Options Abound in Insuring a Leased Aircraft

By Jeff Rhodes

In recent years, many individuals and companies of all sizes have found that there can be several advantages in using private aircraft for their transportation needs.

The "corporate aircraft" has certainly come into its own, and our perception of what a corporate aircraft is has changed. Of late, in addition to the tried and true large cabin bizjet that most readily comes to mind, we have seen the emergence of high-performance piston singles, single-engine and twin turboprops, and light and very light jets as corporate and personal traveling machines.

As more individuals and companies seek to obtain high-priced private aircraft, they continue to find creative ways to afford the aircraft or justify the expense. While capital costs are generally manageable, the fixed expense of owning a reliable, business-travel capable aircraft may be difficult to sell to the corporate accounting department. This is especially true when the aircraft owner cannot really operate the aircraft enough hours annually to maximize its efficiency, in respect to fixed ownership expense.

To address these problems, many aircraft owners have attempted to increase the annual utilization of their aircraft by allowing other entities the right to use the aircraft during times of excess availability. This use (through a dry lease) helps economize the aircraft operation by having it spend more time flying and less time sitting in a hangar. Fixed costs are spread over more annual flight hours and to entities other than the aircraft's owner.

Depending on the specific purpose of the dry lease and the wording used in the lease agreement itself, there can be insurance and risk management concerns related to the implementation of such an agreement.

First, let's take a look at the different types of aircraft leases that an aircraft owner might explore. I have divided the lease types into generalized categories that are commonly associated with corporate aircraft operations. These categories are not defined in strict legal terms, and all lease agreements differ somewhat in the details.

The "All in the Family" Lease

An All in the Family lease is one that a corporate organization employs to allow use of the aircraft by individual stockholders or sister, subsidiary, or parent companies. It is a legal and accounting tool that lets one department reimburse another department for travel expenses. Many companies use this type of lease, although the degree of the lease's formal structure and adherence varies widely. These leases exist to technically satisfy the Federal Aviation Administration (FAA) and the Internal Revenue Service (IRS) that the aircraft is being operated and expenses are being accounted for to the letter of the respective agency's regulations.

To the insurer, an All in the Family Lease changes little from an exposure standpoint. The aircraft is being operated by the underwritten pilots and on behalf and at the direction of the Named Insured. My advice is to send this lease to your agent. Make sure your agent completely understands the purpose of the lease so that the lease can be properly presented to the underwriter. Most of the time, this type of lease will be approved with no coverage or premium consequences.

The "Additional User" Lease

We have seen many corporate aircraft owners put lease arrangements together for the purpose of allowing use of the aircraft by unrelated people or businesses. This arrangement affords the aircraft owner the cost-sharing benefits of a partnership without requiring the owner to relinquish control of the asset or enter into a long-term relationship. These lease arrangements can take many forms.

Under a pseudo "dry" lease arrangement, the lessee pays an hourly or monthly fee to the owner for use of the aircraft. The lessee is then responsible for fueling the aircraft and paying all fees and charges incurred during the trip (i.e., landing fees, catering fees, etc.). Typically, lessees are also responsible for hiring their own pilots to fly the aircraft. The owner remains responsible for aircraft maintenance, insurance, long-term storage of the aircraft, and other fixed expenses.

Under a "wet" lease, the owner/lessor is fully obligated to deliver the aircraft ready to fly. The owner pays for both fixed and variable expenses. The user/lessee pays a fixed hourly or daily rate to rent the aircraft. If the owner also provides a flight crew, the lease arrangement becomes a "charter" operation that is conducted under Part 135 of the Federal Aviation Regulations (FARs).

These types of additional user leases usually require close scrutiny by an insurance company underwriter. An underwriter will carefully review the wording of the legal contract to determine the extent to which the exposure to the insurance company might be changed. Questions to be answered include:

1. Is the policy protecting (from a liability coverage standpoint) entities that ordinarily would not be protected under the policy?
2. Will the utilization of the aircraft increase to levels not originally anticipated?
3. Will operational control of the aircraft transfer to parties that were not anticipated or appropriately underwritten?
4. Does the lease arrangement change the duty of care of the named insured to an obligation more closely associated with a commercial operation? If the lease arrangement does engender the change, then the awards to injured parties may be greater than those of a strict owner-operated risk.

It is important to note that these types of lease arrangements can be insured. If the contract adds or modifies who is to be protected, then policy endorsements may be necessary. If additional exposure or additional risk is created, then additional premium may be charged. If the insurer cannot or will not accept the changed risk, then another company may need to be brought in to quote the new situation. An attorney along with an aviation insurance specialist can walk you through this process and will probably be able to offer a good bit of guidance before the final draft of the lease is even written.

“Lessee-Operator” Leases

With both types of aircraft leases discussed above, the aircraft owner is responsible for the operation of the aircraft and for insuring the aircraft. The lessee is a part-time user of the aircraft and is entitled to use it under the supervision of the owner. The lessee is provided protection by the owner’s insurance policy to the extent of the lessee’s use of the aircraft.

With a Lessee-Operator lease, however, the lessee, not the aircraft owner, is the principal decision maker when it comes to operation of the aircraft. In this instance, the owner simply supplies a capital asset, while the lessee “uses” the asset.

These types of leases are well-suited to flight schools, charter operators, and even corporate flight departments operating aircraft that they do not own but use regularly and exclusively. In these cases, the insurance companies prefer to underwrite the operators — not the owners. The policies should be in the operators’ names. Owners and lessors are (should be) recognized as such with a loss payee clause and expected protection from liability by being named as an Additional Insured, or a Second Named Insured, should the owner require the ability to cancel or modify the coverage.

No-Nos of Leased Aircraft Insurance

There are a few mistakes that we have seen when lessors and lessees attempt to insure aircraft subject to lease agreements. We have also seen many mistakes go into the language of the lease contract itself. In many cases, the mistakes are a result of the attempted modification of land, building, or other equipment lease forms to suit an aviation lease application. In principal, a lease is a lease from a legal standpoint. However, aviation leases do need to contain certain terminology and follow certain protocol that may not apply to other industries.

Don’t have the wrong party carry insurance. As we have seen, different situations call for either the lessor or the lessee to carry the insurance policy. Make sure your lease agreement follows this preference. For the most part, it comes down to “who is the regular user of the aircraft?” That user should carry the coverage.

Don’t leave yourself unprotected. In any lessee/lessor arrangement, both parties should be protected from liability claims. The lease should spell out that the party responsible for carrying insurance should defend and indemnify (make whole) the other party for any claims that may come about regarding the aircraft in question.

Don’t double insure. Never attempt to have both the lessor and lessee carry separate policies on the same aircraft, each of them thinking that one policy will apply to one use and user and another policy will apply to another use and user. The claims process will be a nightmare, and at the end, you may find that you have breached the contract of both policies. Have an agent lay out the entire situation to an underwriter. Include all the uses and all the parties that are to be afforded protection. Let the underwriting market quote, then buy the best package for your needs.

Do involve an attorney, your agent, and the insurance company’s underwriters before the lease agreement is signed — preferably <u>before</u> it is even written.

Properly written and insured, an aircraft lease can be a good way to allocate costs, increase utilization, or make an aircraft available for a specific business function. The important thing is to plan out all aspects of the arrangement ahead of time. ✈