



## Planning Issues in Aircraft Management Agreements

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Different sets of aircraft management issues need to be addressed depending on whether your aircraft is owned and operated for the benefit of one company, for the benefit of two or more companies, or your aircraft is also made available to charter customers. In each case, a wide variety of commercial and operational issues are foreseeable and should be identified and resolved. If there is loan or lease financing in place, there may be important additional limitations on management and use of an aircraft that must be complied with. Some issues must be resolved in aircraft lease agreements, some in aircraft management agreements, some in joint ownership agreements, some in pilot and crew agreements, and some in shareholder agreements. Care must be taken to leave operational control of your aircraft in the hands of licensed operators. Despite the inherent complexity, your aircraft management agreements should contain only the minimum amount of complexity actually required for your situation.

### Ownership of an Aircraft By One Company

An aircraft that is owned by a single owner will typically have two agreements in place that affect management of the aircraft: a lease agreement to convey the aircraft from the owner to an operator, and an aircraft management agreement. Sometimes a lease agreement and a management agreement are combined into a single aircraft management and lease agreement. In this article, we refer to the lessee as the "Manager" of the aircraft.

The lease agreement will typically be terminable on 30 days notice by either party and will set out whether the Manager is entitled to operate the Aircraft on charter flights with charter customers. If this is a US registered aircraft, the lease will specify whether the aircraft is to be operated in accordance with Part 135 of the Federal Aviation Administration (FAA) Regulations or Part 91, when common carriage is not involved.

The lease will typically specify that the Manager shall have exclusive possession, command, and control of the aircraft, and shall exercise operational control during all flight operations conducted by Manager, and the pilots of any such flight by Manager shall be under the exclusive command of Manager during all such flights.

Various legal systems define the expression "operational control" and in substance it refers to who is exercising the authority over the flights. In practice, it can be quite difficult to make determine who

has the operational control over the aircraft and is thus legally responsible for the operation. This is particularly the case in aircraft which are operated on behalf of private owners by aircraft Manager, or where only certain aspects of the operation of the aircraft is managed by a Manager. It is therefore important to clearly determine in the management agreement who assumes the operational control of the aircraft and to make sure that such agreement is in line with the legal requirements of the nationality of the aircraft.

Typically, the Manager is obligated to obtain or supply all services and supplies necessary to the operation, maintenance, and storage of the Aircraft, however, at the owner's expense. The Manager will obtain all fuel and oil, pay the fixed hourly cost of any maintenance service plans, maintain the Aircraft, store the Aircraft when not in use in an appropriate and adequate indoor facility at an agreed operating base; obtain the services of pilots; and maintain all aircraft documents.

The Manager will maintain insurance for the aircraft. Significant cost differences can be found in insurances. An owner will have to determine to what extent coverage should be provided for. A Manager might be able to provide fleet insurance coverage to its customers, which commonly results in lower insurance premiums for the owner. An owner is therefore well advised to compare quotes of different insurers and the insurance conditions. Also it should be made sure that insurance premiums are paid when due and that the insurance terms are complied with strictly.

Various airframe and engine manufacturers provide different maintenance programs, which typically covers the cost of parts for scheduled maintenance. An owner is well advised to check the coverage of such programs in particular the economics of such programs in connection with the flight time and the transfer of such programs in case of a sale of the aircraft. In certain cases, a new owner will have to buy into such programs which can be a significant additional expense on top of the purchase price.

Of particular importance are the services of the Manager with respect to aircraft maintenance supervision. In our view it is highly advisable that each maintenance conducted on the aircraft should thoroughly be revised by the Manager, possibly with the maintenance supervisor on site during the maintenance respectively checking the maintenance performed before taking it back into service and possibly conducting a test flight. Also, before maintenance work is conducted on an aircraft, a specific quote should be made available and the progress of work should be followed while an aircraft is in maintenance. In the management agreement, often certain threshold amounts are provided for where the express consent of the owner is required before proceeding to such maintenance. Furthermore the owner should inquire about maintenance facilities which are used by the Manager. A Manager may be affiliated with a service center, which could in certain cases result in a potential conflict of interest. However on the other side, an owner might be able to profit from good business relations between a specific Manager and a maintenance center.

An owner is well advised to have, before entering the agreement, a commercial budget established by the Manager, based on precise details about the prospective operation. Such budget should provide for contingencies and itemize fixed and variable costs.

The amount of the monthly management fee payable by the owner to the Manager, or retained out of the proceeds of charter flights, will be subject to negotiation, and these amounts vary widely. Typically, the Manager may offset against the amount payable to the owner a substantial hourly fee based on flight hours each month, and a substantial management fee against amounts payable to the owner. Other offsets against charter revenue include the cost of fuel purchased by the Manager, maintenance costs incurred at a specified rate per hour for all maintenance services; taxes paid, flight crew services, and other expenses, fees or subscriptions associated directly with the operation of the aircraft.

When a Manager takes over the aircraft from the owner, the agreement should provide for appropriate documentation of such event. Typically, a delivery receipt is provided for this purpose, which states the condition of the aircraft at the time of delivery to the Manager. The delivery receipt should, in addition to the condition of the aircraft state the hours, cycles and clearly identify the avionics and equipment. It could also be advisable to make an inventory of the loose equipment. Oftentimes such delivery coincides with an acquisition of the aircraft by the owner by a third party or even the leasing of the aircraft from a lessor. In such event, it is still advisable to separately document the delivery of the aircraft to the Manager by the owner.

The aircraft management agreement should also address the issue of responsibility for registration issues. Aircraft registration can take up to several months depending on the desired nationality of the aircraft and its technical status.

The aircraft owner's interest lies in cost transparency and competitive pricing of services. Some Managers add handling charges which are expressed in percentage of the overall expenses of the aircraft invoiced to the owner, some provide different service packages, where services are procured from third parties. Typically the management fee covers the actual services rendered by the Manager, but does not cover services rendered by third party and any expenses. In a management agreement it should therefore be made clear which services are rendered by the Manager itself and whether the Manager is entitled to procure services from a third party, which typically will not be part of the management fee.

An owner should insist on a transparent agreement administration, which will include monthly statements itemizing the expenses incurred along with supporting documentation (third party invoices receipts etc.). Some Managers will provide such statement on CD-ROM and the owner is well advised to check and screen such statements for accuracy. Sometimes Managers insist on agreement clauses that in case of no objection to the statements such statements are deemed to have been accepted by the owner. Depending on the applicable law to the management agreement such clauses may however not be enforceable in all instances.

In case where the Manager assumes operational control over the aircraft, the Manager will want to have a veto right in crew selection. Oftentimes the crew selection process is not done with the required vigour and an owner is well advised in the interest of his or her own safety to conduct background screen on the crew and a thorough review of the qualifications of the crew members, in particular with regards to the qualifications and experience of the particular type of aircraft and its specific operating procedures.

Oftentimes, crew is entering into a direct employment relationship with the Manager, who therefore assumes liability of the employer towards the employee. Questions may arise in this context since the crew will in such instance be subordinated to its employer, not the owner, which can potentially cause some conflict between the owner and the Manager in case of issues arising in connection with the pilots.

Depending on the frequency the owner will want to use the aircraft and the particular flight scheme, a decision will have to be made of how many crew should be dedicated to the aircraft, or whether to work with freelance crew in case of increased use of the aircraft or in case of exceeding duty times.

Last but not least, a thorough recordkeeping of the aircraft is key to its safety and its value and marketability. The agreement should therefore provide that the records are kept continuously and in fashioned order by the Manager. There are various programs that will support the Manager in record keeping and the owner should inquire about which programs the Manager is using.

Typically, there is an operating deposit initially of several hundred thousand United States Dollars placed on deposit with the Manager by the owner to pay costs and expenses, and this deposited amount is replenished with money earned from charter flights or paid by the owner with regard to its use of the aircraft. There is a substantially lower cost per hour of use of the aircraft by the owner, as compared to the cost per flight hour charged to charter customers.

An owner should consider that invoicing will often be deferred for one or more months, due to the issuance of third party invoices. In case of a termination of the agreement the management agreement should specifically address such wrap-up period.

The chosen management structure should in any case be thoroughly assessed with specialized tax counsel with respect to the tax consequences. Recent and prospective VAT changes occurred within the European Union and certain of its member states upon request of the European Commission signify that tax consequences may change in certain settings. Given the average VAT rates throughout the European Union such changes may have a significant impact on operating structures.

Every agreement should make specific provision as to its terms and how it ends. In a private management, an owner will want to have the liberty to terminate the agreement within a short period of time (i.e. in case of a sale of the aircraft or if the owner decides to discontinue the relationship with the Manager). A Manager however, in terms of business planning and continuity, typically will want to have early visibility of termination. A particular item that should be emphasized is the expenses of the Manager, which may be incurred beyond the effective date of termination of the management agreement (e.g. crew salaries, severance payments due to applicable statutory laws, etc.). The management agreement should mention such costs in particular, as in case of termination most of the time such costs are subject to discussions between owners and Managers.

If the Manager is not paid by the owner, the Manager may want to refuse to redeliver the aircraft until all outstanding amounts are paid by the owner. In certain cases and depending on the circumstances, such refusal may be abusive or cause damages to the owner. The management agreement can provide mechanism to overcome such undesirable situation, e.g. by allowing the owner to deposit a sum equal to the litigious sum in escrow, whereupon the Manager shall release the aircraft. The parties can then agree or litigate about the outstanding amounts without the risk of incurring additional damages by a grounded aircraft.

In any case, the management agreement should provide for the consequences of termination, which will vary depending on the reason of the termination. If e.g. termination is due to Manager's default which remains uncured or due to a material breach of agreement, the agreement may be terminable with immediate effect. The agreement should provide for guidance what happens in such instance. The imminent risk of the owner is thereby that the Manager refuses redelivery of the aircraft, whereas the Manager's risk is that with the redelivery of the aircraft he may not be secured for its payments or that in case of an unjustified refusal to redeliver the aircraft, the Manager may face significant claims in connection with the impossibility of the owner to dispose or use the aircraft.

The customs status of the aircraft should always be carefully assessed both at the inception of the agreement as well as at the termination. There is a certain complexity to this and an owner is well advised to retain a specialized customs agent to handle the required paperwork.

Of particular importance is the applicable law for a management agreement and the jurisdiction. This is not to be mixed up with questions of public laws applicable to the operation of the aircraft, as imposed by the state of its registration and international treaties. Depending on the applicable law on the agreement, a management agreement may not spell out in all details the governing provisions and it is well possible that statutory provisions will apply to the relationship. This may have a significant impact on the relationship of the parties.

Ownership of an Aircraft By Two or More Companies

An aircraft may be jointly owned by two or more companies. This may be accomplished in a number of different manners. In the US, the FAA records may record that there are multiple owners of an aircraft. For example, there may be two joint owners of an aircraft and each would be entitled to lease its fifty percent ownership rights to a management company pursuant to two separate lease agreements. Typically, where there are more than one owner, they each lease their interest in the aircraft to a single management company. The direct ownership interests in the aircraft allow depreciation deductions to be taken with regard to the value of the aircraft by each owner. Alternatively, ownership of an aircraft may be shared indirectly by means of indirect co-owners purchasing shares of stock in a company, for example, that is the sole shareholder of a special purpose company that owns an aircraft.

Where there are direct or indirect co-owners of an aircraft, the aircraft management agreement may be revised as a joint use and management agreement. A number of additional issues about sharing use of the aircraft between the owners must be addressed, and also sharing use of the aircraft with charter customers, if this is also planned.

A related but different form of joint ownership is fractional ownership of an aircraft. In this case, it is possible to purchase a 1/16th or a 1/32 interest in an aircraft. In such programs, that fractional ownership interest in an aircraft allows the owner of that fractional interest to make a certain number of hours of use of any aircraft in the fractional program company's fleet of aircraft. Quite possibly, an owner will never actually fly on the exact aircraft in which it owns an interest. Some jurisdictions take the view that the owner of a fractional interest in an aircraft has not actually acquired "property", but has acquired a travel service, i.e., the right to a certain number of hours of flight. Accordingly, for tax purposes, an owner may or may not be allowed to claim tax deductions for depreciation, if a jurisdiction holds that such an agreement is not really about property rights, but is about access to a travel service. It is beyond the scope of this article to discuss legal aspects of true fractional programs, but it is interesting to note that such programs and joint use agreements have in common the need to address certain core issues about a procedure for a decision to be made to re-sell an aircraft and how to share expenses.

In summary, though it may seem daunting to comprehend and negotiate the foregoing issues, you may take some comfort from knowing that almost all issues that may possibly come up in the course of your ownership and management of your solely or jointly-owned aircraft have previously been negotiated and there is a way to accomplish your objectives with the minimum amount of complexity that is actually required.