An Analysis of the Largest Proposed Civil Penalty ($3.3 Million) in FAA History against a Private Company: The Hinman Company Enforcement Action

VedderPrice

An Analysis of the Largest Proposed Civil Penalty ($3.3 Million) in FAA History against a Private Company: The Hinman Company Enforcement Action

By David M. Hernandez, Shareholder, Vedder Price P.C.[1]
October 2018

Aviation is one of the most heavily regulated industries in the United States. Thousands of complex Federal Aviation Regulations[2] (**"FARs"**) exist governing the operation, ownership and maintenance of aircraft. This article is an analysis of the consequences of alleged FAR violations. Specifically, the Federal Aviation Administration (the **"FAA"**) alleged that the Hinman Company (**"Hinman"**) was operating as a *de facto* charter air carrier for compensation without the required FAA approvals and as a result, the FAA proposed a $3.3 million civil penalty against Hinman for the related FAR violations. Given the complexity of the FARs, a massive multi-million dollar civil penalty was not a question of *if* it would happen, but *when*. This enforcement action represents the largest proposed civil penalty in FAA history received by any company purporting to operate business aircraft under 14 C.F.R. part 91 (**"Part 91"**). Despite the complexity of FAR compliance and the enforcement process, many companies simply try to handle matters internally without seeking advice from knowledgeable aviation counsel (until it's too late).

As discussed in detail below, Hinman owned two aircraft that apparently were not being fully utilized, so it decided to lease the aircraft to local businesses and the parties entered into FAA-regulated arrangements, called time sharing agreements (**"TSAs"**). A TSA is "an arrangement whereby a person leases his airplane with flight crew to another person, and no charge is made for the flights conducted under that arrangement other than" very specific charges.[3] Here, the FAA alleges that Hinman charged more than those specific charges to the TSA lessees, and as a result, was acting a as commercial charter air carrier without FAA approval. When the FAA became aware of Hinman's action, it sent Hinman a letter requesting an explanation, called a **"Letter of Investigation."** Hinman promptly responded to the Letter of Investigation, and its responses[4] to the Letter of Investigation[5] and Civil Penalty Letter[6] provide rare and fascinating insight into how easy it is for a company to receive a proposed multi-million dollar fine.

This article provides an analysis of circumstances that gave rise to Hinman's $3.3 million proposed civil penalty, the FAA's case, and the FAA's subsequent referral to the U.S. Attorney's Office for the Western District of Michigan (**"USAO,"** collectively with the FAA, the "Government"), with the primary goal of educating companies on how to avoid being the next seven-figure civil penalty enforcement action. The article is based on enforcement file documents received from the FAA following a Freedom of Information Act (**"FOIA"**) request and the Complaint filed by the USAO on October 4, 2018. The FAA's referral to the USAO and the filing of the Complaint[7] that nearly mirrors the Civil Penalty Letter allegations strongly suggests that the Government is confident about the merits of its case.

1 David M. Hernandez, a Shareholder at Vedder Price P.C., is a former U.S. Department of Transportation (**"DOT"**) Honors Program Attorney and a former FAA Enforcement Attorney/Prosecutor (AGC-300) with significant experience assisting clients with a wide variety of aircraft transactional, operational, tax and enforcement matters. Contact: (202) 312-3340, dhernandez@vedderprice.com.

2 14 C.F.R. parts 1–399.

3 14 C.F.R. § 91.501(c)(1).

4 Letter from Darin Caranci, CFO, The Hinman Company, to Amanda J. Theisen, Principal Operations Inspector, Grand Rapids Flight Standards District Office, January 20, 2017 (the **"First Letter of Investigation Response"**); Letter from Hinman's Counsel to Amanda J. Theisen, Principal Operations Inspector, Grand Rapids Flight Standards District Office, February 20, 2017 (**"Second Letter of Investigation Response"**).

5 Letter to Darin Caranci, Chief Financial Offer, The Hinman Company, from Amanda J. Theisen, Principal Operations Inspector, Grand Rapids Flight Standards District Office, January 11, 2017 (the **"Letter of Investigation"**).

6 Civil Penalty Letter to Roger Hinman, President and CEO, The Hinman Company, from Naomi Tsuda, Assistant Chief Counsel for Enforcement, and Lauren Hoyson, Federal Aviation Administration, Case Number 2017GL090002, June 12, 2018 (the **"Civil Penalty Letter"**).

7 Complaint for Damages, *United States of America v. The Hinman Company*, Case No. 1:18-cv-01140, October 4, 2018 (the **"Complaint"**).

Background

Hinman[8] is a Portage, Michigan-based real estate management company that owns and operates, through its wholly owned subsidiary HincoJet, LLC, two business jet aircraft.[9] Apparently, because Hinman's "fleet of aircraft provided more flight capacity than Hinman required, in 2014 Hinman entered into Timesharing Agreements with other local businesses."[10] Hinman entered into six TSA agreements. Between August 2009 and November 2013, Hinman entered into six TSAs with un-affiliated parties (the **"Timesharees"**) for the use of the aircraft. Each of the TSAs stressed that Hinman would provide the aircraft and the crew to the Timesharees on a time-sharing basis "in accordance with FARs 91.501(b)(6), 91.501(c)(1) and 91.501(d)."[11] From October 4, 2013 to January 20, 2017, Hinman sent the Timesharees invoices for a total of 812 flights.[12] Each of the TSAs also provided that Hinman would bill the relevant Timesharee an amount equal to the sum of the following specific FAR expenses:

- Fuel, oil, lubricants and other additives;
- Travel expenses of the crew, including food, lodging and ground transportation;
- Hangar and tie-down costs away from the aircraft's base of operation;
- Insurance obtained for the specific flight;
- Landing fees, airport taxes and similar assessments;
- Customs, foreign permit and similar fees directly related to the flight;
- In-flight food and beverages;
- Passenger ground transportation;
- Flight planning and weather contract services; and
- An additional charge equal to one hundred percent (100%) of the fuel, oil, lubricants, and other additives expenses.[13]

Each TSA provides that Hinman shall provide the relevant Timesharee with an invoice for the charges specified, and that "all such invoices shall separately itemize the [permitted] expenses . . . for each flight included in the invoice."[14]

TSA arrangements are governed by Part 91 general (noncommercial) operating rules, and are permissible exceptions to the FAA's commercial charter air carrier regulations: 14 C.F.R. part 119 (**"Part 119"**) and 14 C.F.R. part 135 (**"Part 135"**).[15] Neither Hinman nor HincoJet possessed a Part 119 air carrier certificate or Part 135 operations specifications required to provide commercial charter flights.

At the end of 2016, the FAA apparently inquired about Hinman's flight activity and its multiple TSAs. In response to the FAA's inquiry, on or about December 14, 2016, Hinman wrote a letter to the FAA describing its operations, submitted various invoices, and claimed that any amounts invoiced are allowable under the FARs.[16] On January 11, 2017, the FAA responded with the Letter of Investigation, and stated that it disagreed with Hinman's conclusion that the charges were permissible under the FARs and requested all invoices for the previous two years. The Letter of Investigation also provided that Hinman had ten days to respond and that Hinman's "statement should contain all pertinent facts and any mitigating circumstances you believe may have a bearing on the matter."[17]

8 https://hinmancompany.com

9 A 2001 Raytheon Beechjet 400A aircraft and a 2008 Hawker 900XP aircraft.

10 Second Letter of Investigation Response (emphasis added).

11 Complaint, ¶¶ 5–12.

12 Complaint, ¶ 15. The Civil Penalty Letter alleged between August 1, 2013 and January 20, 2017, Hinman sent the timeshares invoice for approximately 850 flights. However, the USAO had to adjust the time frame and number of flights because they occurred prior to the 5-year statute of limitations period of October 4, 2013. 28 U.S.C. § 2462.

13 *Compare* 14 C.F.R. § 91.501(d).

14 Complaint, ¶ 13.

15 Part 119 contains the FARs that govern certification of air carriers and commercial operations and Part 135 contains FARs that govern the operating requirements for commuter and on-demand operations for compensation or hire.

16 14 C.F.R. § 91.501(d).

17 *Id.* at ¶ 14.

On January 20, 2017, Hinman responded to the Letter of Investigation and provided *some* of the invoices for the previous twenty-four (24) months, including itemized detailed charges for each specific flight. Hinman in fact admitted, "that after conferring with legal counsel, we discovered a *misunderstanding in the applicable regulation*s."[18] Hinman then wrote that "[a]lthough Hinman deviated from the standards set forth in the Federal Aviation Regulations, such a deviation was unintentional, inadvertent and did not involve any flight safety issues. The amounts billed for MSP [maintenance service plans] are in the process of being refunded to the Lessee's [sic] under the applicable Time Share Agreements."[19]

On February 20, 2017, Hinman's counsel sent the FAA a second response letter, which revealed that the FAA may also be pursuing enforcement actions against Hinman's four pilots for operating under Part 135 without the proper authority.[20]

Hinman's counsel explained that Hinman "misinterpreted" an FAA legal interpretation and "believed that it was entitled to recover the prorated cost of an engine maintenance program as part of its pass-through costs for the Timeshare Agreements."[22] Hinman's counsel also admitted that "a proration of the engine maintenance program is not an allowed cost pursuant to 14 CFR § 91.501(d)" and that "Hinman has stopped billing this cost and is in the process of refunding the full amount of impermissible fees initially billed to timeshare lessees."[23] Hinman disclosed to the FAA that it charged the Timesharees over $550,000 in MSP fees and that it overcharged the Timesharees approximately $373,830.44.[24]

Presumably, in an effort to proactively address the pilot enforcement actions, Hinman's counsel also wrote "You may have noticed that there has been no substantive mention of the pilots until now in this letter. The reason that the pilots have escaped mention up to this point is that none of these pilots had any direct involvement in the creation, execution, implementation, invoicing, or administration of the Timeshare Agreements."[25] The pilot allegations are important in the context of an enforcement action because it is rare for the FAA to pursue enforcement action against companies and their pilots.

Hinman then explained to the FAA that the problem was a "simple misunderstanding of the relevant regulations" that was "corrected, remediated, and training has been provided." Hinman added "that this is an accounting rather than a safety issue."[26] With respect to the pilots, Hinman added that "insofar as this matter has been determined to be an accounting issue" and "there is no evidence that any of the subject flights involved a deviation from acceptable flight standards or safety regulations, it would be inappropriate to hold the pilots responsible for matters wholly beyond their control or authority."

Hinman then requested that the enforcement actions related to the pilots and the Company be closed administratively, without any further enforcement action.

Obviously, that did not happen.

On June 12, 2018, exactly a year-and-a-half after the First Letter of Investigation Response, as detailed below, the FAA issued a $3.3 million proposed civil penalty against Hinman for essentially acting as a charter air carrier without FAA authorization by conducting 850 charter flights, disguised as time sharing agreement flights without the requisite regulatory authority. On June 29, 2018, the FAA issued on its website a press release titled **"Press Release – FAA Proposes $3.3 Million Civil Penalty Against The Hinman Co."**[27]

18 First Letter of Investigation Response (emphasis added).

19 *Id.*

20 Second Letter of Investigation Response.

21 Legal Interpretation to Robert J. Thole, Law Clerk, Bradshaw, Fowler, Proctor & Fairgrave, P.C. from Rebecca MacPherson, Assistant Chief Counsel for Regulations, AGC-300, March 15, 2012 ("**Thole Interpretation**"). It is wise to understand the context of an FAA interpretation..

22 Second Letter of Investigation Response.

23 *Id.*

24 Second Letter of Investigation Response, Exhibit O.

25 *Id.*

26 *Id.*

27 https://www.faa.gov/news/press_releases/news_story.cfm?newsid=22874

Shortly after the issuance of the Civil Penalty Letter, Hinman and FAA conducted a settlement conference, but Hinman and the FAA were unable to settle the matter. As a result, on October 4, 2018, with the 5-year statute of limitations eliminating violations each day, the USAO filed the Complaint listing ten specific FAR violations and revealed that Hinman could be subject to a civil penalty not to exceed $11,000 for each FAR violation, which would subject Hinman to a maximum civil penalty of $90 million; but such a large civil penalty against a small business would be inconsistent with FAA enforcement guidance.[28] However, Hinman still could be facing a $11,000 penalty for each of the 812 flights, and because the parties were unable to settle the matter, Hinman's civil penalty exposure potentially tripled to nearly $9 million, which is more realistic based on FAA enforcement guidance.[29]

The Government's Case

The Government alleges for nearly three years, Hinman was operating as an impermissible Part 135 air carrier when it provided 812 charter flights disguised as TSA flights. Specifically, Hinman allegedly billed the Timesharees for a total of 812 flights between October 4, 2013 and January 20, 2017, and between October 4, 2013 and December 23, 2016, and each invoice that Hinman sent to the Timesharees included a charge for "fuel x's 2" *and* a maintenance service plan (**"MSP"**) charge. MSP charges are clearly not listed as an authorized charge in FAR section 91.501(d) ("**FAR 91.501(d)"**).

As a result, the Government alleged that Hinman charged for more than the amount permitted by FAR 91.501(d) when it charged for double the fuel, oil, lubricants and other additives and the MSP. Specifically, Hinman charged one Timesharee for de-icing or anti-icing for flights conducted under a TSA on January 27, March 12–16 and April 14–15, 2014. Hinman also charged another Timesharee for de-icing or anti-icing for flights conducted under a TSA on January 29 and 31, 2014. However, de-icing charges are clearly not listed as an authorized charge in FAR 91.501(d).[30]

Interestingly, according to the Government, Hinman billed two Timesharees each the entire amount permitted under FAR 91.501(d) plus the MSP for a flight conducted on or about May 18, 2015. Hinman also allegedly billed one Timesharee twice for a trip conducted from May 27 to June 2, 2016, and twice for a trip conducted on July 5, 2016.[31]

The Government also alleged that Hinman billed another Timesharee for a trip that was conducted on one aircraft on September 30, 2015, from Groton, Connecticut, to Wilmington, North Carolina, to Ocean Reef, Florida, and billed a different Timesharee for a trip in the same aircraft conducted on the same date from Kalamazoo, Michigan to Detroit, Michigan to Huntington, Indiana to Indianapolis, Indiana, to Romeoville, Illinois, to Palwaukee Airport, Wheeling, Illinois, and back to Kalamazoo, Michigan. The Government asserted that the aircraft could not have conducted both trips in the same day.[32] The Government further alleged that each of the invoices Hinman sent to the Timesharees between August 1, 2016 and December 23, 2016, billed for multiple flight legs and did not itemize the expenses for each specific flight, as required by FAR 91.501(d). Hinman also invoiced two Timesharees for approximately 25 flight legs from January 2, 2017 to March 1, 2017, which included expenses for multiple flight legs, but did not itemize the expenses for each specific flight.[33]

28 *See* FAA Order 2150.C3.

29 The FAA and USAO have significant discretion regarding the civil penalty calculation, but one hypothetical calculation is 812 flights multiplied by $11,000 equaling $8.93 million, which disregards the ten violations per flight.

30 Complaint, ¶ 20–22.

31 *Id.* at ¶ 24–26.

32 *Id.* at ¶ 27.

33 *Id.* at ¶ 28–30.

The FAR Violations

The Complaint alleges that Hinman was operating as a charter air carrier without the required FAA authority when it conducted 812 commercial flights without: (i) an air carrier certificate issued under Part 119; (ii) operations specifications appropriate to conduct charter operations under Part 135; (iii) an accepted current manual containing its policies and procedures; and (iv) the appropriate DOT economic authority.

As a result, the Government concluded that Hinman violated the following FARs:

a. 14 C.F.R. § 119.5(g), which states that no person may operate as a direct air carrier or as a commercial operator without, or in violation of, an appropriate certificate and appropriate operations specifications;

b. 14 C.F.R. § 119.5(i), which states that no person may operate as a direct air carrier without holding appropriate economic authority from the Department of Transportation;

c. 14 C.F.R. § 135.21(a), which states that each certificate holder, other than one who uses only one pilot in the certificate holder's operations, shall prepare and keep current a manual setting forth the certificate holder's procedures and policies, acceptable to the administrator;

d. 14 C.F.R. § 135.63(a)(4), which states each certificate holder shall keep at its principal business office or at other places approved by the administrator and shall make available for inspection by the administrator an individual record of each pilot used in operations under this Part;

e. 14 C.F.R. § 135.77, which states that each certificate holder is responsible for operational control and shall list, in the manual required by § 135.21, the name and title of each person authorized by it to exercise operational control;

f. 14 C.F.R. § 135.293(a), which states that no certificate holder may use a pilot, nor may any person serve as a pilot, unless, since the beginning of the 12th calendar month before that service, that pilot has passed a written or oral test, given by the administrator or an authorized check on that pilot's knowledge in the areas set forth by that section;

g. 14 C.F.R. § 135.297(a), which states that no certificate holder may use a pilot, nor may any person serve, as a pilot in command of an aircraft under IFR unless, since the beginning of the 6th calendar month before that service, that pilot has passed an instrument proficiency check under this section administered by the administrator or performed an authorized check on the pilot;

h. 14 C.F.R. § 135.299, which states that no certificate holder may use a pilot, nor may any person serve, as a pilot in command of a flight unless, since the beginning of the 12th calendar month before that service, that pilot has passed a flight check in one of the types of aircraft which that pilot is to fly;

i. 14 C.F.R. § 135.323(a), which states that each certificate holder required to have a training program under § 135.341 shall establish and implement a training program that satisfies the requirements of this subpart and that ensures that each crewmember, aircraft dispatcher, flight instructor and check airman is adequately trained to perform his or her assigned duties. Prior to implementation, the certificate holder must obtain initial and final FAA approval of the training program; and

j. 14 C.F.R. § 135.343, which states that no certificate holder may use a person, nor may any person serve, as a crewmember in operations under this part unless that crewmember has completed the appropriate initial or recurrent training phase of the training program appropriate to the type of operation in which the crewmember is to serve since the beginning of the 12th calendar month before that service.

The Government concluded that under 49 U.S.C. § 46301(a)(5)(A), Hinman is subject to a civil penalty not to exceed $11,000 for *each violation* of the FARs.

Analysis

A common question aviation attorneys are often asked at conferences, networking events and professional gatherings is: *Does the FAA actually take enforcement actions against business aircraft operators?* We can now say definitively, *"Yes."* More importantly, the violations above are likely the exact same FAR violations that most operators—and pilots—would face for operating impermissible commercial operations for compensation without a Part 119 air carrier certificate or Part 135 operations specifications. With limited exceptions,[34] the only way to operate most business aircraft for compensation without an air carrier certificate and associated operations specifications is in accordance with the specific exemptions set forth in FAR 91.501.[35] To be clear, if the proposed flights do not fall within one of the FAR 91.501 exceptions, then the flights likely must be flown by an FAA certificated air carrier, generally under FAR Part 135. That is exactly what happened here: Hinman asserted that its TSA operations were permissible under Part 91 without possessing FAA authorization (in the form of a Part 119 air carrier certificate and Part 135 operations specifications), and the Government disagreed.

There are three primary ways that a company may be investigated by the FAA: (1) an accident, incident or blatant air traffic control violation, (2) a random FAA audit or ramp check or (3) a third-party complaint (either formal or anonymous). In addition, the trade association representing FAA-certificated air carriers, the National Air Transportation Association ("NATA"), has been aggressively raising awareness of unauthorized or "illegal" charter.[36] NATA has formed a task force, called the NATA Illegal Charter Task Force, to reinforce its ongoing efforts to address the growing concern of entities providing air transportation without FAA and DOT authorization. Specifically, the goal of the task force is to collaborate and work with: (1) the FAA to provide guidance to identify and assist the FAA with enforcement actions, (2) the Internal Revenue Service ("IRS") to understand the tax consequences of illegal charter, (3) Congress to better equip the FAA to act, and (4) the public to increase awareness of the importance of flying legally.[37]

34 *See* 14 C.F.R. 91.321, Carriage of candidate in elections; and 14 C.F.R. 91.146, Passenger-carrying flights for the benefit of a charitable, nonprofit, or community event.

35 *See* Part 91.501. "This subpart provides operating rules, in addition to those prescribed in other subparts of Part 91, governing the operation of large airplanes of U.S. registry, turbojet-powered multiengine civil airplanes of U.S. registry, and fractional ownership program aircraft of U.S. registry that are operating under subpart K of Part 91 in operations not involving common carriage." *See also*, *"Large aircraft* means aircraft of more than 12,500 pounds, maximum certificated takeoff weight." FAR 1.1.

36 Business & Commercial Aviation, p. 16, July 2018.

37 *Id.*

Here, it is not clear how the FAA became aware of Hinman's operations, but the fact of the matter is that the Company had been operating its time sharing arrangement since 2009 (*for nearly eight years*) prior its receipt of the Letter of Investigation.

Time Sharing Arrangement

A strong argument could be made that Hinman's practice of time sharing to unrelated third parties simply does not make sense financially because TSA lessors subsidize the flights of TSA lessees. The FAA specifically designed TSAs to prohibit any profit motive when it capped the permissible. As a result, it is unclear why a for-profit company would provide subsidized flights to unrelated third parties. It would be also problematic if the TSA lessees are clients or customers of the TSA lessor because of the potential for a *quid pro quo* arrangement. According to the FAA, companies may not provide subsidized TSA flights in exchange for other forms of compensation, such as good will or incidental consideration, because such compensation is likely impermissible under the FARs.[38] The FAA's definition of compensation is very broad and the FAA potentially could find that most actions in *quid pro quo* arrangements constitute impermissible compensation.[39]

More importantly, in most instances the FAA prohibits charging potential clients and customers for air transportation, *even under a TSA*. Specifically, FAR 91.501(b)(9) provides:

> The carriage of persons on an airplane operated by a person in the furtherance of a business other than transportation by air for the purpose of selling them land, goods, or property, including franchises or distributorships [is permissible], when the carriage is within the scope of, and incidental to, that business *and no charge, assessment, or fee is made for that carriage.*[40]

Simply put, the carriage must be within the scope of, and incidental to, a company's business *and* the company cannot receive any compensation for providing air transportation under Part 91 from prospective clients or customers except as otherwise permitted under FARs, *i.e.*, demonstration flights.

Typically, a company with multiple aircraft and excess capacity that wants to offset its costs would usually consider (i) leasing its aircraft to a certificated Part 135 air carrier to charter to third parties or (ii) selling the aircraft. Also, from a risk perspective, with a TSA, the lessor possesses FAA operational control and IRS possession, command and control for the TSA flights, which means that the lessor also possesses all of the FAA regulatory, tort and tax liability (and headaches associated with all of that). With respect to tax risk, many companies do not realize that TSA flights are subject to federal excise taxes (**"FET"**) and often do not collect FET and remit them to the IRS. Moreover, it's unclear how to charge for empty leg repositioning or "deadhead" flights under a TSA. Deadhead flights are not one of the permissible expenses itemized in FAR 91.501(d); someone has to pay. We are currently unaware of any FAA guidance regarding the permissibility of charging for TSA deadhead flights. Simply put, companies must fully understand the relevant risks and nuances associated with a TSA arrangement.

38 Legal interpretation to Robert P. Silverberg, Silverberg, Goldman & Bikoff, from Mark W. Bury, Assistant Chief Counsel for International Law, Legislation and Regulations, AGC-200, December 4, 2013.

39 Legal interpretation to Jeffrey Hills, Partner, Crowe & Dunlevy, from Lorelei Peter, Assistant Chief Counsel for Regulation, Federal Aviation Administration, June 30, 2017; *see also, Id*.

40 14 C.F.R. § 91.501(b)(9) (emphasis added).

Multiple Billings and Itemized Expenses

The Government alleged that Hinman double billed two Timesharees for two trips. Given the egregious nature of such actions and the complexity of aircraft billing and accounting operations, it is conceivable that these allegations may actually be accounting or billing errors. However, FAA enforcement guidance[41] provides that if credible evidence exists that Hinman's actions were intentional, then that would represent a *signi icant aggravating circumstance*, which presumably validates in large part the FAA's $3.3 million proposed penalty and the inability to reach a settlement. Unfortunately, it is unclear from the FOIA material whether the FAA asked Hinman to address the allegations prior to the issuance of the civil penalty, and that is not generally the FAA's practice in connection with an enforcement action.

Indeed, most companies feel ambushed by the receipt of an FAA Notice of Proposed Civil Penalty or a Civil Penalty Letter, which is usually followed by an FAA Press Release that is usually re-published by various media outlets. The FAA does not provide any warning whatsoever of its actions, and the FAA does not issue any press release retractions for dismissed allegations. Here, the FAA waited 18 months after the First Letter of Investigation Response to issue the Civil Penalty Letter, and the delay also forced the Government to rush to file the Complaint because the statute of limitations was eroding the Government's case.

As for providing itemized invoices, FAR 91.501(d) does not expressly require a TSA lessor to provide a time share lessee itemized invoices based on the FAR 91.501(d) expenses. However, here, Hinman actually added the requirement in its TSA: "all such invoices shall separately itemize the expenses in items (a) through (j) for each flight included in the invoice." Typically, a time share lessor just charges twice the fuel, which is permissible and doesn't waste time itemizing the other FAR 91.501(d) expenses. Accordingly, with respect to the invoices Hinman sent one Timesharee for the 25 flight legs from January 2, 2017 to March 1, 2017, if each of the invoices was limited to twice the fuel, but did not itemize the expenses, arguably Hinman complied with FAR 91.501, but ironically, not its self-imposed TSA requirement. In sum, if a company prepares a TSA with specific requirements then it should comply with the specific requirements, otherwise it will likely result in additional FAA scrutiny.

Understanding the FARs and the Enforcement Process

The best way to avoid these complex aircraft charging regulations and an FAA enforcement action is to understand the applicable FARs and the FAA enforcement process. Based on Hinman's comments, it appears that Hinman's first mistake was trying to wing it and interpret complex FARs and an FAA legal interpretation without seeking advice from an experienced FAA counsel. In particular, the Thole Interpretation, upon which Hinman claimed that it relied to establish its operations, clearly provides that the maximum that can be charged to a TSA lessee is the FAR 91.501(d) expenses, citing relevant regulatory history that explains the underlying rationale.[42] The regulatory history provides that the purpose of FAR 91.501(d) (formerly 91.181(d)) is to "ensure a profit is not made" and that Section 91.501(d) "allows an additional charge equal to 100 percent of the [fuel, oil, lubricants and other additives] and *does not provide for authorization by the administrator of any other charge."* [43]

41 *See* FAA Order 2150.3B, Compliance and Enforcement Program.

42 38 Fed. Reg. at 19024–25 (July 17, 1973).

43 *Id.* at 19024.

Next, Hinman's initial seemingly limited knowledge of the FAA enforcement process and procedures was problematic. When Hinman received the Letter of Investigation with a ten-day response deadline, it should have immediately requested an extension to enable it to provide a comprehensive, exhaustive response that addresses all of the FAA concerns. It is virtually impossible to respond to such a comprehensive request in ten days with or without counsel. Interestingly, despite informing the FAA that it had retained counsel, Hinman still did not request an extension to respond, and then Hinman only partially responded. Hinman's counsel replied a month later with a more comprehensive Letter of Investigation response.

The FOIA materials indicate that the FAA initiated multiple enforcement actions, which may explain why Hinman attempted to proactively address potential pilot enforcement actions when it wrote "You may have noticed that there has been no substantive mention of the pilots until now in this letter. The reason that the pilots have escaped mention up to this point is that none of these pilots had any direct involvement" in the TSAs.[44] However, it important to stress that from the FAA's perspective and the relevant FARs, as *pilot-in-command* of the TSA flights, the pilots had "direct involvement" in the TSAs. Specifically, FARs 135.293(a), 135.297(a), 135.299, 135.323(a) and 135.343 all prohibit pilots from conducting Part 135 operations without being properly qualified. The FAA's position is that a pilot must know whether he or she is qualified to operate a particular flight, which does not seem unreasonable given that the Government alleges that Hinman was operating as a *de facto* charter operator, performing hundreds of flights for unrelated third parties for compensation. Again, pilots have an undisputed obligation to know whether they are qualified to perform a particular flight and, if any doubt exists, ask the appropriate parties the relevant questions. While the Complaint does not contain any allegations against the pilots, companies and pilots must be aware of the potential FAR exposure while acting as pilot-in-command.

FAA Interactions

The FAA is a safety agency, and it achieves safety primarily by educating the public about the FARs, performing surveillance and enforcing the FAR violations. As such, it is important to view facts and circumstances from the FAA's perspective and to avoid regulatory red flags before interacting with the FAA. For example, when considering an aircraft-related limited liability company name, avoid using names that include "Jet" or "Aviation" because they are red flags that raise suspicion as to whether the company is an flight department that requires Part 119 certification. FAA letter of authorization requests, changes and amendments are ideal times for the FAA to scrutinize and audit a company's operating structure. Companies should ensure that their flight operations and organizational structure comply with the FARs before requesting FAA authorizations or approvals. Also, regarding potential risks, NATA has created a task force and established a comprehensive plan to attack "illegal" charter, and NATA's *"No. 1 concern is the danger illegal charter does to their businesses and the industry as a whole."*[45] NATA also maintains an effective line of communication with the FAA and DOT.

44 *See* Second Letter of Investigation Response. .

45 Business & Commercial Aviation, p. 16, July 2018, comment from Timothy Obitts, NATA Executive Vice President of Operations and General Counsel.

As with any FAA interaction action, companies must also be concerned that everything that they disclose to the FAA could be used against them and could lead to potential additional regulatory exposure. To illustrate, based on the FOIA documents, Hinman's operating structure may have some regulatory exposure as an impermissible flight department company.[46] Hinman wrote that "[t]hrough its wholly-owned subsidiary, HincoJet LLC, Hinman hangars and operates two aircraft . . .".[47] If HincoJet's "primary business purpose is to operate Aircraft, then it is a flight department company, subject to part 119 certification" according to the FAA.[48]

Decades of FAA legal interpretations provide that if the primary business purpose of a company is to operate aircraft, then that company is a flight department company, subject to Part 119 certification. Nevertheless, many companies, whose primary business purpose is to operate aircraft, continue to operate as impermissible flight department companies without Part 119 certification. Moreover, Part 135 air carriers are subject to very stringent DOT/FAA drug and alcohol testing regulations,[49] and if the FAA determines that a company's operations are subject to Part 135, then it is also conceivable that the company is subject to antidrug and alcohol testing requirements for all of its safety sensitive employees, including its pilots and mechanics.

It is well within the FAA prosecutorial discretion to pursue additional FAR violations if discovered as a result of a pending enforcement action. The FAA simply generates another letter of investigation based on the newly discovered alleged violations. Fortunately for Hinman, the Complaint does not reveal any DOT/FAA drug and alcohol testing regulations allegations.

Corrective Action and Prosecutorial Discretion

FAA Order 2150.3C, FAA Compliance and Enforcement Program provides that the only realistic way to reduce a civil penalty is corrective action and inability to pay. Order 2150.3C provides that:

> Corrective action is a mitigating factor when it exceeds regulatory or statutory requirements, corrects the underlying violation, and is designed to prevent future violations. The significance of corrective action as a mitigating factor is determined by the timeliness of the action (e.g., before FAA discovery of the violation, after discovery but before legal enforcement action is initiated, or after legal enforcement action is taken) and how extensive it is. Prompt corrective action ordinarily warrants greater mitigation than delayed corrective action. Systemic change intended to prevent future violations should be given greater mitigation consideration. Corrective action that simply places the violator in compliance with the regulations is not a mitigating factor.[51]

Here, it appears that Hinman's actions—ceasing impermissible charges and refunds—merely places it in compliance with the regulations, so it is unlikely Hinman's corrective actions will mitigate the civil penalty.

46 Legal interpretation to James Cooling, Cooling & Herbers P.C. from Lorelei Peter, Assistant Chief Counsel for Regulations, AGC-200, August 22, 2017.

47 *Id.*

48 *See Id.*

49 14 C.F.R. part 120.

50 FAA Order 2150.3C, FAA Compliance and Enforcement Program, September 18, 2018. Although the Hinman case would be governed by FAA Order 2150.3B, which was superseded by FAA Order 2150.3C, on September 18, 2018, the relevant FAA enforcement policy did not change.

51 *FAA Order 2150.3C, page 9 - 8.*

This case is unique for three reasons: (1) Hinman's actions, (2) the size of the civil penalty and (3) the USAO referral. It is obvious that the FAA wanted to send a message to the industry that such actions will not be tolerated. FAA Order 2150.3C generally provides that a civil penalty for a company like Hinman, a small business, should be approximately $500,000–$600,000 for numerous violations from a single act. In Hinman's case, while an argument could be made that Hinman's alleged misunderstanding of the TSA charges was a result of the single action (*i.e.*, predicated on its misinterpretation of the Thole Interpretation), we suspect the FAA considered and summarily rejected that argument.

Here, the FAA apparently believed a deviation from the recommended sanction guidance was warranted based on aggravating circumstances and the relevant facts and circumstances. Still, even at $3.3 million, Hinman should have been motivated to settle because now with the USAO referral, the USAO is not limited by the dollar amount sought by the Civil Penalty Letter, and could potentially seek as high as a $9 million civil penalty, if not greater.[52]

The fact of the matter is that FAA enforcement attorneys have broad prosecutorial discretion. Indeed, FAA Order 2150.3C provides:

> The agency exercises broad discretion in the initial decision to bring a legal enforcement action and in any later case determinations, including whether to compromise or settle a case. The FAA's discretion in these areas is absolute and immune from review. *Heckler v. Cheney,* 470 U.S. 821, 831 (1985).[53]

In addition, unlike most companies, the Government is not particularly concerned about litigation risk or expense. The FAA is a safety agency and its primary function is to ensure aviation safety by enforcing the FARs. The goals of the FAA Compliance and Enforcement Program are generally to educate, deter and punish, and the FAA takes its mission very seriously.

Conclusion

The Hinman case is a great example of an FAA enforcement action against a business aircraft operator, and provides rare and comprehensive insight into a company's *and its pilots'* potential exposure for FARs violations. FAR compliance is complex with many nuances to consider. Although Hinman's actions may seem extreme they are certainly not uncommon, and it is conceivable that other companies are conducting similar, or perhaps more egregious activities.

Now that the case has been referred to the USAO, it is unclear how the matter will be resolved, but suffice it to say, in hindsight Hinman would likely have done things differently if given the chance. Readers are urged to review their operations and, if applicable, time-sharing arrangements, leases and interchanges and determine which specific FAR 91.501 provision applies. Fortunately, a company's executive reading this article has the opportunity to be proactive and comprehensively audit the company's operations and regulatory compliance before receiving an FAA letter of investigation—because by then, it's too late.

52 FAA Order 2150.3B, page 6-31.

53 *Id.* at page 9-1.

Chicago

222 NORTH LASALLE STREET
CHICAGO, IL 60601
P +1 (312) 609 7500
F +1 (312) 609 5005

New York

1633 BROADWAY
47TH FLOOR
NEW YORK, NY 10019
P +1 (212) 407 7700
F +1 (212) 407 7799

Washington, DC

1401 I STREET NW
SUITE 1100
WASHINGTON, DC 20005
P +1 (202) 312 3320
F +1 (202) 312 3322

London

4 COLEMAN STREET
LONDON EC2R 5AR
ENGLAND
P +44 (0)20 3667 2900
F +44 (0)20 3667 2901

San Francisco

275 BATTERY STREET
SUITE 2464
SAN FRANCISCO, CA 94111
P +1 (415) 749 9500
F +1 (415) 749 9502

Los Angeles

1925 CENTURY PARK EAST
SUITE 1900
LOS ANGELES, CA 90067
P +1 (424) 204 7700
F +1 (424) 204 7702

Singapore

10 COLLYER QUAY
#37 06/10
OCEAN FINANCIAL CENTRE
SINGAPORE 049315
P +65 6206 1300
F +65 6206 1301

VedderPrice