U.S. Department of Transportation
Federal Aviation Administration

Memorandum

Subject: "Wet lease" Arrangements Proposed in US/EU Air Service Negotiations

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The purpose of this memo is to analyze certain commercial contracts characterized by industry as "wet leases" to determine whether they are consistent with the regulatory requirements of part 119 of the Federal Aviation Regulations ("FARs"). Specifically, we examined existing and proposed agreements between foreign and U.S. air carriers under which they provide air transport services for one another, typically for the carriage of cargo but potentially for passenger carriage as well.[1] We reviewed the agreements as a result of questions arising out of the U.S./European Union air services negotiations. We were asked to consider whether the agreements being contemplated were in fact prohibited by 14 C.F.R. § 119.53(b), and if so, whether regulatory action was required by the FAA to facilitate these agreements. Section 119.53(b) bars U.S. air carriers from wet leasing foreign aircraft and crew into their operations.

As discussed below, our conclusion is that the existing and proposed agreements – because they do not involve a transfer of legal possession of any aircraft – are simply not leasing arrangements and thus are not prohibited "wet leases." Rather, these agreements are really

[1] The carriers include Atlas Air, Inc. ("Atlas"), Federal Express ("FedEx"), China Cargo Airlines, Ltd., the International Airline of the United Arab Emirates and Qantas Airways Ltd

charter arrangements, which do not require FAA review. Unfortunately, the FAA has never issued comprehensive guidance to industry on this matter, and has accepted for filing as "wet leases" contracts that in fact are charter agreements and not leases. As a result, there is considerable misunderstanding by industry as to which arrangements with foreign carriers are in fact prohibited under Part 119. Thus, although a formal rulemaking or policy change by the FAA is not required (because we are not altering an established interpretation), should the United States Government decide to take action to facilitate the proposed arrangements between U.S. and foreign air carriers, it is likely that industry will require a definitive interpretation of Part 119.

Background

Part 119 of the FARs requires that prior to conducting operations under a "wet lease" a U.S. air carrier must provide a copy of the wet lease to the FAA for review. The regulations then require the FAA to determine which party to the lease has operational control and to then make appropriate changes in the parties' operations specifications. Specifically, the regulations provide as follows:

> **14 C.F.R. § 119.53** *Wet leasing of aircraft and other arrangements for transportation by air.*
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> (a) Unless otherwise authorized by the Administrator, prior to conducting operations involving a wet lease, each certificate holder under this part authorized to conduct common carriage operations under this subchapter shall provide the Administrator with a copy of the wet lease to be executed which would lease the aircraft to any other person engaged in common carriage operations under this subchapter, including foreign air carriers, or to any other foreign person engaged in common carriage wholly outside the United States.
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> **(b) No certificate holder under this part may wet lease from a foreign air carrier or any other foreign person or any person not authorized to engage in common carriage.**
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> (c) Upon receiving a copy of a wet lease, the Administrator determines which party to the agreement has operational control of the aircraft and issues amendments to the operations specifications of each party to the agreement, as needed. The lessor must provide the

following information to be incorporated into the operations specifications of both parties, as needed.

(1) The names of the parties to the agreement and the duration thereof.

(2) The nationality and registration markings of each aircraft involved in the agreement.

(3) The kind of operation (e.g., domestic, flag, supplemental, commuter, or on-demand).

(4) The airports or areas of operation.

(5) A statement specifying the party deemed to have operational control and the times, airports, or areas under which such operational control is exercised.

(d) In making the determination of paragraph (c) of this section, the Administrator will consider the following:

(1) Crewmembers and training.

(2) Airworthiness and performance of maintenance.

(3) Dispatch.

(4) Servicing the aircraft.

(5) Scheduling.

(6) Any other factor the Administrator considers relevant.

Elsewhere, the regulations define a wet lease as "any *leasing arrangement* whereby a person agrees to provide an entire aircraft and at least one crewmember." (emphasis supplied)[2]

Leases versus Charters

The most critical factor in determining whether an agreement constitutes a lease as opposed to a mere charter[3] is whether or not the lessee gets *exclusive legal possession* of the

[2] Codeshare arrangements are specifically excluded from the wet lease definition. 14 C.F.R. § 119.3 (2004).

[3] A charter in the FAA's view is an agreement whereby a person provides lift capacity (in terms of cargo to be shipped or passengers to be transported) to another person for a defined period of time or number of flights. *See Comparison of Aircraft Leases and Charters*, FAA International Affairs and Legal Policy Staff, Apr. 21, 1999.

aircraft.[4] If the grantor never transfers *legal* possession the aircraft, then the agreement is not a lease. Likewise, if the agreement makes it clear that *actual* possession is never transferred, the agreement is not a lease. Instead, as stated above, such an arrangement might actually be a charter.[5]

In the typical charter, a customer arranges to have an air carrier transport passengers or cargo from one point to another. However, the charter agreement does not involve any legal transfer of the possessory rights to the aircraft used in the transportation, and it would be unusual to refer to the charter agreement as a "lease" of the aircraft from the charter operator to the customer. In other words, the charter is a services agreement --for the provision of a flight service -- and possession of the aircraft does not transfer to the customer.[6]

Simply put, the FAA's concept of an aircraft lease is consistent with traditional leasing arrangements found in other commercial contexts.[7] When a person leases a car, for example, it is generally understood that the possessory rights to the car are being transferred for the period of

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[4] *See* Feb. 5, 1998 Letter to E. Driscoll, National Air Carrier Association from J. Conte, Manager, Operations Law Branch. *See also* Jun. 17, 1975 Letter to C. Reid from K. Geier, Regional Counsel ("A lease implies that the lessee has custody of the property for a defined period").

[5] *See* Apr. 29, 1999 Letter to D. Woerth, Air Line Pilots Association, Int'l, from N. Garaufis, FAA Chief Counsel (a lease involves the transfer of a piece of equipment while a charter involves the provision of a flight service).

[6] On the other hand, the charter operator providing the flight services described above may have leased an aircraft from an owner (e.g. a bank) for use in its charter business. In that case, the owner has transferred legal and actual possession of the aircraft to the charter operator. The charter operator would have exclusive legal possession of the aircraft for the term of the lease, and through its pilots, would operate the aircraft. The aircraft owner (the bank) would not be permitted to use the aircraft during the lease term.

[7] The FAA's approach thus differs from that of the Department with respect to its rules concerning lease by foreign air carriers or other foreign persons of aircraft with crew. 14 C.F.R. 218.1 provides, that "For purposes of this part the term *lease* shall mean an arrangement under which an aircraft is furnished by one party to the agreement to the other party, irrespective of whether the agreement constitutes a true lease, charter arrangement, or some other arrangement." (emphasis supplied)

the lease. The lessor retains title and ownership to the vehicle, but the possessory rights and the corresponding authority to use the car, are transferred to the lessee. Likewise, in a true aircraft leasing arrangement, for purposes of applying the FAA rules in § 119.53, the lessee is granted an exclusive legal possessory interest in an aircraft for a specified period.

Wet Leases

In December 1995, the FAA defined wet lease for the first time when it adopted the "Commuter Rule" in part 119 of the FARs. The FAA has long maintained that a wet lease is a commercial arrangement whereby an aircraft owner leases both the aircraft and at least one crewmember to another person for his/her exclusive use for a specified period or a defined number of flights. To "provide an entire aircraft" means to grant the right of exclusive possession and use of a specifically identified aircraft to another person for a specified period of time or a defined number of flights. Thus, a wet lease, as the FAA uses the term, must contain the following characteristics:

- Identification of a specific aircraft.
- Grant of exclusive possession and use of that aircraft to the lessee.
- Defined duration for the grant of possession and use.
- Provision by the lessor of at least one crewmember[8] with the aircraft.

Wet Leases v. Dry Leases

There are two basic distinctions between wet and dry leases for purposes of applying the FAA's rules. First, in a wet lease, the aircraft and crew are provided by the same person, whereas

[8] The crewmember does not have to be a pilot in order for the agreement to be considered a wet lease. *See* 60 FR 16259 (Mar. 29, 1995) (If a person leases an airplane with any crewmember, including flight attendants and flight engineers, the agreement would still be considered a wet lease).

in a dry lease, a person provides an aircraft without any crewmembers. Second, with a wet lease, the lessor surrenders *legal possession* of the aircraft to the lessee, but retains *actual possession* (and, more often than not, operational control)[9] of the aircraft by virtue of providing and controlling the crewmembers. In contrast, the lessor in a dry lease transfers legal and actual possession of the aircraft to the lessee. Consequently, the "dry lessor" does not have operational control of the aircraft and bears no responsibility for the safe operation of the aircraft.[10]

Operational Control and the Prohibition on Wet Leases from Foreign Air Carriers

In a wet lease the party exercising operational control is held responsible for the safety and regulatory compliance of the flights.[11] Accordingly, under part 119, after receiving a copy of a wet lease between two U.S. air carriers, the FAA determines which party has operational control of the aircraft and issues amendments to the operation specifications of each party as appropriate. As noted earlier, the FAA considers a variety of factors when making its threshold determination regarding operational control. They include who provides the crewmembers and training, who is responsible for airworthiness and performance of maintenance, who handles dispatch, who services the aircraft, and who schedules flight operations.

[9] Operational control is defined as the exercise of authority over initiating, conducting or terminating a flight. 14 C.F.R. §1.1 (2004).

[10] The (dry) lessee, as the operator of the aircraft, must hold the necessary economic and operating authority for the aircraft and must provide the necessary flight and cabin crewmembers, ground personnel, dispatchers and ground facilities for the aircraft. *See* FAA Order 8400.10, vol. 2, chap. 4 (2004).

[11] In the vast majority of cases involving a wet lease, the FAA will find that "the lessor has operational control and direction of the aircraft through its employees and is in substance the operator of the aircraft for purposes of safety regulation." *See* Dec. 16, 1968 Letter to Intercontinental Air-Lease Operation from A.W. Lalle, FAA Office of the Chief Counsel.

When part 119 was codified, the FAA prohibited wet lease arrangements in which a foreign air carrier is the lessor and a U.S. carrier is a lessee, to avoid creating confusion over which regulatory regime governed the operations -- those of the United States, or those of the foreign country certificating the foreign carrier's operations. [12] For example, if a foreign carrier wet leased an aircraft to a U.S. carrier, it might be argued that the U.S. carrier's legal possession of the aircraft should be equated with its having control of the aircraft. At the same time, however, the U.S. carrier's control of the aircraft operation would be questionable because the foreign carrier would be directing and controlling the crew it provides. Thus, the U.S. carrier's legal possession of the aircraft could make the foreign carrier a "putative lessor",[13] because the foreign carrier most likely retains actual possession and control of the aircraft operation by virtue of controlling the crewmembers. Moreover, the foreign air carrier and its pilots may have obligations to a foreign civil aviation authority that are inconsistent with FAA standards. For these reasons, the FAA prohibits aircraft wet leases from a foreign lessor to a U.S. air carrier.[14]

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[12] Specifically, § 119.53(b) prohibits foreign air carriers, foreign persons or any person not authorized to engage in common carriage from acting as lessors in wet lease arrangements with U.S. air carriers. This provision simply codified existing FAA policy on wet leasing. "The FAA requires operators conducting wet leasing operations to hold operations specifications for the same kind of operation as that being conducted in order to be sure that the operator is qualified to conduct that kind of operation. Since foreign carriers may conduct operations only under part 129, they do not hold operations specifications for current part 121 or part 135 certificate holders, and therefore, may not conduct wet leasing operations for part 121 or part 135 certificate holders." 60 FR 65884 (Dec. 20, 1995).

[13] The term putative lessor describes a grantor in a situation where something less than exclusive actual possession of the aircraft is conveyed.

[14] The prohibition is also aimed at preventing cabotage under 49 U.S.C. § 41703 (2004). *See also* 14 C.F.R. §§ 121.153(c), and 135.25(d) (A certificate holder may operate in common carriage, and for the carriage of mail, a civil aircraft which is leased or chartered to it *without crew* and is registered in a country which is a party to the Convention on International Civil Aviation) (emphasis added).

The Atlas "Wet Lease" Agreements

In June 2003, Atlas entered into an agreement with Fed Ex by which it agreed to provide Fed Ex with aircraft to be used for a specific period in its cargo operations. Labeling the agreement a "wet lease," Atlas and Fed Ex provided copies to the FAA, in apparent compliance with §119.53(a) of the FARs. According to the explicit terms of the agreement, however, *Atlas retained exclusive possession, direction and operational control of the aircraft.*[15] Atlas's retention of both legal and actual possession of the aircraft means that, at least from the perspective of our regulations, the agreement is not a wet lease. Instead, the FAA would characterize it as a charter. The FAA's determination that the agreement is not a lease affects the air carriers' compliance obligations with part 119 of the FARs, as well as the FAA's assessment of the factors regarding operational control of the aircraft.

We examined several of these contracts styled as "wet leases" between Atlas (as "lessor") and its various airline customers that were filed with the FAA. They all follow a similar pattern. As in the Fed Ex agreement, for example, the contract terms typically provide that the "Aircraft shall at all times be under the exclusive possession, direction, and operational control of Atlas." Under the agreements, Atlas provides and trains the crewmembers and performs maintenance to ensure the airworthiness of the aircraft, while the customer schedules the times that it needs the use of the aircraft, and, although not entirely clear from the agreements, may be involved in dispatching the aircraft for its flights. In any event, the agreements do not create ambiguities about operational control because they clearly provide that Atlas retains possession of the aircraft at all times. Therefore, Atlas has operational control of the aircraft primarily because it controls

[15] *Wet Lease Agreement between Federal Express Corp. and Atlas Air, Inc.*, Article 4.1, June 24, 2003.

the crew, but also because it never surrenders legal or actual possession of the aircraft, and because it has responsibilities for aircraft maintenance and airworthiness.[16]

The FAA considered chiefly the contract terms regarding possession and operational control of the aircraft in determining whether or not the agreements were in fact leases. The specific terms that directly influenced the agency's decision are below:

Agreement between Federal Express Corp. and Atlas Air, Inc.

Article 4.1 of the Atlas/Fed Ex agreement states that "the Aircraft shall at all times be under the exclusive possession, direction, and operations control of Atlas, whose Captain or Dispatcher shall have complete discretion concerning preparation of the Aircraft for flight and flight of the Aircraft, the load carried and how distributed, whether or not a flight shall be undertaken, the route to be flown, whether and where landings shall be made, and all other matters relating to the operation of the Aircraft, and the decision of Atlas's Captain or Dispatcher shall be binding upon the Parties. The Aircraft shall at all times be operated in accordance with Atlas's FAA approved standard air carrier security program."

Agreement between International Airline of the United Arab Emirates ("UAE") and Atlas Air, Inc.

Article 5.1 of the Atlas/UAE agreement states that "the Aircraft shall at all times be under the exclusive possession, direction, and operations control of Atlas, whose Captain and dispatcher shall have complete discretion concerning preparation of the Aircraft for flight and flight of the Aircraft, the load carried and its distribution; whether or not a Flight shall be undertaken, the route to be flown, whether and where landings shall be made, and all other matters relating to the operation of the Aircraft, and Customer and subservice carriers shall accept such decisions as final and binding."

Agreement between China Cargo Airlines, Ltd. ("China Cargo") and Atlas Air, Inc.
Article 4.1 of the Atlas/China Cargo agreement states that "the Aircraft shall at all times be under the exclusive possession, direction, and operations control of Atlas, whose Captain or Dispatcher shall have complete discretion concerning preparation of the Aircraft for Flight(s), the load carried (as well as the distribution thereof), whether a Flight shall be undertaken, the route to be flown, whether landings shall be made, and all other matters relating to or arising out of operation of the Aircraft. Such decision(s) of the Captain or dispatcher shall be final and binding upon the Parties."

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[16] *See Wet Lease/Operational Control Background Paper*, FAA Operations Law Branch, Jan. 18, 1999.

Agreement between Polar Air Cargo ("Polar") and Qantas Airways, Ltd. ("Qantas")

> Article 4.1 of the Polar/Qantas agreement states that "the Aircraft shall at all times be under the exclusive possession, direction, and operational control of Polar, whose Captain and dispatcher shall have complete discretion concerning preparation of the Aircraft for Flight(s), the load carried (as well as the distribution thereof); whether a Flight shall be undertaken, the route to be flown, whether landings shall be made, and all other matters relating to or arising out of operation of the Aircraft. Such decision(s) of the Captain or dispatcher shall be final and binding upon the Parties."

The FAA does not consider any agreement to be a lease if it contains language that provides that the grantor retains possession, direction and control of the aircraft. Therefore, these agreements, though labeled wet leases, contain terms that are incompatible with the FAA's concept of an aircraft lease. Accordingly, the FAA determined that the agreements were not leases because the grantor never transfers legal and actual possession of the aircraft to the purported lessee.[17]

In addition to the provisions quoted above, the FAA also considered other factors such as the lessor's ability to substitute aircraft used in the lessee's operations, and the lessor's right to use the leased aircraft for purposes other than the lessee's flights. Again, the FAA found that those contractual terms were inconsistent with its definition of a lease, which is an agreement

[17] Only if the contracts transferred legal and actual possession to Fed Ex and if Atlas pilots, or any other Atlas employees, served as crewmembers on the aircraft, would the agreement be a "wet lease" under § 119.53 requiring FAA approval prior to Atlas conducting operations. It is important to note, however, that an issue of operational control would exist because although Fed Ex had a possessory interest in the aircraft, Atlas employees would be serving as crewmembers on the aircraft. The FAA only analyzes which carrier has operational control in a wet lease between two U.S. air carriers. A true wet lease from a foreign carrier is prohibited by the regulations and the FAA does not engage in a case by case analysis of which carrier might have control.

that: 1) identifies a specific aircraft; and 2) grants exclusive possession and use of that aircraft to the lessee for a specified period.[18]

For example, in the Polar/Qantas agreement, a specific aircraft (N450PA) is identified in the contract, but Polar, as the "lessor," is permitted to substitute as many as five other aircraft in its fleet for Qantas' operations.[19] Moreover, the parties agree that throughout the "lease" term, Polar has the right to use the aircraft for its own purposes as long as that use does not interfere with the scheduled weekly flights[20] that Polar operates for Qantas.[21] Similar provisions are found in the Atlas agreements with Fed Ex,[22] UAE[23] and China Cargo.[24] However, as stated above, an

[18] As explained above, the agreement is a *wet* lease if a crewmember is also provided with the aircraft.

[19] Article 1.1 of Annex A provides that "the Aircraft referred to in Article 1.1 of the Agreement shall be aircraft N450PA or such other substitute B747-400F aircraft from Polar's fleet including: N451PA, N452PA, N453PA, N454PA and N496MC. This list of Aircraft may be modified, if necessary, subject to notice to the FAA and upon the mutual agreement of the Parties."

[20] The notion of scheduled weekly flights between specific city pairs is also more consistent with a charter arrangement, than with a lease arrangement.

[21] Paragraph 4.10 of the Polar/Qantas agreement states that "Polar shall have the right in its sole discretion to utilize the Aircraft for its own purposes during periods of Customer's scheduled or unscheduled downtimes provided such use does not interfere with Customer's scheduled operations under this Agreement. Polar's use of the Aircraft under this section shall be without compensation, credit or offset to Customer, and shall not reduce Customer's Monthly Minimum Block Hour Guarantee hereunder."

[22] Paragraph 4.10 of the Atlas/Fed Ex agreement sates that "Atlas may substitute for operation of the Flights any B747 freighter aircraft listed in the Atlas Air Operations Specifications or use any such substitute aircraft for the operation of additional Flights within the authorized operating areas listed in the Atlas Air Operation Specifications; provided that all aircraft used and all such aircraft shall meet all governmental and regulatory requirements established in this Agreement." *See also* Paragraph 4.11: "Atlas shall have the right, subject to Customer's consent which shall not be unreasonably withheld, to utilize the Aircraft for its own purposes during periods of Customer's scheduled or unscheduled downtimes, provided such use does not interfere with Customer's scheduled operations under this Agreement. Atlas' use of the Aircraft under this section shall be without compensation, credit or offset to Customer, and shall not reduce Customer's minimum block hour guarantees hereunder."

FAA lease requires the identification of a specific aircraft, and the lessee's exclusive use and possession of the aircraft. Thus, contract terms that permit substitution of aircraft or that allow the lessor to use the aircraft during the lease term, are factors that would weigh heavily against the FAA finding that the agreement is a lease. In light of these provisions, the agency determined that the agreements simply do not constitute wet leases under part 119, and in fact are not leases at all. Accordingly, they are not subject to the part 119 prohibition on U.S. air carriers leasing aircraft and crew from foreign air carriers, and there is no regulatory action required by the FAA for these arrangements.

Conclusion

The FAA's view of a lease agreement hinges on the possessory interests in the aircraft. An agreement is not a lease if the grantor retains possession, direction and control of the aircraft. In these situations, the term "wet lease" is a misnomer because legal and actual possession is not conveyed to the purported lessee. Instead, the agreement is, in essence, a charter arrangement where flight services are provided to a customer.

Since the agreements are not leases, they are not subject to the foreign lessor prohibition found in § 119.53(b) of the FARs. Thus, a U.S. carrier could engage in this type of charter arrangement with a foreign air carrier. In such a situation, the FAA probably would find that the

[23] Paragraph 2.5 of the Atlas/UAE agreement provides that "Atlas' scheduling of the aircraft shall be for the benefit of Customer with Customer's scheduled operations as provided herein having first priority."

[24] Paragraph 5.10 of the Atlas/China Cargo agreement states that "Atlas may substitute for operation of the Flights any B747 Freighter Aircraft listed in the Atlas Air Operations Specification or use such Aircraft for the operation of additional Flights within the authorized operating areas listed in the Atlas Air Operations Specifications; provided that all aircraft used and all such Flights shall meet all governmental and regulatory requirements." *See also* Paragraph 4.10 which states that "Atlas shall have the right in its sole discretion to utilize the aircraft for its own purposes during periods of Customer's scheduled or unscheduled downtimes, provided that such use does not interfere with Customer's scheduled operations under this Agreement. Atlas' use of the Aircraft under this section shall be without compensation, credit or offset to Customer, and shall not reduce Customer's minimum block hour guarantees hereunder."

party providing the crew (whether U.S. or foreign) has operational control of the aircraft and is responsible for complying with the air carrier standards prescribed by the FAA or by that carrier's national civil aviation authority. Moreover, foreign operators in U.S. airspace must comply with 14 C.F.R. § 129, and any aircraft flown in U.S. airspace must comply with the rules applicable to all operators (*e.g.* 14 C.F.R. § 91).

In the case of true wet leases (transfer of legal possession of the aircraft with crewmembers), a U.S. air carrier could not be a wet lessee with a foreign air carrier lessor since such transactions are specifically prohibited by § 119.53(b) of the FARs. However, a U.S. carrier could be the lessor in a wet lease to a foreign air carrier. In this situation, as with the charters described above, the FAA determines operational control based on the party providing the crew (as well as on the other factors listed in § 119.53(d)). Thus, in a true wet lease from a U.S. carrier to a foreign carrier, the U.S. carrier would be deemed to have operational control of the aircraft and would be responsible for safety and regulatory compliance with FAA standards; and the FAA would assert oversight responsibility over such an operation.