CEP Magazine - February 2021
Dodge legal turbulence: Cover FAA regulations in your compliance program

By Michelle Wade, Esq.

Michelle Wade (mwade@jetstreamlaw.com) is Partner at Jetstream Aviation Law based in Olathe, Kansas, USA.

The company jet is a useful business tool providing safety and privacy while on board during business trips; however, even private aircraft are highly regulated. US government agencies, including the Federal Aviation Administration (FAA), Internal Revenue Service, Securities and Exchange Commission, and state departments of revenue, to name a few, all have regulations concerning the company jet. The increasing complexity of government regulations and company structures makes it difficult to identify when a change in the company affects regulatory compliance of the company jet.

Foisting nonflying responsibilities onto the flight department is common. A pilot's primary job is to safely fly the plane, and the chief pilot also generally manages the flight department. Is it reasonable to expect the pilot to know how to safely operate a complex piece of machinery and also know the details of regulations regarding aircraft registration and FAA legal interpretations of regulations on the structure of aircraft operations? Probably not.

If your company operates a company plane, whether it is an aircraft owned by the company or an aircraft in a fractional program, your compliance checklist should include confirming whether the registration and operation of the jet are in compliance with the applicable federal aviation regulations.

Aircraft registration

14 C.F.R. § 47 regulates aircraft registration. The FAA registry has additional requirements for aircraft registration, and after a 2020 Government Accountability Office report[1] stating that the FAA needs to better prevent, detect, and respond to fraud and abuse risks in aircraft registration, more regulations are likely forthcoming.

Currently, the FAA relies on self-certification and doesn't verify key information at the time of initial registration or throughout the term of an aircraft's registration. It is easy to inadvertently become noncompliant with the US federal aviation regulations regarding aircraft registration and for this noncompliance to exist for years because no one confirms that the facts are the same and the aircraft still has a valid registration.

If the aircraft's registration is in the name of a corporation and a new president is appointed who is not a US citizen, then the aircraft's registration becomes invalid, because per 14 C.F.R. § 47.2, the president of a corporation must be a citizen of the United States, among other requirements. If a foreign (non-US) investor buys a 30% voting interest in the corporation, the aircraft's registration becomes invalid, because per 14 C.F.R. § 47.2, at least 75% of the voting interest must be "owned or controlled by persons that are citizens of the United States."

Aircraft operations

The concept of aircraft "operations" has multiple meanings. The first involves the physical operation of the aircraft, requiring compliance with regulations such as the type of equipment required to be on board for certain operations and the requirement that the pilots communicate with air traffic control in certain airspace. The pilots and mechanics in the flight department can comply with these regulations and generally participate in continuing education on these topics.

A second concept of aircraft operations involves identifying which entity owns the aircraft; whether there are any leases, timeshare agreements, or interchange agreements; and whether the terms of the agreements, the way the aircraft is operated pursuant to these agreements, and the way payments are made pursuant to these agreements are in regulatory compliance. The pilots and mechanics in the flight department generally do not receive education on these topics. Plus, to determine whether the aircraft operation complies with the regulations requires knowledge of the current facts, and the pilots rarely receive information on who is making payments and in what amount to cover what expenses.

One example of common regulatory violations in this area is the operation of the aircraft by an entity whose sole purpose is to own and operate the aircraft. This violates the federal aviation regulations per FAA's interpretations.[2] A second example of a common regulatory violation with aircraft operations involves a "dry lease," which is a type of lease commonly used with private planes; however, this term is frequently misunderstood. A common misperception is that a dry lease only requires that the lessee buy fuel for the plane, but to the FAA, a dry lease means that the owner provides the aircraft and the lessee supplies its own flight crew and retains operational control of the aircraft.[3]

The method of making payments is also critical to compliance with certain aviation regulations, but it can unexpectedly change when there is a change of personnel in the payables department. The initial payables personnel may have received education that due to regulatory compliance requirements, the lessee under a dry lease of the aircraft must write two checks, one to the crew and a separate check to the lessor for the lease of the aircraft. New personnel may not receive training as to the regulatory requirement for two checks for the aircraft dry lease, but they may identify the ability to streamline their workflow and combine the payments into one check. Unfortunately, this action creates an inadvertent violation of the aviation regulations.

Those at the higher levels of the corporation may also inadvertently create regulatory violations by actions such as promising a flight to a customer's executive in exchange for a payment covering operating costs or offering a flight on the company jet as a prize at a charity auction.

Risks of noncompliance

The risks created by violations of aviation regulations are not immediately visible but can become unpleasantly visible should an event occur that results in an investigation by the FAA or a claim on the insurance. In videos on its YouTube channel,[4] the FAA states that it generally views regulatory violators as clueless, careless, or criminal.

The FAA is currently operating under a compliance philosophy, which may result in the FAA addressing minor infractions with specifically tailored remedial measures with a goal of improving aviation safety. However, regulatory violations may also result in the FAA pursuing civil penalties against the company. Many of these civil penalties are imposed on a per-flight basis and can be hundreds of thousands of dollars because the violation occurs on each flight over a significant period. The FAA may also revoke or suspend the pilot certificate of pilots involved in the operation. The FAA refers serious cases for criminal enforcement.

The FAA has been actively promoting a campaign of public awareness on common regulatory violations, such as an entity with no business purpose operating an aircraft. The ready availability of free information and the availability of experienced aviation counsel to hire to advise the company on whether the company's aircraft ownership and structure of operations is in regulatory compliance can make ignorance of the problem appear more like willful blindness than a minor infraction.

In addition to FAA civil penalties, there is a risk of the insurance company denying coverage if a claim is made and the aircraft's operation was not in compliance with aviation regulations. After an incident has occurred, no one wants to hear that the insurance policy does not provide coverage due to the company's regulatory violations. Aviation claims are rarely small.

Reputational risk can also be significant if the FAA issues a press release about a significant civil penalty that is being pursued against the company[5] and the press release is then picked up by local and industry publications.

How to avoid common regulatory violations

Noncompliance with aircraft registration regulations frequently arises without the knowledge of the flight department. Does anyone in the company tell the flight department when a foreign investor buys a voting interest in the corporation or whether the new company president is a US citizen? Many in-house counsel are not familiar with the details of the FAA requirements for aircraft registration and operation, and gaining that knowledge can be time-consuming, because it involves researching the law and regulations and sorting through decades of FAA chief counsel interpretations.

The compliance department should consider whether oversight of compliance with the federal aviation regulations should involve an annual review of the current facts against the applicable regulations, especially those regulations regarding registration of the aircraft and how the aircraft operation is structured. To achieve the best results, consider creating a team consisting of personnel from the flight department, compliance department, legal department, payables department, and outside aviation counsel to perform the annual review. The review can cover topics such as what aircraft are owned or leased by the company, whether the owner is still eligible to register the aircraft under the FAA's regulations, who is using the aircraft and in what capacity, and what entities and accounts are used to pay for pilots and operating expenses of the aircraft. In some years, nothing will have changed and it will be a short meeting, but other reviews will identify a change that requires further review to confirm whether the aircraft operation is still in regulatory compliance.

Ensure that personnel with the information understand the need to share that information with the people responsible for aviation regulatory compliance. Also ensure that personnel responsible for aviation regulatory compliance have the authority to ask questions and obtain relevant information to confirm that no changes have occurred that negatively affect compliance. These actions, in addition to an annual review, help maintain aviation regulatory compliance.

Takeaways

- Compliance programs should consider whether the company is in compliance with aviation regulations.
- Do not assume that "everything" involving the company jet will be handled by the flight department.
- Aviation regulations are complex and not intuitive.
- The potential for significant civil penalties and denial of insurance coverage after a claim is a strong incentive to remain in compliance with aviation regulations.
- An annual review with relevant personnel can ensure that changes affecting the company jet's registration

and operation are addressed when evaluating compliance with aviation regulations.

1 Government Accountability Office, *FAA Needs to Better Prevent, Detect, and Respond to Fraud and Abuse Risks in Aircraft Registration,* March 2020, https://bit.ly/3mxOZVN.
2 Lorelei Peter, "Re: Operations carried out by limited liability companies under 14 C.F.R. § 91.501(b)(4)," FAA interpretation, August 22, 2017, https://bit.ly/344DONf.
3 Rebecca B. MacPherson, Letter to Mr. Johnson, FAA interpretation, August 11, 2011, https://bit.ly/2Vtk3dj.
4 Federal Aviation Administration, "LIVE: FAA Safe Air Charter Workshop," streamed live on November 5, 2020, YouTube video, 45:30, https://bit.ly/2IEXJdY.
5 Federal Aviation Administration, "FAA Proposes $3.3 Million Civil Penalty Against The Hinman Co.," news release, June 29, 2018, https://bit.ly/3oik1Bk.