lease must be carried on board; and
- the parties must comply with certain requirements to notify the FAA.<sup>7</sup>

It is important to note, however, that the § 91.23 truth-in-leasing requirements do not apply to leases or contracts of conditional sale of small aircraft (12,500 lbs. MTOW or less), or where the lessor or lessee is a foreign air carrier or a certificate holder under FAR Parts 121, 125, 135 or 141. While written leases are not required for aircraft 12,500 lbs. MTOW and less, they are highly recommended – the FAA presumes the owner of the aircraft is the operator unless evidence indicates otherwise. A written lease can also be useful evidence that a lease existed and it should be shared with the insurance provider. Additionally, a written lease can also help avoid misunderstandings between a lessor and lessee.

### Summary

Aircraft leases are important tools in the commercial, business and private use of aircraft in the U.S., but it is critical that the parties to such leases fully understand the rights, obligations and regulatory responsibilities they contain in order to ensure that the appropriate level of safety and regulatory oversight is applied to those operations. Therefore, the following section will provide a more detailed discussion of

- Operational Control: Classification of an Agreement as a “Wet” or “Dry” Lease, and
- Operational Control: Exclusive Leases vs. Non-Exclusive Leases

## Part Two: Discussion

### OPERATIONAL CONTROL: CLASSIFICATION OF AN AGREEMENT AS A “WET” OR “DRY” LEASE

A key component in evaluating who has operational control over the use of an aircraft – and therefore who is ultimately responsible for the safe conduct of those flights – starts with the determination of whether the lease is a “wet” lease or a “dry” lease. The distinction between the two can be explained as:

#### Wet Leases

As specifically defined in the FAR, a “wet lease” is any lease whereby the lessor provides both the aircraft and at least one crewmember (whether flight crewmember or cabin crewmember). The FAA’s presumption is that under a wet lease, the lessor retains operational control of the flight. Accordingly, and as discussed in more detail below, when an agreement provides for the lease of an aircraft with a flight crew employed or procured, either directly or indirectly by the lessor, operational control remains in the hands of the lessor.

#### Dry Leases

Conversely, and although not specifically defined in the FAR, a dry lease of an aircraft is therefore one in which the lessor provides the aircraft and the lessee supplies its own crewmembers. The presumption is that under a true dry lease, operational control has been passed to the lessee. As discussed in more detail below, the FAA will look to a number of factors in order to determine whether operational control has been properly transferred and the lease is in fact a dry lease, but the key factor is the source of the crewmembers. If the lessor provides one or more crewmembers (whether flight crewmembers or cabin crewmembers),<sup>8</sup> then the lease cannot be characterized as a dry lease.

In summary, there is no one clear and easy test to determine whether or not the parties to a lease have truly created a successful dry lease that transfers operational control from the lessor to the lessee. Instead, this analysis must be made by looking to the following sources and background information that have been developed over the years by Congress, the FAA, and applicable case law: (a) the basic regulatory definitions for terms such as “operational control” and “wet lease” as found in FAR §§ 1.1 and 110.2; (b) the requirements of who must hold what types of air carrier or operating certificates as found in FAR Part 119; (c) fundamental guidance to safety inspectors on whether a lease is a wet lease or a dry lease as

<sup>7</sup> A copy of the lease must be mailed to the Aircraft Technical Section of the FAA Aircraft Registry within 24 hours after execution, a copy carried on board the aircraft for all operations under the lease, and requisite notice of the first flight under the lease provided by telephone or in person to the responsible FAA Flight Standards Office at least 48 hours prior to takeoff of such flight (unless otherwise authorized by that office).

<sup>8</sup> By including the reference not only to flight crewmembers but also to cabin crewmembers, the FAA is taking the position that even if the flight crew is truly independent of the lessor, the use of cabin crew employed, contracted or provided directly or indirectly by lessor would result in the classification of the agreement as a wet lease. The reason for the FAA’s inclusion of cabin crew in determining whether an agreement is a dry or wet lease is not explained. It is interesting to note, however, that in defining dry and wet leases in the air carrier context, the FAA refers to a dry and wet leases as the lease of an aircraft (a) “without flight crewmembers” (dry lease) and (b) “with at least one pilot flight crewmember” (wet lease). See Order 8900.1, Vol. 3, Ch. 13, Sec. 3-398 A.(2) and (3), respectively, (emphasis added). Given that more stringent rules apply to air carriers and that, in most instances, cabin crew is not even required for the operation of business aircraft, it is puzzling why the source of cabin crew for a Part 91 operation could affect the classification of an agreement as a dry or wet lease while the source of required cabin crew does not even matter for air carriers.

found in various parts of the FSIMS;<sup>9</sup> and (d) various FAA Advisory Circulars, and various other FAA guidance materials such as policy statements and FAA Chief Counsel interpretation letters that have been published over many years. In taking all of these sources together, arguably the proper method for assessing whether or not a lease is in fact a dry lease and operational control has been properly transferred to the lessee boils down to: (1) answering the question of who is providing the flight crew; and (2) making an assessment of certain other factors that the FAA has enumerated over time to assist in making this determination. Each of these two assessment tools are discussed below in more detail.

### **Selection of Flight Crew**

At a basic level, if a lease clearly and specifically states that the lessor will provide flight crew, or if the lessee is required to use certain flight crew of lessor's choice, then the lease will be categorized as a wet lease. Where the lease is silent on which party is to provide the crew, or where the lease indicates that it is the lessee that will provide the flight crew, then making a final determination as to whether the lessee is in fact independently obtaining its own flight crew as opposed to the lessor actually providing crew, or whether the crew is truly independent,<sup>10</sup> or whether there is an identity of interest between the lessor and the entity providing pilots,<sup>11</sup> may require consideration of numerous factors beyond the language in the lease itself, including:

- Is the crew that will be used by the lessee employed by the lessor or the lessor's owner (or their affiliates or agents or management company)?
- Does the lease (or a separate verbal or written agreement) provide for the lessor to supply or arrange pilot(s) for the lessee (even if it is being done as a "convenience" for the lessee)?
  - Is the crew agreement prepared by the lessor?
  - Does the lessor assist the lessee in reviewing and/or completing the documents?
  - Do the pilots being retained by a lessee for its flights have knowledge of the terms of the agreement that govern their relationship with the lessee?
- If the crew is obtained from a third party, does that party have ties to the lessor (e.g., financial, employment, etc.) or is it acting in concert with the lessor?
- Is the lessee obligated to use the crew used or selected by the lessor?
- Does the lessor place conditions on the crew that may be retained by the lessee (other than minimum regulatory and insurance requirements)?

If the parties desire to establish a true dry lease, then it is important that the lease contain specific provisions requiring the lessee to obtain its own crewmembers. While this is generally not an issue where the lessee is a pilot, or where professional pilots are directly employed as "W-2 employees" of the lessee, it is very common for lessees to use independent contractor pilots rather than employing them full time as part of an internal staff. Such independent contractor pilots may be contracted for directly by the lessee or may be provided by an aircraft management company to the lessee pursuant to a pilot services agreement.

As such, in cases other than where the lessee is an individual pilot who has also become the operator – in other words where the lessee is an individual or business operator that needs to engage the services of one or more professional pilots to assist in its operations of the aircraft – every effort must be made to establish independent lessee-pilot relationships. In such situations it is recommended that each lessee, in a separate written agreement, clearly and specifically appoint the pilots it has selected to act as that lessee's agents and acknowledge that the lessee is responsible for such pilots' acts and/or omissions because it is the lessee – rather than the lessor or the professional pilot – that has operational control of the aircraft at all times during its lease period. This would apply both to pilots that are being hired individually, as well as to a management or pilot services company that is being engaged to provide pilot services as part of its agreement with the lessee.

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<sup>9</sup> See, e.g., Order 8900.1, Vol. 3, Ch. 13, sec. 3-498 (B), Change 703 (Apr. 28, 2020).

<sup>10</sup> See, e.g., Memorandum to Larry Richards from Mark W. Bury (Feb. 20, 2013)(due to ownership of the aircraft and crew companies by the same individual and uniform use of same crew, the parties were acting in concert resulting in a wet lease); Letter to Eric L. Johnson from Rebecca MacPherson (Aug. 11, 2011)(use of same management company may indicate a "wet lease in disguise"); Memorandum to Wichita Flight Standards Office (July 1, 1992) from Timothy Titus; Letter to Melvin Huber from Timothy Titus (July 27, 1990)(pilot must either be an employee or independent contractor from a source unrelated to the lessor); Letter to Mike Green from Kenneth Geir (July 28, 1989)(a pilot who is an independent contractor with no financial or employment relationship with the lessor other than when he is hired to be a pilot is independent).

<sup>11</sup> See, e.g., Letter to Rodney J. Arenda from Kenneth E. Geir (March 15, 1979) ("So long as the aircraft and crew come from different sources with no actual identity of interest, notwithstanding whatever may be put down on paper, we believe that the operation could properly be conducted under part 91. If, however, there would be an identity of interest between your company and the holding company for the aircraft, we would have to regard the situation as a subterfuge in order to avoid application of the Part 135 rules.")

Additionally, beyond having specific language in the lease directing the lessee to act as or provide its own pilots, it is important to realize that the FAA will not only look for such language in the lease, the FAA will also look to the actual performance of the parties and other related facts and circumstances. This information is used to determine whether the lessee has actually secured its own crew, or whether the lessor instead has facilitated or assisted the lessee in retaining crew and thus the lessee is obtaining the aircraft and the air crew as a “package deal” in some form or fashion (i.e., it does not matter what the lease says if the parties do not actually follow that language). For example, if the lessor provides a list of local qualified pilots to the lessee, are the pilots truly independent or do they have ties to the lessor? If such a list is presented, is it implied that the lessee must use one of those pilots? How would the pilots answer if asked, “To whom do you report for this flight?” The FAA will also consider whether the lessee typically used the same crew as the lessor even though the lessee had the right to use different crew. If the pilots were not truly independent or if the same crew is typically used, the FAA could be inclined to classify the lease as a wet lease.

However, it is important to note some caveats. The fact that the lessor may require the pilots selected by the lessee to meet certain conditions does not in itself mean that the FAA will classify the lease as a wet lease. For example, the FAA recognizes that there may be circumstances under which the lessor may include certain specific requirements that must be met by the lessee’s crew (e.g., regulatory and insurance requirements) and has stated that even though such requirements “may indicate a certain level of control, it does not singularly create a ‘wet lease.’”<sup>12</sup> Another example might occur where there are very few pilots in a certain geographic location that are qualified to fly a certain type of aircraft, and simply from necessity the lessee may end up using the same pilots as are utilized by the lessor. Moreover, it can make sense under certain circumstances for lessees to independently decide to use pilots that also fly for the lessor or other lessees because those pilots may be more familiar with the aircraft, which can lead to a safer flight operation. Ultimately, the key question is whether or not it was the lessee that knowledgeable and intentionally selected the crew members that are being used of its own volition, and understands that it has assumed the responsibility for that selection and the conduct and performance of those crew members while they are acting as the lessee’s crew members for that lessee’s flights.

Note that when the lessor and lessee are related (i.e., a subsidiary company leases the aircraft to its parent company or one company leases an aircraft to a related company or individual), there is typically not a concern regarding assisting each other with drafting, reviewing and completing agreements and acting in concert with each other.

Finally, when the lessee is a pilot flying the aircraft for his or her own purposes, or the pilot owns the company listed as lessee (i.e., a lawyer, whose law firm leases an aircraft and who flies himself or herself in the aircraft to and from meetings and trials), there is typically not a concern regarding flight crew.

### **Other Factors**

In addition to the crew analysis, the FAA has identified numerous other factors that might lead it to determine that a dry lease is actually a “wet lease in disguise.” Not surprisingly, these factors are quite similar to the operational control analysis. Among others, the FAA has identified the following:<sup>13</sup>

- Who makes the decision to assign crewmembers and aircraft; accept flight requests; and initiate, conduct, and terminate flights?
- Who ensures that crewmembers are trained and qualified in accordance with the applicable regulations?
- Who specifies the conditions under which a flight may be operated?
- Who determines weather/fuel requirements, and who directly pays for the fuel?
- Who directly pays for the airport fees, parking/hangar costs, food service, and/or rental cars?
- Prior to departure, who ensures the flight, aircraft, and crew comply with regulations?
- Who ensures that the aircraft is airworthy and in compliance with applicable regulations?
- Who is maintaining the aircraft and where it is maintained?
- Who decides when/where maintenance is accomplished, and who directly pays for the maintenance?

The FAA also notes that the lease should state that functions such as flight following, dispatch, communications, weather, and fueling are to be performed by the lessee.<sup>14</sup>

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<sup>12</sup> See Order 8900.1, Vol. 3, Ch. 13, sec. 3-507 C, Note.

<sup>13</sup> See Order 8900.1, Vol. 3, Ch. 13, sec. 3-507 C. 5 and 6, Change 703 (Apr. 28, 2020) and related Notes. See also Letter to David Kroontje from Mark Bury (June 19, 2014)(requirements that particular maintenance or crew providers be used by the lessee may cause the agreement to be a wet lease).

<sup>14</sup> See Order 8900.1 Vol. 3, ch. 13, sec 3-507C. 7, Change 703 (Apr. 28, 2020) and related Notes.

It is important to note that a key question in reviewing these factors is not necessarily who is physically performing each function, but who is ultimately responsible to ensure that the functions have been properly performed. For example, an executive of a company that is exercising operational control over a flight can rely on the expertise of that operator's pilots or management personnel without having to perform the function himself or herself, so long as that operator (the executive acting on behalf of that company) understands that the company is responsible to ensure the function is properly performed. Likewise, it is common for aircraft operators to contract for the performance of maintenance by certificated repair stations or manufacturer maintenance facilities, and as such that operator is not physically performing the maintenance. But as a Part 91 non-commercial operator, that operator does have the ultimate responsibility to conduct enough due diligence to ensure that the maintenance was in fact completed properly and that the aircraft is in an airworthy condition prior to flight.

It is important to note that individuals or companies that have shared ownership of an LLC or other entity which owns an aircraft are not deemed owners of an aircraft. Entities are distinct legal personalities from owners and managers, not alter egos, even when structured as closely held companies. Owners, when they wish to use the aircraft, need to have a lease in place (in writing if over 12,500 lbs. MTOW) and should not cover operating costs with capital contributions. Similarly, individuals who are owners of single member LLCs that own an aircraft must lease the aircraft from the LLC.

In summary, while the factors listed above are not individually dispositive to the analysis of whether a lease is a dry lease or a wet lease, the more of these responsibilities that remain with the lessor, the more likely that the FAA will determine that the lessor has retained operational control and the lease is in fact a wet lease.

Finally, one tool that parties may use to both emphasize who has operational control, and to ensure that operational control has been properly transferred under a dry lease, is to include certain mechanisms in the lease to document and track when such a transfer occurs. For example, in one chief counsel legal interpretation letter, the FAA referred to the Subpart K requirement for an Acknowledgement of Operational Control in a non-fractional ownership context as "useful instructions concerning operational control responsibilities."<sup>15</sup> Although the FAA did not go so far as to say that the use of a similar document in a lease could make the difference between the classification of an agreement as a dry versus a wet lease, such an approach could help, especially since it could offset some of the FAA's concern that lessees do not necessarily understand their roles and responsibilities under a lease.

## **OPERATIONAL CONTROL: EXCLUSIVE LEASES VS. NON-EXCLUSIVE LEASES**

As noted above, in a wet lease arrangement, the party in operational control is the lessor. In a proper dry lease arrangement, the party in operational control is the lessee. As such, when attempting to put into place a proper dry lease arrangement, it is particularly important that the lessee truly has, and understands that it has, operational control. One key factor that arises when assessing whether operational control has been properly transferred to a lessee is whether there is one exclusive dry lease that places all of the burden of maintaining and operating the aircraft on one lessee, or if there are multiple non-exclusive leases that place this burden on different lessees at different points in time when each lessee assumes the possession and use of the aircraft for its own flights.

### **Exclusive Dry Leases**

In an exclusive dry lease arrangement, the aircraft is subject to one lease only, and the lessor transfers custody and control for all flights for the term of the lease. It is likely that the lessee will pilot the aircraft himself/herself or employ or contract for the pilot; insure, maintain, schedule, fuel and conduct all flight following for the aircraft; and know and understand its operational control responsibilities. Aircraft financing leases and most aircraft owner trust operating agreements are common examples of exclusive dry lease arrangements. There is rarely an issue arising with respect to whether or not operational control has been properly transferred to the lessee under an exclusive dry lease.

### **Non-Exclusive Dry Leases**

Dry lease arrangements may also be non-exclusive, where the aircraft may be operated by the owner and/or more than one lessee. Under this structure, one party has possession and use of the aircraft at a time, with such party having operational control for the flights during each of its periods of use only. Although not specifically defined in the FAR, a non-exclusive dry lease of aircraft may be an option when a party wants part-time access to an aircraft and has the ability and desire to take on the responsibility for operation of the aircraft under FAR Part 91 by providing its own crew and otherwise assuming operational control of the aircraft for those flights. Generally, appropriate non-exclusive dry leases fall into three categories:

- **Short Term Rentals to Pilots**

A classic example of this is the short-term rental of an aircraft by a fixed based operator ("FBO"), flying club or flight school to a pilot. Although the FBO, flying club or flight school insures and maintains the aircraft, the pilot manipulates the con-

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<sup>15</sup> See Letter to David Kroontje from Mark Bury (June 19, 2014).

trols, determines the schedule, has operational control, and is responsible for the safe, legal operation of the aircraft during his/her rental period. Hourly aircraft rental rates may or may not include the cost of fuel.

- **Non-Exclusive Related Party Leases**

For example, an individual owns Company A, which owns an aircraft. The individual also owns several affiliated business entities all under common ownership of the individual. Company A may lease aircraft to each affiliate for short term rental periods for operations by those affiliates, with each affiliate hiring crew for their operations and otherwise taking appropriate steps to assume operational control for its own flights.<sup>16</sup> Another common and appropriate variation of this type of lease is where three individuals own Company A, and Company A, as its sole purpose, owns an aircraft. In this situation, not only is it appropriate but it is essentially required under the FAA's interpretation of the FARs that Company A enter into three separate dry leases, one with each of the three owners of Company A, so that those individuals may possess and use the aircraft, exercising operational control over the aircraft for each of that individual member's own flights by each individual lessee obtaining their own pilots and otherwise assuming responsibility for the other factors critical to assuming operational control (such as remaining responsible for ensuring the maintenance is current, the pilots are qualified, the aircraft and its operations are properly insured, and so forth).

- **Non-Exclusive Leases to Third-Parties**

For example, Company A may lease an aircraft to an unrelated Company B that is on the same airfield for Company B's operations, when the aircraft is not being used by Company A, again with Company B engaging its own crew and otherwise taking appropriate steps to assume operational control of its own flights (again, such as remaining responsible for ensuring the maintenance is current, the pilots are qualified, the aircraft and its operations are properly insured, and so forth). Be aware, however, that if Company A were to enter into numerous dry leases with third-parties, this would be a "red flag" that an appropriate transfer of operational control is not occurring such that the dry leases are "wet leases in disguise," or sham dry leases, and that Company A may be engaged in illegal charter. Smaller aircraft owned by pilots are sometimes leased to non-owner pilots to operate the aircraft for their own (non-commercial pilots flying third parties who are riding along) personal or business use on a non-exclusive basis, particularly when the owner is not able to fly the aircraft for a period of time.

While non-exclusive dry leases can be very valuable and appropriate tools for the use of an aircraft when structured properly, using non-exclusive dry leases can be fraught with challenges because this approach has, at times, been used by parties to engage in illegal wet leasing. Non-exclusive leases, especially to third-parties, may draw FAA scrutiny. That does not mean that all non-exclusive leases are "devious leases" or "wet leases in disguise." What it does mean is that setting up a legitimate non-exclusive lease arrangement will require attention to many of the minute details that surround the operation of an aircraft and implementing the arrangement will require adherence to the structure. While terms of the lease are important, it is equally important that the lease is executed as described and in accordance with legal requirements in order to avoid penalties.

There are a number of other, very narrowly construed, options for the operation of an aircraft under Part 91 on a part time basis such as joint ownership<sup>17</sup> and fractional ownership.<sup>18</sup> Further, when a party wants part-time access to an aircraft and the parties do not have the ability or desire to use these options to operate the aircraft under FAR Part 91, that party may charter an aircraft from a duly licensed air carrier under FAR Part 135 directly or indirectly through a broker or card program.

### **Additional Considerations for Non-Exclusive Leases**

While it may typically be very clear under an exclusive lease that all of the factors discussed above clearly fall under the responsibility of the lessee (and therefore the lease is very clearly a true dry lease), additional issues should be addressed and emphasized in non-exclusive lease arrangements because, by definition, there will be multiple parties who may have shared or overlapping obligations with respect to these factors at different times. Among other things, the following questions should be considered:

- What process and documentation will be used to deliver/redeliver the aircraft between the parties?
- How will the beginning and end of each party's lease period be determined?

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<sup>16</sup> While under common ownership of an individual, because these entities are part of the same corporate family, the intra-corporate provisions of FAR 91.501(b)(5) do not apply.

<sup>17</sup> A joint ownership arrangement is available for large aircraft and multi-engine turbojet aircraft (or pursuant to the NBAA small aircraft or other applicable exemption) and requires the parties to acquire and register the aircraft at the FAA in their names.

<sup>18</sup> Fractional ownership requires the purchase or lease of an interest in an aircraft that is part fractional ownership program managed by a company that holds management specifications under Part 91, Subpart K and requires the party to sign a series of agreements including a purchase or lease agreement for the interest, a management services agreement with the program manager and a dry lease exchange agreement with the other members of the program that allow each of the participants in the program to use aircraft belonging to other program participants when the aircraft in which they hold an interest is not available. Although the fractional aircraft can be operated under Part 91, it must be operated in accordance with the more stringent requirements in Part 91, Subpart K.



- Who will be responsible for ensuring that appropriate maintenance has been performed and how it will be accomplished?
- How will the crew be coordinated?
- Who is providing the insurance?
- Does the insurer understand and recognize the agreements and the roles of the parties?
- Is the use of another pilot conditioned on the approval of the lessor's pilot?

What follows is a more detailed discussion of these various considerations.

### **Identification of Lease Periods**

When there are multiple users (beyond the lessee and the lessor), the ability to identify the party responsible for the aircraft at any point in time is more difficult, which makes the need for a process to ensure clarity that much more important. If the distinctions and separation of the lessees and lessor are not clear, the arrangement is more likely to be viewed by the FAA as one arrangement centered on the lessor. In that case, there is a higher risk that the FAA may view the arrangement as a wet lease under which the lessor is providing transportation for compensation or hire and therefore must operate under a Part 135 certificate.

- Defined Rental Period

In setting up the structure, the parties need to decide when each lessee's lease period begins and ends and who is responsible when the aircraft is not being operated. For example, does the lease period begin immediately before the respective lessee (through its crew) begins the pre-flight inspection and does it end upon completion of the post-flight inspection? If so, provisions should be made for the aircraft to be delivered by the lessor to the lessee and redelivered by such lessee to the lessor. Consideration should also be given to how redelivery would be accomplished if the aircraft is away from its base. If the aircraft will not be returned to the lessor, does that lessee have responsibility for the aircraft until the aircraft is delivered to the next lessee and would the lessee be responsible for such delivery. A continuation of a lessee's lease period until the commencement of the next lessee's lease period would also make the ability to identify the responsible party at any point in time more challenging. By redelivering the aircraft to the lessor between each lessee's lease period, the arrangement is more akin to the arrangements used when an aircraft is rented from an FBO.

- Process for Delivery/Redelivery

One method of documentation would be for the lessee to execute a delivery receipt/certificate that identifies the moment in time when it accepted the aircraft (and the responsibility for it). When the aircraft is returned to the lessor, the lessor would execute a re-delivery receipt/certificate that identifies the moment in time when the aircraft is returned to it and it reassumes responsibility for the aircraft. Another approach would involve the use of a delivery/redelivery log, a copy of which would stay with the aircraft, with another copy to be kept in different location or electronically to preserve the information in case of loss or destruction of the aircraft. Such a log would identify the lessee (and the party delivering the aircraft if other than the lessor), the date, time and location of such delivery, such other information desired by the parties and would be signed by the party accepting delivery. At redelivery the same type of information would be included and the log would be signed by the party accepting re-delivery. Since multiple parties are involved in a non-exclusive lease, the process needs to be adapted so that it is administratively workable. The chosen approach should not only provide documentation to enable the parties to monitor and keep track of the use of the aircraft but also provide the FAA with a means of identifying the operator at any particular time.

### **Use of the Same Pilots by Multiple Lessees**

As noted above, as a fundamental matter of being able to clearly show that a dry lessee has assumed operational control of the aircraft when that lessee is using the services of one or more professional pilots to assist in those operations, it is recommended that each lessee, in a separate written agreement, clearly and specifically appoint the pilots it has selected to act as that lessee's agents and acknowledge that the lessee is responsible for such pilots' acts/omissions because it is the lessee – rather than the lessor or the professional pilot – that has operational control of the aircraft at all times during its lease period. Again, this would apply both to pilots that are being hired individually, as well as to a management or pilot services company that is being engaged to provide pilot services as part of its agreement with the lessee.

An additional layer of complexity to this basic issue often arises with respect to non-exclusive leases when the lessor and/or lessees seek to use the same pilots or pilot services companies to assist them in the operations of their aircraft. In such situations, care must be taken to ensure that the lessor is not indirectly providing the crew to one or more lessees through a "back door." For example, in most instances, one component of the amount paid to a management company consists of salary and benefits for the crew. If a lessee also wants to obtain crew services from the management company, is the lessee paying separately for such services? If it does not, the independence of that relationship would be undercut. If the lessee is

paying such an amount separately, is that amount being credited against the amount otherwise to be paid to the management company by the lessor (a common practice for many years)? If there is a credit, it may provide some indication that the lessor is actually providing the crew, albeit indirectly. The viability of this approach will depend on the parties and circumstances.

Since the parties as a business matter would likely not want double payment to be made, the approach to crew salaries in such arrangements will need to be carefully considered. If the pilots come from a separate crew services company, each party may be able to contract based on a set number of hours of crew services to be paid by such party regardless of whether they use that many hours. This would enable an independent crew company to manage its revenue and serve multiple parties.

Although there is no guarantee that the FAA would agree that such steps create sufficient separation of aircraft and crew, it may bring the parties and the FAA closer to an acceptable and practical arrangement that furthers the interests of safety.

In any event, and as already stressed above, it is critical to understand that, when operating under an aircraft dry lease, it is the lessee who must obtain – and who is ultimately responsible for the performance of – the air crew that will assist that lessee in operating the aircraft.

## **Maintenance**

In the case of an exclusive lease, it is typical to see the maintenance obligation placed on the lessee. But how would this work when there is more than one lessee? As already stressed above, the FAA has noted that the party providing or arranging maintenance is a key factor considered in determining if a lease is a dry or wet lease. In evaluating this factor, it is important to remember that the airworthiness of the aircraft and safety of flight is of critical importance. It is also important to remember that a lessee (as a party with operational control) is obligated to ensure that the aircraft is airworthy and in compliance before commencing flight. While including a provision in the lease that the lessee is responsible for maintenance may on the surface make sense, having multiple parties responsible for the same thing increases the chance of an inadvertent oversight. As such, in light of the fact that the FAA has noted that the party providing or arranging maintenance could affect the classification of a lease as a dry or wet lease, and in order to ensure the safe operation of the aircraft, great attention must be given to the manner in which the parties fulfill their responsibilities for the airworthiness of the aircraft.

Given the critical role that maintenance plays in ensuring safety of flight, it is vital that maintenance and inspections be readily tracked and monitored. As noted above, even under exclusive leases, the operator may not physically perform his, her or its own maintenance. However, that operator does retain the ultimate responsibility to ensure that the maintenance has in fact been completed. Moreover, it is not practical, and is arguably less safe, for more than one operator of an aircraft to be performing its own maintenance in a vacuum as if the other operators do not exist.

For example, to ensure safety, consistency and continuity, one party (including possibly the lessor) could have primary authority to implement the maintenance requirements in an effort to reduce or eliminate any possibility of something slipping between the cracks. Even if the party selected is the lessor, that does not mean that the lessees have no maintenance responsibility. The lessee would still have responsibility for the airworthiness and maintenance status of the aircraft. The lessee would then satisfy its responsibility before and after departure, either directly or through the use of its properly-designated agents, by (i) reviewing the records to confirm that the aircraft is in the required condition and that all open items have been properly closed out, (ii) performing all pre- and post-flight inspections, (iii) documenting any and all discrepancies and airworthiness or maintenance issues that are identified during flight or during the checks, and (iv) reporting the information and providing the documentation to the party designated as maintenance coordinator. When the aircraft is used by a subsequent lessee, such lessee would be able to review the records, ensure that all items raised by the prior lessee have been closed and that the aircraft is otherwise in the required condition before taking off.

It is important to stress that based on the fact that the FAA has acknowledged in related and other contexts that parties are allowed to delegate the performance of (but not the responsibility for) certain tasks to parties with aviation expertise without abdicating their operational control of the relevant aircraft, such an allocation of responsibility requires the lessee to accept responsibility for maintenance since it is making the ultimate airworthiness determination before the flight. Under this analysis, even if the lessor or lessor's management company is the maintenance coordinator, this fact alone should not trigger a determination by the FAA that the lease is a wet lease. But, if the lessee simply boards the aircraft and departs as a charter passenger would do, the likelihood of classification as a wet lease, or sham dry lease, is increased.

Finally, the maintenance cost could be covered by maintenance reserves paid by each of the lessees to the lessor. This allows the contributions to the cost of maintenance to be allocated based on the amount of use by each lessee. Of course, the parties would need to agree upon the commercial terms including what costs would be covered by the aircraft owner and what would be covered by the reserves. If the lessees are neither responsible for confirming the airworthiness of the aircraft or the cost of the maintenance, the FAA may be more likely to view the arrangement as a wet lease because the lessee is not exercising operational control.

## **Authorizations**

Necessary authorizations, such as letters of authorization (“LOAs”), need to be issued in the name of the operator. That means that each of the non-exclusive lessees needs to have any required LOAs issued in that lessee’s own name, not in the name of the lessor or of a management company or other party that is not exercising operational control over the flight. This will require coordination with the FAA and could lead to scrutiny of the proposed arrangements. The absence of required LOAs issued in the lessee’s name is an indication to the FAA that the lessee does not actually have operational control.

## **Insurance**

An aviation insurance policy generally consists of hull (physical damage) coverage for the aircraft itself, liability coverage for third party claims for property damage and bodily injury or death, and a collection of other coverages all relating to the aircraft. When there is more than one possible operator of an aircraft, or when an aircraft is covered under a management company’s “fleet policy,” each aircraft is generally covered under only one aviation insurance policy designed to cover all operators and all operations of that aircraft. This is done partly as a matter of convenience, but more importantly, also as a means to ensure that no conflicts over coverage arise so that there is one policy that will respond to an accident or incident and provide coverage for the benefit of the aircraft’s passengers.

In order for this approach to work as described, however, it is critical that when one policy is used (for example the lessor may purchase and pay for the policy in its status as a first named insured), as each new lessee is added, then the lessee is also added to that insurance policy with appropriate endorsements acknowledging that the lessee is covered for its own operations of the aircraft rather than coverage being limited only to the operations of the lessor. In this instance, the lessee is either paying for its pro rata share of the insurance through the rental payment it is making, or it may be assessed an individual charge if the insurance provider increases its premium in order to extend the coverage to the additional lessee.

It is critical that when this approach is taken, the insurer understand the proposed arrangement and that the insurer has been given copies of the relevant agreements and has affirmatively recognized that these agreements are covered contracts under the policy so that appropriate coverage will be available to relevant parties when needed.

The fact that the lessor pays for the policy, which is arguably the most common approach, should not result in a wet lease classification provided that it is clear to the insurer that each of the lessees will assume operational control of the aircraft for their flights. If the policy is written in a way that reflects that operations of the aircraft are to be conducted only by the lessor (or its management company), then the lessee would appear to be a mere passenger only and therefore not a party that has actual operational control and use of the aircraft during its lease periods. The policy should also be reviewed to ensure that there are no provisions that require approvals or performance by the lessor or its management company. For example, if only pilots approved by the lessor’s pilot can operate the aircraft, a lessee’s ability to obtain its own crew is somewhat restricted. Although approval does not necessarily need to be deleted, it should not apply to all of the crew qualification options. A better option would be the use of an objective assessment so that pilots meeting such objective qualifications could be used.

Similar to the analysis of which party is responsible to ensure appropriate maintenance has been performed as discussed above, the key with respect to insurance should not necessarily be that each individual lessee must obtain its own separate insurance policy, but that it must either obtain its own policy or in the alternative ensure that it has been added to the lessor’s policy. If the lessee elects to be added to the lessor’s policy, then the insurance carrier must be fully informed of the arrangements such that full hull and liability insurance coverage will be available for that lessee’s use of the aircraft.

## **CONCLUSION**

The FAA’s guidance material and legal interpretations make clear that the classification of a lease as a dry lease or a wet lease is dependent on the totality of the circumstances. This includes the terms of the lease, the specific facts of the arrangement, and the implementation of the lease provisions.

There is no one solution that will fit all needs nor is there a guarantee that the FAA will agree that a lease or the agreements under a non-exclusive lease arrangement are in fact dry leases. However, by approaching the structure, documentation and actual operations in a manner that (i) reflects the assumption of responsibility by the lessee, or each of the lessees individually under non-exclusive leases, for operations and maintenance, (ii) clearly identifies the delivery and re-delivery of the aircraft and therefore which party is responsible for the safe conduct of flight at any point in time, and (iii) ensures that the lessee is obtaining its own crew and otherwise properly addressing each of the factors that have been enumerated in its analysis of whether or not operational control has been successfully transferred to a dry lessee, there is a solid basis for the FAA to find the proposed leasing arrangements to be legitimate.

# Part Three: Frequently Asked Questions

## GENERAL QUESTIONS

### 1. Why is the government so concerned about the aircraft leasing practices of private parties?

Our modern system of aviation regulation is based on the distinction between private aviation and commercial aviation. Private aviation is regulated to promote safety, but these regulatory requirements are relatively less burdensome because the persons engaging in private aviation are considered responsible for their own wellbeing and the wellbeing of their guests. In contrast, those who operate commercial flights are held to a higher degree of care in order to better protect the members of the public that they are paid to carry. This system of accountability and safety is badly undermined if people operate under the private aviation rules while actually performing commercial services for a segment of the public.

The FAA initiative is focused on illegal charter and is driven by safety concerns for passengers, the agency having identified cases of non-certificated operators providing common carriage<sup>19</sup> by holding out air transportation to the public through “devious” or “sham” dry lease arrangements. Such “holding out” may be in the form of dry lease web-based advertising, or dry lease programs where the documents purport to transfer operational control to the passenger through a non-exclusive dry lease, but in fact the provider is packaging the aircraft with the provision of flight crew (often through a related entity).

The FAA also remains concerned about unauthorized private carriage for hire (i.e., where a party may effectively provide air transportation for compensation to other entities, not in accordance with the limited provisions of FAR 91.501). This includes for example the non-exclusive dry lease arrangements discussed in the guidance, where operational control is not effectively transferred to the Lessee.

### 2. What is the difference between a Part 91 operator and an air carrier or commercial operator?

Simply put, a Part 91 operator can conduct operations following the regulations in FAR Part 91, while an air carrier or commercial operator must be certificated by the FAA under FAR Part 119, and are typically required to operate under the rules of FAR Part 135 (charter) or Part 121 (airlines).<sup>20</sup> Commercial aviation involves carrying people or cargo for compensation, including non-monetary benefits.

### 3. What is the difference between a “dry” lease and a “wet” lease for aircraft?

Both types of lease involve a transfer of possession of an aircraft and allow the use of its entire cabin capacity. Fundamentally, a “dry” lease provides the aircraft without a crew (i.e., the lessee must obtain its own crew), whereas a “wet” lease provides an aircraft with a crew. The FAA will then look to additional factors such as who is responsible for maintaining the aircraft, who is responsible for insuring the aircraft, who is providing the fuel, and so forth. Under a wet lease the lessor retains operational control of the aircraft and is being compensated for providing an air transportation service – it is acting as a commercial operator – and under a dry less operational control is transferred to the lessee. The next question, then, is whether that lessee is acting as a private operator (i.e., carrying its own passengers or property with no compensation occurring), or is instead being reimbursed and therefore acting as a commercial operator.

### 4. Are there times when I can operate a wet lease under Part 91?

Under certain circumstances, large aircraft (more than 12,500 lbs. MTOW) can engage in certain narrow types of wet lease operations enumerated in FAR 91.501, such as time-sharing agreements, subject to compliance with truth-in-leasing requirements. Small aircraft (12,500 lbs. MTOW or less) can engage in wet leasing pursuant to 91.501 if they meet the requirements of the NBAA small aircraft exception, including being NBAA members, complying with specific maintenance requirements, and filing a notice of joinder with the FAA.<sup>21,22</sup>

### 5. Why are some leases considered acceptable for a Part 91 operator while others require an air carrier or commercial operator certificate?

The answer to this question involves the connection between possession of an aircraft, on the one hand, and the operation of that aircraft, on the other. In the case of a dry lease, the lessor gives the lessee possession of the aircraft and also transfers operational control – the privileges and responsibilities of operating the aircraft – to the lessee. If that lessee is then carrying passengers or property without receiving any compensation or reimbursement for those flights, then it may operate under the private aviation rules. The same cannot be said for a wet lease. In the case of a wet lease, the lessor is considered

<sup>19</sup> See Advisory Circular 120-12A (Private Carriage Versus Common Carriage of Persons or Property).

<sup>20</sup> Note that FAR 91.321 and 91.501 contain a few exceptions to this general rule.

<sup>21</sup> For more information go to <https://nbaa.org/flight-department-administration/aircraft-operating-ownership-options/nbaas-small-aircraft-exemption/>.

<sup>22</sup> See also FAR 91.321 for carriage of candidates in elections

to have retained both possession and control of the aircraft operation because the lessor is providing not only the aircraft but also the crew that will pilot it. Because the lessee has paid the lessor under the wet lease, the flight that is operated by the lessor (through the crew it provides) is considered a form of commercial aviation.

## **6. Why should I care to avoid a situation where my aircraft lease is considered a wet lease that requires an air carrier or commercial operator certificate?**

If you want to operate a commercial flight under a wet leasing arrangement, unless one of the narrow exceptions of FAR 91.501 applies, you must among other things: (a) comply with the licensing requirements of the Department of Transportation, (b) comply with the safety licensing and operating standards of the FAA, and (c) comply with the security program requirements of the Transportation Security Administration. The operator of a commercial flight under a wet leasing arrangement may also be required to collect and remit various taxes to the Internal Revenue Service and to Customs & Border Protection. Failure to do any of the above can result in substantial civil penalties and, at a certain level, even criminal penalties. Additionally, the language of many individual aviation liability policies is written to cover only private aviation flights. So, if you inadvertently engage in commercial operations through a leasing arrangement, you might be doing so without the protection of the insurance policy that you purchased.

## **7. What does the FAA mean by “totality of the circumstances” in determining which party has operational control?**

To ensure that parties do not disguise wet leases as dry leases, FAA inspectors will look at several factors in determining which entity effectively has “operational control” of the aircraft under a leasing arrangement.

FAA guidance provides broad questions such as “who decides when maintenance is accomplished”, “who pays for airport fees” and “for whom do the pilots work as direct employees or agents” to aid parties and FAA inspectors in determining which entity has operational control and other FAA guidance.<sup>23</sup> The answers are factors to weigh in determining whether the lessor, lessee, or potentially the manager is actually in operational control, and is not intended to be a “required” checklist where the lessee must have all indicators of operational control. (These factors are discussed above in the *Part Two - Operational Control: Classification of an Agreement as a “Wet” or “Dry” Lease* section of this publication).

In practice, in a non-exclusive lease, the lessee will rarely if ever have all indicators of operational control. By weighting these factors, one can determine whether the lessee or the lessor is effectively in operational control. (For example, if based on the totality of the factors the lessee is in operational control, then the fact that some indicators of control remain with lessor does not make a dry lease into a wet lease).

In fact, from a safety perspective it often makes sense for the lessor to undertake certain tasks rather than the hourly renter/lessee. For example as discussed above (in the *Part Two - Operational Control: Exclusive Leases Vs. Non-Exclusive Leases - Additional Consideration for Non-Exclusive Leases* section of this publication), the lessor may perform maintenance, but the lessee would still need to understand that for any particular flight in which it is in operational control, it should determine, or instruct its pilots to determine, that the aircraft is airworthy by conducting routine pre-flight checks. (See discussion of delegation of responsibility by the responsible person in Question 20).

## **BEST PRACTICES FOR “DRY” LEASING AND OPERATION CONTROL**

### **8. What agreements are recommended for a dry lease arrangement?**

It is always recommended, and in many cases legally required, that you have a written lease agreement signed both by the lessor and the lessee. For the lessee to be able to prove that it has operational control of the leased aircraft, it is strongly recommended that the lessee have written agreements for the crewmembers that it directly employs or that it engages and uses through sources other than the lessor (or anyone owned or controlled by the lessor).

In the lease agreement, the following elements should be addressed in addition to the other customary business terms for such agreements. This list is by no means exhaustive.

- The requirements of the FAA’s Truth in Leasing rules (FAR 91.23), if applicable.
- An acknowledgement by the lessee of the authority and responsibility that it is assuming as it takes possession of the aircraft under this lease and operates it. In addition to this acknowledgement of operational control responsibility, it is important that the lessor and lessee document when and how the operational control will be shifted between them during the course of the lease. For a long-term, exclusive lease, this is easy. For short-term, non-exclusive leases, this becomes more important, because possession and control may move back and forth among two or more parties.

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<sup>23</sup> FAA Advisory Circular AC 91-37B, § 6.3 and FAA Order 8900.1 Vol. 3, Chapter 13 § 6, 3-507.

- The responsibility for ensuring the maintenance of the aircraft is current and complete. Unless the lessee will possess the aircraft the majority of the time, it often makes sense for the lessor to retain the responsibility for performing general maintenance planning and oversight. However, the lessee must be able to review the maintenance status of the aircraft and exercise the lessee's own judgment to verify the aircraft is airworthy before each flight that the lessee operates.
- The responsibility for ensuring that the aircraft and its use has been properly insured. It often makes the most sense for the lessor to insure the aircraft rather than a lessee, including naming the lessee as an additional insured, so long as the parties coordinate with the insurance carrier to make sure that all operations of the parties are properly covered. Among other things, this enables the lessor to better protect its interests in the asset. In the case of non-exclusive leases involving more than one lessee, having the lessor procure the insurance can help prevent gaps in coverage resulting from any confusion with the lessees. However, the lessee must be able to review the certificate or policy and exercise the lessee's own judgment to verify that sufficient insurance is in place before each flight that the lessee operates.

## **9. What costs can be included in a dry lease arrangement?**

A dry lease normally includes a fee component that compensates the lessor for the capital costs of its aircraft. For short term, non-exclusive leases it is also common for the lessor also to procure insurance (and name the lessee as an insured, in many cases), maintenance, and base hangar facilities for the aircraft and then to include those costs in the lease rate. The cost of crew employment, benefits, or training should never be included in the lease.

## **10. Does the lessee under a dry leasing arrangement need to have its own flight department in order for it to demonstrate operational control of the leased aircraft?**

No, a formal flight department is not required. However, the lessee must be able to demonstrate that it has the ability, either directly or through independent, third-party services, to confirm the airworthiness of the aircraft, plan a safe and compliant flight, and employ or procure the crew members, among other things.

## **“REAL WORLD” QUESTIONS**

### **11. Our business established a subsidiary limited liability company to hold title to our aircraft. Can that limited liability company operate passenger flights and be reimbursed by its parent? Or can that limited liability company lease the aircraft to its parent so that the parent company can carry its own guest passengers?**

The general rule is that an aircraft special-purpose subsidiary may not accept any amount or kind of compensation, including capital contributions, from others (even a related company) to carry passengers. If that special-purpose entity's sole function is to provide transportation for its affiliates, then the FAA would consider the entity to be a "flight department company" and would require it to obtain commercial certification to conduct those flights. However, the subsidiary may dry lease the aircraft to a business entity such as its parent company provided that the lessee company will assume operational control and operate the aircraft incidental to its business. The lessee company will need to employ or procure the aircraft crew or obtain them from some source other than its aircraft special-purpose subsidiary.

### **12. How do I reconcile the flight department company rule (which requires us to respect corporate entities) and FAA guidance on leasing (which looks at the substance and relationship of the entities)?**

FAA guidance is clear that parties must respect corporate entities regarding reimbursements. For example where two individuals are members of a limited liability company (the LLC), generally the LLC cannot operate the aircraft under FAR 91 and receive compensation in any form from the member for those flight, if the primary purpose of the LLC would be to provide air transportation to the members. (The LLC is legally distinct from the members.) Conversely when the members lease the aircraft on a non-exclusive basis from the LLC, the FAA will look through the corporate entities and contractual arrangements, including ownership, in determining whether the LLC has effectively transferred operational control to the member for that member's flights. For example, the fact that the members each hire the same pilots who may be employed or procured by the manager hired by the LLC to maintain the aircraft may require further inquiry to determine whether the LLC has effectively transferred operational control to the members.

Reconciling these can be difficult. However, keep in mind that the FAR and FAA interpretation are driven by safety concerns. And the flight department company rule (which was originally created as part the promulgation to what is now FAR § 91.501(b)(5) and has been further defined through a series of interpretations) is designed to prevent illegal holding out and charter, rather than to impose a catch-22 on individuals and companies that are trying to comply with the FARs. Historically, FAA enforcement has focused on the schemes to provide illegal charter rather than the latter.

This issue as well as others relating to FAA guidance on dry leasing are the subject of ongoing dialogue between the FAA and industry groups.

**13. If we do not want to bother with making such a lease and having separate crewing arrangements, may we carry passengers for free? May we accept capital contributions from the parent company as a way to offset the cost of operating the free passenger flights?**

Carrying passengers for free is one way to ensure that a flight is not deemed commercial. However, if the flight is labeled free while payments are made in an alternative form, such as a recurring capital contribution to the company that is operating the flight, your flight may be considered commercial anyway. To help assess the appropriateness of a capital contribution to a company, you can look to see whether the contribution is used to run the general affairs of the business entity or is actually being made to cover the costs of the aircraft operations. You also should consider whether the contribution provides the funding necessary to purchase and preserve the aircraft as an asset, or whether the contributed funds really offset operational costs for the aircraft. Finally, if there is no business in that company other than the aircraft itself, then the company will be considered to be a flight department company that must obtain commercial certification to operate the aircraft.

**14. We do not charge others for being passengers on our flights. We only have our own employees on the aircraft. But we do want our customers to reimburse us for the cost of these flights because it was a travel expense for our business. Is this okay?**

If you only carry your own company's employees or property as passengers or cargo without receiving compensation, then it does not appear that you are providing a commercial transportation service to others. With respect to the carriage of customers who are not employees, the general rule is that you cannot seek compensation for those flights. That said, if your operation does qualify for the exceptions found in FAR § 91.501, you may be able to seek pro rata reimbursement for flights that are conducted incidental to and within the scope of your own business activity in accordance with 91.501(b)(5).

**15. Do these commercial-versus-private and dry-versus-wet leasing considerations change if our company hires a management company that also holds a DOT air taxi registration and FAA Part 135 air carrier certificate?**

If the aircraft operations are conducted by and under the exclusive operational control of a management company that holds a Part 135 certificate then these are commercial flight operations. It is also common for such management arrangements to provide for Part 91 operations by the owner, or for owners to dry lease the aircraft to a related entity on a non-exclusive basis. However, in such cases, all of the requirements discussed in the guidance regarding dry leasing and operational control would apply.

For example, a typical scenario is where the aircraft owner is an entity that does not operate the aircraft (because of the flight department company rule) but rather leases the aircraft on a non-exclusive basis to one or more beneficial owners of the aircraft owner entity for such beneficial owner/lessee's use. Each lessee would separately contract for pilot services, which may be obtained from the aircraft owner entity's management company. Provided the lessees contractually have operational control and understand their responsibilities as operators for those flights, such an arrangement generally does not raise the same types of concerns about "illegal holding out" or "devious leasing" arrangements, such as those described in these guidelines. And in fact, there are a number of aspects that enhance safety including: having the same pilots that are routinely assigned to the aircraft for charter operations, flying as agents of the beneficial owner/lessee for beneficial owner/lessee's Part 91 flights, and the management company providing a higher level of maintenance oversight. In addition, the management company should ensure that its POI has reviewed such arrangements for compliance with the FAR.

**16. Can related parties hire the manager of the aircraft (that is not a certificated air taxi operator) to provide pilot services, to support a non-exclusive dry lease from the owner?**

Similar to the scenario described in Question 15, sometimes an aircraft owner entity will hire a non-certificated manager to manage an aircraft, and because of the flight department company rule, the aircraft owner entity will lease the aircraft to each beneficial owner with each beneficial owner separately contracting for pilot services, typically from the manager. As with Question 15, this generally does not raise the same concerns as multiple-dry leases to unrelated parties and is a common practice. However, the parties would still need to ensure that as between the lessees and manager in particular, it is clear that each lessee, rather than the manager, is in operational control of flights.

**17. Does it matter to the FAA if we have multiple dry leases? Is there a limit on the number of dry leases we can have?**

There is no set rule on the number of dry leases you may lawfully have.

For example, it is normal for small aircraft rental companies to lease out their aircraft to private operators for mere hours or days at a time, resulting in many leases for each aircraft in the course of a year. There is nothing wrong with this so long as the lessee in each case obtains its own crew apart from the lessor, and so long as the lessee otherwise exercises operational control as described in the law and summarized in this guide.

However, if there were a number of leases of the aircraft to unrelated lessees who all hire the same pilots, the FAA would look closely at whether there was a “holding out” of air transportation, and the leases may be construed as illegal wet leases. See discussion in Question 1. In addition, FAA instructions suggest that “[i]f an aircraft is on numerous leases, dry or wet, the office should give greater consideration to conducting a ramp inspection, as a large number of leases may indicate that a lessor is attempting to circumvent part 119 requirements.”<sup>24</sup>

Further, if your company is planning to have more than one lessee for its aircraft, you should verify that you are not directly or indirectly providing or selecting the crew that will be used by any lessee. It is also a best practice to be aware that the closer your lease price is to prevailing charter rates, the more likely it may be suspected by government authorities as an unauthorized wet lease.

**18. There are only so many pilots in our area with the right qualifications to fly the aircraft we are leasing. Can a lessor and lessee ever use the same pilots? Can separate lessees use the same pilots?**

There is no clear rule on this. In each case, you must make sure that the engagement with the pilots is not given by, directed by, or otherwise controlled by the lessor of the aircraft. The lessor can have a say in the pilot standards that will be applied (e.g., license requirements and safe operating history) but the lessor must not be involved in providing the crewmembers. Further, the pilots hired should not have any financial interest in the aircraft or employment relationship with the lessor.

**19. Evaluation of a leasing arrangement appears to be a complex and somewhat subjective analysis; How will the FAA enforce these requirements? And how does this fit with the FAA new compliance program?**

We expect the FAA will be aggressive in taking action where operators are deliberately using sham leasing arrangements to hold out transportation to the public. We would expect to see the use of civil penalties, cease and desist orders, and potential suspension or revocation of certificates for pilots involved, especially those who were knowingly complicit in such actions. Even in cases where a pilot contends that he or she did not understand the legal implications of a lease arrangement, the FAA may still seek legal enforcement action based on circumstantial evidence.

Although the FAA may not review every lease after receiving a notification as required by truth-in-leasing requirements, when the FAA does review arrangements as part of truth-in-leasing filings prior to any flights under those agreements, anecdotally we believe that inspectors may advise parties if the arrangements raise issues of potential non-compliance.

Where the FAA reviews existing arrangements involving related party leases, during a ramp check or otherwise, and determines that there has not been an effective transfer of operational control to the lessee, but that there does not appear to be any attempt to hold out to the public or intentional conduct to violate the regulations, we anticipate that, consistent with FAA compliance program, the FAA would work with the parties to educate and correct the parties rather than immediately take enforcement action. However, if the FAA takes the position that the matter is not within the scope of the compliance program, then it is likely to be resolved with legal enforcement action which can include certificate suspension or revocation and civil monetary penalties.

**20. I understand as lessee, I am responsible for operational control - can I delegate performance of some tasks I am responsible for?**

The short answer is yes. For example, you may contract with a manager to provide pilots, who will pilot the aircraft as your agents, perform flight planning, and handle logistics. Similarly, you can delegate to the pilots to perform pre-flight checks to meet your responsibility for determining the airworthiness of the aircraft. From a safety perspective it is imperative that licensed pilots and mechanics perform key functions. However, it must be clear both contractually and in practice that you as lessee under a dry lease are ultimately responsible for these functions, even if delegated.

**21. Does a dry lease trigger any tax consequences?**

Generally speaking, the answer is yes. Leasing revenue and related expenses may have federal and state income tax implications. Leasing activities may also trigger sales/use tax obligations at the state and/or local level. Anyone engaged in a dry leasing activity should consult their tax advisor to determine how to properly structure and report the activity.

**22. Does operational control have an impact on lessor or owner liability?**

Yes. The FAA Reauthorization Act of 2018 confirmed the pre-emptive effect of 49 USC sec. 44112(b). That statute provides for lessor and/or owner liability for personal injury, death, or property loss only when the aircraft is in the actual possession or operational control of the lessor or owner. Therefore, the relevance of operational control is not limited to an analysis of FAR compliance.

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<sup>24</sup> Order 8900.1 Vol. 3, Chapter 13 Section 6, 3-504(d).





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