Operating Illegal Flight Department?

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And what if the boss says: "Who cares?"

AFTER SPEAKING AT A RECENT SEMINAR, I was handed a note that stated the following: "We operate improperly as a flight department company. Following the session, I called our company president, and suggested that we might want to change. His response was 'Who cares?' Are there any actual cases of pilot enforcement actions, insurance denials or fines as a result of an illegal structure?"

I often hear from pilots who say their company is violating FARs and/or insurance restrictions, but the boss simply shrugs it off. Mistake.

FAA revokes pilot certificates for illegal charter. Even an unsympathetic boss should recognize the company's investment in training, typing and keeping crewmembers current. Insurance companies can and do deny accident coverage for Part 91 operators who collect reimbursement unallowed under the policy. And both the FAA and the DOT have assessed civil penalties against companies for receiving such reimbursements.

So what did that pilot mean when he said his operation improperly operated as a "flight department company"? He had just learned that Part 91.501(b)(5) prohibits creating a subsidiary whose sole purpose is to serve as a flight department under Part 91. The regulation is not a model of clarity, but when the FAA published it in 1972, the preamble stated:

It should be noted, however, that if a corporation is established solely for the purpose of providing transportation to the parent corporation, a subsidiary or other corporation, [then] the primary business of the corporation operating the airplane is transportation and the carriage of persons or goods for any other corporation, for a fee or charge of any kind would require the corporation operating the airplane to hold a commercial operator certificate under Part 121 or 135, as appropriate.

There is simply no question that a corporation operating under Part 91 whose sole purpose is to provide air transportation is an improper commercial operation in the eyes of the FAA.

And there are many revocation cases against pilots who knew their passengers were wrongly paying. In the case of a flight department company, every flight is improper. But even in a properly structured department, if the passengers pay any amount that is not specifically allowed under Part 91, the pilots are at great risk.

Then there's the matter of insurance. In Avemco Ins. Co. v. Auburn Flying Serv., 242 F.3d 819 (8th Cir. 2001), Avemco succeeded in denying coverage for a fatal accident under its "commercial purpose" exclusion. In October 1997, several organizations conducted a "fly-in" at the Auburn, Neb., Airport. Attendees could pay $10 for a 10- to 15-minute flight in an Aero Commander. This money was collected at a table near the runway, which had a sign near it advertising the rides. While landing after one such flight, the aircraft struck a passing tractor-trailer and crashed. Three passengers were killed and the pilot died four months later.

Avemco's a noncommercial aviation insurance policy covering the aircraft to Auburn Flying Service stated: "This policy does not cover bodily injury, property damage or loss . . . when your insured aircraft is . . . used for a commercial purpose." The policy further defined "commercial purpose" as meaning "any use of your insured aircraft for which an insured person receives, or intends to receive, money or other benefits. It does not include: (a) the equal sharing among occupants of the operating cost of the flight." The parties to the action had agreed before the court that the money collected by the pilot was not sufficient to cover the operating expenses of the flight. After the crash, representatives of the deceased passengers filed suit against Auburn Flying Service. Avemco, in turn, filed a declaratory action seeking to determine if coverage existed under the policy. Avemco convinced the courts that the $10 was not an equal sharing of the flight costs and thus there was no coverage under the policy for the accident.

Aircraft insurance policies for Part 91 operations are generally cheaper than commercial coverage because the insurance carrier can depend on workers' compensation laws capping the company's liability, and workers' compensation insurance paying for the death of or injuries to the company employees on the aircraft. Aviation insurance policies for non-commercial operations generally allow the operator to collect amounts allowed under Part 91. However, there is no room for mistakes. If the policy does not allow compensation in a given situation, then there is no accident coverage for a flight for which the operator received even 10 bucks too much.

Moreover, the government may assess civil penalties for illegal charter ops. In 2004, the DOT issued three separate compromise civil penalty public Consent Orders (Order 2004-3-28, Order 2004-3-29 and Order 2004-3-30), one for $10,000 and the others for $20,000. And in 2007 the FAA set a new record when it reached a $10 million settlement agreement in 2007 with TAG Aviation USA, Inc. and TAG Holding SA of Geneva, Switzerland, for allegedly operating flights for compensation or hire without an air carrier certificate.

In tough economic times, it's hard to say "No" when the bosses downtown want to collect money that they shouldn't for a Part 91 flight. But the threat of loss of insurance coverage and significant fines against the company should help to convince them that "No" is the only answer. ■