

By Gregory W. Carboy

Assist your client in developing plans to minimize the client's civil, regulatory and overall risk.

An Alternative to the Increasingly “Unfriendly Skies”

Over the past several months, it seems that almost weekly one could either read or hear a news item about the economic challenges facing the U.S. airline industry and the traveler's increasing dissatisfaction with the

industry's overall performance and customer service. The 18th annual national Airline Quality Ratings, recently published by Wichita State University and University of Nebraska at Omaha, indicate that customer satisfaction with the industry's performance reached a 20-year low. Roger Yu, Airlines' Performance Near 20 Year Low, http://www.usatoday.com/travel/flights/2008-04-06-airlinecomplaints_N.htm (citing Brent D. Bowen & Dean E. Headley, *Airline Quality Rating 2008*, <http://www.aqr.aero/aqrreports/2008aqr.pdf>). In 2008, at least three air carriers—Aloha, Skybus and ATA—incapable of weathering historically high fuel prices and declining demand, filed for bankruptcy and ceased operations. A fourth, Frontier Airlines, filed for Chapter 11 reorganization, continuing to operate under the bankruptcy court's protection. Delta and Northwest, buffeted by the same economic headwinds, announced their merger. And all carriers are now confronted with a zero tolerance Federal Aviation Administration (“FAA”), determined to ensure strict

compliance with mandatory maintenance requirements without regard for economic impact. In fact, American Airlines, over a four day period in April 2008, was forced to cancel more than 3,000 flights in order to repeat mandatory safety inspections of wire bundles in all its MD-80 aircraft. The re-inspections were ordered after an FAA inspector questioned American's technical compliance with Airworthiness Directives affecting the installation and condition of the bundles.

Estimates are that the ensuing disruption of American's service left over 250,000 travelers either stranded or significantly inconvenienced and in search of alternative transportation. In addition, the disruption cost American tens of millions of dollars in lost revenue. Terry Maxon, *Cutbacks Planned After Loss*, Dallas Morning News, April 17, 2008, at 6D. The impact of American's April flight cancellations on the economy has not yet been determined, but in general, the negative economic impact resulting from flight disruptions and the



■ Gregory W. Carboy is a shareholder of Cowles & Thompson, P.C. in Dallas. As a trial attorney with over 16 years experience, Mr. Carboy concentrates his practice in the areas of product liability, transportation and commercial litigation, and he provides general legal counsel to many aviation related enterprises. He is also the current chair of the Aviation Specialized Litigation Group of the DRI Product Liability Committee.

growing strain on the air traffic system cannot be understated. In a January 2008 speech to the Aero Club of Washington, D.C., Transportation Secretary Mary Peters estimated that flight delays for domestic and international flights cost the U.S. economy almost \$15 billion dollars a year in actual costs and lost productivity. Del Quentin Wilber, *Delayed: The Soaring Toll*, The Washington Post, January 27, 2008, at A01. The secretary's estimate, however, may have been low. In May 2008, the Majority Staff of Congress's Joint Economic Committee estimated the total cost to the U.S. economy from domestic flight delays to be as much as \$41 billion dollars, \$12 billion of which was lost employee productivity and business opportunities. Majority Staff of Joint Economic Comm., 110th Cong., *Your Flight Has Been Delayed Again: Flight Delays Cost Passengers, Airlines, and the U.S. Economy Billions 1* (Comm. Print 2008), available at <http://jec.senate.gov/> (follow link to May 22, 2008 report).

Due to the increasing cost of flight delays and the adverse impact on employee productivity, many businesses now consider private aviation for employees and executives a reasonable alternative to scheduled carrier service. Once viewed as a perk to corporate executives, private aviation is now perceived as a way to maintain, if not increase, employee productivity by providing a safe, efficient means of transportation.

Regardless of the nature of your practice, one day you may be asked by your business clients for guidance regarding alternative aviation transportation and possible private aircraft ownership. If so, you can advise your client of options that include aircraft charter, aircraft leasing, aircraft ownership and "fractional ownership," each of which offer unique benefits, risks and costs. Deciding whether one option is more economical or appropriate for your client is obviously dependent on the client's specific needs, desires, and financial circumstances. More importantly, your client's selection will be significantly influenced by the amount of control the client wishes to retain over the transportation of its employees, as well as the degree of willingness and ability to manage the risk concomitant with aircraft ownership and operation.

The cost-benefit factors used to determine the best option for a client are numer-

ous and each analysis is sufficiently unique to be beyond the scope of this article. However, the prudent practitioner should be aware of the federal regulatory requirements governing each option as you assist your client in developing plans to minimize the client's civil, regulatory and overall risk.

Aircraft Charter

Whether carrying passengers by charter or scheduled service, an air carrier must obtain both "economic" authority from the Office of the Secretary of Transportation and "safety" authority from the FAA to carry passengers or air-cargo within the United States. 49 U.S.C. §41101; 14 C.F.R. pt. 201. To obtain economic authority, the carrier must demonstrate that it is "fit, willing, and able to provide the transportation to be authorized by the certificate" and capable of complying with FAA regulations. 49 U.S.C. §41102(b). The air carrier also must have liability insurance "sufficient to pay... for bodily injury to, or death of, an individual or for loss of, or damage to, property of others, resulting from the operation or maintenance of the aircraft under the certificate." 49 U.S.C. §41112.

While both charter operators and scheduled carriers operate by the authority of an Air Carrier Certificate under 14 C.F.R. §119.5, and are subject to strict federal regulation and FAA oversight, their respective operations are subject to different regulatory provisions and requirements. Specifically, charter operations are governed by 14 C.F.R. part 135; scheduled carrier operations are governed by 14 C.F.R. part 121. Generally, both parts 121 and 135 subject the air carriers to stringent operational and maintenance requirements. Even with stringent FAA regulatory oversight, the public still perceives charter operations as less safe for a variety of possible reasons: lack of name recognition for many charter operators; the relatively smaller size of a typical charter aircraft; and the statistically higher accident rate for charter operations in general, skewed by accidents and incidents occurring in high risk operations, such as medical air ambulance.

Despite the public misperception about the safety of charter flights, aircraft charter service can still be attractive to clients with limited resources or who have spo-

radic need for private corporate travel. A client's proposed charter cost is calculated based on the number of flight hours for the trip plus any additional costs, such as car rental fees at the destination or costs to be incurred by the flight crew in the event of an overnight layover. If acceptable, a contract is signed with the carrier for the specific flight. In effect, the aircraft charter flight is a so-

An action may lie based upon the principal's "negligent selection" of a carrier.

phisticated taxi service. But since a charter customer does not own the aircraft and is not responsible for its maintenance or operation, it has little, if any, potential liability with respect to the flight operation.

The limited exposure to liability created by the use of charter services arises from the client's conduct in selecting the charter operator. The client arguably assumes the duty to act reasonably when selecting the carrier and coordinating the charter services. This duty has its roots in the duty to exercise reasonable care in selecting independent contractors recognized in the Second Restatement of Torts. *See* Restatement (Second) Torts §411 (1965). While it is well-settled in most jurisdictions that principals are not liable for the negligence of independent contractors, an action may lie based upon the principal's "negligent selection" of a carrier. *See, e.g., Wilson v. Am. Trans Air, Inc.*, 874 F.2d 386 (7th Cir. 1989) (discussing negligent selection theory with respect to charter tour operator).

In *Shannon v. Taesa Airlines*, No. C-2-93-689, 1993 U.S. Dist. LEXIS 21125 (S.D. Ohio July 13, 1993), negligent selection was alleged against a travel agent for selecting a carrier for a flight on which the plaintiff was assaulted. The court applied the theory to the agent's conduct citing cases discussing "negligent selection," including *Wilson*. The court found for the agent holding that "[a]bsent prior complaints or other indications that there may be a problem

with TAESA's on-board security measures, [agent] was under no duty to make specific inquiries into TAESA's on-board security measures." *Id.* at *11.

Similarly, in *Casino Air Charter, Inc., et al. v Sierra Pac. Power Co., et al.*, 95 Nev. 507, 596 P.2d 496 (Nev. 1976), the heirs of a charter passenger unsuccessfully asserted negligence claims against Sierra Pacific

Conduct at least a cursory investigation to ensure the competence and safety of the proposed charter carrier.

with respect to its coordination of a charter flight that crashed causing the passenger's death. Although the decision does not discuss the basis on which Sierra obtained summary judgment, it nevertheless is instructive as it demonstrates the arguable duty for an entity to act reasonably when coordinating charter flights.

Most cases have found no duty on the part of the principal to ensure the safety of the carrier unless the principal has information that would lead a reasonable person to inquire further. *See, e.g., Sova v. Apple Vacations*, 984 F. Supp. 1136, 1142 (S.D. Ohio 1997) ("such a claim of negligent selection will not survive where the evidence shows that the information available to the defendant revealed no safety concerns sufficient to trigger a duty to investigate or to warn."); *but see Schramm v. Foster*, 341 F. Supp. 2d 536, 552 (D. Md. 2004) (holding duty under Maryland law with respect to selecting a motor carrier requires the principal to at least (1) check the safety statistics and evaluations of the carriers with whom it contracts available on the SafeStat database maintained by FMSCA, and (2) maintain internal records of the persons with whom it contracts to assure that they are not manipulating their business practices in order to avoid unsatisfactory SafeStat ratings). It makes sense, therefore, for your clients to conduct at least a cursory investigation to

ensure the competence and safety of the proposed charter carrier.

One way to investigate a charter carrier is to submit a written Freedom of Information Act ("FOIA") request to the FAA seeking information on the carrier's performance and compliance history. Such a request should uncover an operator's accident history or previous failure to comply with regulatory requirements that may have resulted in FAA civil penalties or suspension of the carrier's operations. While prior accidents or incidents may have been unavoidable, a checkered compliance history raises a red flag that should disqualify the carrier from the selection process.

The FOIA request will also confirm whether the proposed service provider is a certificated air carrier or an air charter broker, an entity that serves as a middleman between a customer and a licensed air carrier. Air charter brokering is not illegal, provided the broker clearly defines its role and does not misrepresent the services it provides. In 2004, the Secretary of Transportation announced that the Transportation Department had become aware of certain air charter brokers illegally misrepresenting themselves as air carriers and contracting with customers to provide charter services without having obtained economic authority from the Department of Transportation. The notice stated:

...such arrangements by air charter brokers that do not hold economic authority from the Department [] violate specific Department regulations designed to protect the public in other respects from unfair and deceptive practices and unfair methods of competition in violation of 49 U.S.C. 41712... [a]ccordingly, any advertising by an air charter broker without economic authority should clearly convey the fact that the broker is not a direct air carrier and that the air service advertised will be provided by a properly licensed carrier.

Notice on the Role of Air Charter Brokers in Arranging Air Transportation, 69 Fed. Reg. 61,429 (Oct. 18, 2004).

The notice went on to advise that air charter broker services were legal only if the broker acted either as the customer's agent or the agent of the carrier, provided the broker, when acting as the carrier's agent, disclosed that it was not a direct air

carrier and the air service would be provided by a licensed air carrier. *Id.*

While air charter broker services are not illegal, they may present a significant risk because your client may not know the identity of the carrier and therefore, will be unable to investigate its background before taking the flight. For this reason, as well as the economic risk involved in dealing with a potentially dishonest broker, a client should be advised to avoid engaging the services of an air charter broker.

Your client also should be aware that charter operators may refer, or "broker," flights to other charter operators when the referring operator's aircraft are unavailable. Part 135 of Title 14 of the Code of Federal Regulations does not prohibit the practice of brokering flights, provided the operator to which the flight is referred is also an air carrier. Nevertheless, the client, in all probability, will be unaware of the referral because the contract will remain with the referring operator. Your client's employees will have no reason to suspect the operator is different from the one with whom their employer contracted. Your client should, therefore, investigate the possibility that the flight will be referred, or "brokered," before contracting with the carrier. If the client is willing to accept flights being referred, the charter contract should limit the referral to specific carriers and provide that flights can be referred only after first obtaining the client's express approval. The client should similarly investigate the alternative operators' compliance history and insurance coverage as well before accepting the alternative carrier. Of course, the simpler solution would be for the contract to prohibit brokered flights.

Finally, counsel your client to request information pertaining to the operator's liability insurance, including the policy's limits of liability. The operator should have no objection to providing a certificate of insurance identifying the policy and its limits. With this information, the client can then assess whether additional insurance, such as aviation non-owner liability coverage, should be obtained. It will also allow the client to address any additional risk exposure beyond the scope of workers compensation coverage, including exposure for non-employees, such as guests or business clients, who may also be on the flight.

Aircraft Leasing and Ownership

If your client has significant resources and a need for repeated private air transportation, acquiring an aircraft, either by leasing or purchase, is another option. The type of aircraft acquired can range from a small single or multi-engine propeller airplane to a large turboprop or turbine (jet) powered aircraft. Whether leased or purchased, the aircraft's lessor/owner is "... primarily responsible for maintaining the aircraft in an airworthy condition..." 14 C.F.R. §91.403. And, generally, the aircraft's maintenance and operation will be governed by 14 C.F.R. part 91, provided it is used solely for private, non-commercial travel.

Regardless of whether your client is a business or individual, an aircraft should be leased or purchased and owned through a separate corporate entity, to segregate the liability from the core business or personal interests. The typical corporate entity created to own an aircraft is a limited liability company, although limited partnerships, corporations and other corporate forms may be more appropriate depending upon the client's overall business plan.

Before acquiring the aircraft, the client should decide how it will be operated and maintained. If it will be used solely for private travel, the client can hire pilots and mechanics as independent contractors to provide services, provided that they are properly licensed under part 91 of the Federal Aviation Regulations. However, the client will find that the aircraft's insurance usually will dictate the qualifications required for pilots and may also restrict coverage to specific uses of the aircraft and limit coverage to domestic flight operations.

A client with multiple aircraft, or who wishes to retain direct control over the aircraft operations, may establish a corporate flight department and hire pilots and mechanics as employees. This approach obviously requires significant commitment of time and capital and presents unique challenges. It also entails additional risk because the client is directly responsible for flight and maintenance operations. When establishing a flight department, the client is well-advised to exercise due diligence in retaining a qualified manager to supervise the mandatory operational and main-

tenance requirements, and in the hiring of pilots and mechanics.

A cost-efficient alternative to a flight department may be an "aircraft management agreement," under which the aircraft owner contracts with another party to supervise flight and maintenance operations. Charter operators are the best qualified to provide such services. They are organized to comply with the more stringent operational requirements mandated by 14 C.F.R. part 135; managing another party's aircraft to meet part 135 aircraft requirements will take little additional effort. Although the agreement transfers operational control of the aircraft to the charter carrier, it will still be operated under the less restrictive requirements of part 91 when used solely for the owner's private travel. A typical aircraft management agreement specifies a monthly management fee and hourly rates for the pilots and mechanics when operating and maintaining the aircraft. Insurance for the aircraft remains the responsibility of the aircraft owner. It is therefore advisable to include an enforceable indemnification provision in favor of the aircraft owner in the agreement.

In many instances, an aircraft owner who retains a charter carrier to manage an aircraft will ultimately expand the agreement to lease the aircraft to the carrier for charter operations. The lease can be written to allow the owner to employ it for private use, while simultaneously using it to generate charter revenue that will reduce ownership costs. Part 135 regulations require, however, that such leases transfer complete "operational control" of the aircraft to the charter carrier. Insurance coverage will remain under the carrier's policy; although the owner will continue to bear the cost along with the cost of maintenance. The owner will also bear the cost of a "conformity" inspection, performed to conform the aircraft part 135 equipment requirements. Lease payments are made by apportioning charter revenues generated by the aircraft. Despite relinquishing operational control to the charter carrier, an owner can still use the aircraft for private travel conducted under 14 C.F.R. part 91.

If your client elects to lease rather than own an aircraft and you are asked to assist in lease negotiations, you should familiarize

yourself with 14 C.F.R. §91.23 to determine its potential applicability. Section 91.23 applies to leases of "large" aircraft, defined as an aircraft with a maximum take-off weight of more than 12,500 pounds. 14 C.F.R. §1.1. Most large turboprop and jet aircraft fall within this definition.

Section 91.23 requires that leases and conditional sales contracts for large air-

Counsel your client to request information pertaining to the operator's liability insurance.

craft must contain mandatory "truth-in-leasing" clauses. "Lease" is defined as "any agreement by a person to furnish an aircraft to another person for compensation or hire, whether with or without flight crewmembers, other than an agreement for the sale of an aircraft and a contract of conditional sale under section 101 of the Federal Aviation Act of 1958." 14 C.F.R. §19.23(e). These "truth-in-leasing" clauses must appear in large print as a concluding paragraph, immediately preceding the space for signature of the parties. 14 C.F.R. §91.23(a). They must also contain the following language relative to each aircraft identified in the lease or conditional sales contract:

- 1) Identification of the Federal Aviation Regulations under which the aircraft has been maintained and inspected during the 12 months preceding the execution of the lease or contract of conditional sale, and certification by the parties thereto regarding the aircraft's status of compliance with applicable maintenance and inspection requirements in this part for the operation to be conducted under the lease or contract of conditional sale.
- 2) The name and address (printed or typed) and the signature of the person responsible for operational control of the aircraft under the lease or

contract of conditional sale, and certification that each person understands that person's responsibilities for compliance with applicable Federal Aviation Regulations.

- 3) A statement that an explanation of factors bearing on operational control and pertinent Federal Aviation Regulations can be obtained from

■ ■ ■ ■ ■
When establishing a flight department, the client is well-advised to exercise due diligence in retaining a qualified manager.

the nearest FAA Flight Standards district office.

Id. The lease is to be filed of record with the FAA within 24 hours of its execution and must be carried in the aircraft at all times. 14 C.F.R. §91.23(c) (2) & (3). The aircraft lessee or conditional buyer also must notify the FAA, either by person or by telephone, prior to the aircraft's flight. 14 C.F.R. §91.23(c) (3). The "truth-in-leasing" clauses, recordation of the lease with the FAA, and flight notification *are not required when the aircraft is leased by, or to, charter, cargo or scheduled carriers.* See 14 C.F.R. §91.23(b) (1). Consequently, many leased aircraft are operated under the authority of either a charter, cargo or scheduled carrier to avoid the restrictions of 14 C.F.R. §19.23.

When negotiating or reviewing the lease, you should also familiarize yourself with your jurisdiction's version of Article 2A of the Uniform Commercial Code, which has been adopted (in some variant) by all states, with the exception of Louisiana. 2 James J. White & Robert S. Summers, Miller, *UNIFORM COMMERCIAL CODE* (5th ed. 2008) §13-1. Article 2A applies to "any transaction, regardless of form, that creates a lease." U.C.C. §2A-102. A lease "means a transfer of the right to possession and use of goods for a term in return for consideration, but a sale, including a sale on approval or a sale

or return, or retention or creation of a security interest is not a lease. Unless the context clearly indicates otherwise, the term includes a sublease." U.C.C. §2A-103. The sections of Article 2A may apply as gap fillers to define the rights, responsibilities and liabilities of the parties to an aircraft lease where the written lease or course of dealing between the parties is silent. 1 James J. White & Robert S. Summers, Miller, *UNIFORM COMMERCIAL CODE* (5th ed. 2006) §3-4. Thus, a thorough review of Article 2A's provisions should alert you to unanticipated issues, such as implied warranties, casualty, risk of loss, excused performance and other significant matters.

Fractional Ownership

A relatively new and increasingly popular form of private air transportation is "fractional ownership," a program where participants purchase defined interests in specific aircraft, but then use program aircraft for their travel needs. The fractional owner's use of program aircraft, however, is typically limited to the model of aircraft in which it has an ownership interest. Governed by 14 C.F.R. §§91.1001-1143, fractional ownership programs are subject to regulatory requirements similar to those applicable to part 135 charter carriers. The fractional ownership program manager is responsible for providing administrative and aviation support services, including, but not limited to, the (1) establishment and implementation of program safety guidelines; (2) employment, furnishing or contracting of pilots and other crewmembers; (3) training and qualification of pilots and other crewmembers and personnel; (4) scheduling and coordination of the program aircraft and crews; (5) maintenance of program aircraft; (6) satisfaction of recordkeeping requirements; (7) development and use of a program operations manual and procedures; and (8) application for and maintenance of management specifications and other authorizations and approvals. 19 C.F.R. §1101(a) (8). In addition to the acquisition cost for the fractional interest, participants pay monthly management fees to cover all fixed costs, which include the cost of pilots, pilot training, insurance, hangaring, regular refurbishment, and administration. Participants also pay an occupied hourly rate for

the use of program aircraft to cover direct operating costs, including fuel, landing fees and maintenance.

If your client becomes a fractional owner, he or she will have direct exposure to risk as co-owner of the aircraft. Accordingly, you should counsel your client to purchase a fractional interest through a separate corporate entity to segregate any liability from its other interests. Your client should also investigate the scope of coverage under the program's insurance policy and explore acquiring additional coverage, if necessary. For example, in 2001, AIG Aviation, Inc., announced its Fractional Aircraft Ownership Insurance Program which is tailored to fractional owners, providing coverage in excess of the primary aircraft policy, coverage for non-owned aircraft liability and diminution in value. Press Release, AIG Aviation, Inc., *AIG Aviation, Inc. Introduces New Customized Fractional Aircraft Ownership Insurance Program* (August 1, 2001), available at <http://www.aigaviation.com/doc/Aviation-FractionalOwner.doc>. And while the client would not be exposed to charges of negligence arising from the operation of a fractional program flight, he or she might risk exposure for negligent selection for guests or employees on a flight. The client should therefore not only thoroughly investigate the program before acquiring an interest, but diligently monitor the program manager's performance of its regulatory obligations.

Conclusion

As the commercial airline industry continues to struggle, private air transportation will become a more attractive alternative for your clients. Frustrated by unexpected delays and the resulting loss of productivity, your clients may inquire about private air travel. When they do, you should be able to provide counsel on the availability, cost, regulation and risk of liability involved. Private air travel may provide your client with the means to increase efficiency by eliminating the unpredictability that accompanies commercial air service. With a proper understanding of the industry and some creative legal advice, you may be able to help turn a significant business expense into a profit center for a client. When it comes to the future of private air travel, the sky's the limit. 