

FIVE CASE STUDIES REGARDING BUSINESS LEGAL ISSUES

2018 ASA Annual Conference
Workshop H

CASE STUDY NUMBER ONE

Please read the one-page case study

CASE STUDY NUMBER ONE: Questions

- Would you classify these parts as “civil aircraft parts”? Why or why not?
- Would your analysis change if the experimental parts were going on an experimental aircraft rather than in an test cell?
- What does the Agreement on Trade in Civil Aircraft say?

Agreement on Trade in Civil Aircraft

Article 1 Product Coverage

1.1 This Agreement applies to the following products:

- (a) all civil aircraft,
- (b) all civil aircraft engines and their parts and components,
- (c) all other parts, components, and sub-assemblies of civil aircraft,
- (d) all ground flight simulators and their parts and components,

* * *

1.2 For the purposes of this Agreement "civil aircraft" means (a) all aircraft other than military aircraft and (b) all other products set out in Article 1.1 above.

Article 2 Customs Duties and Other Charges

Signatories agree:

2.1.1 to eliminate by 1 January 1980 . . . all customs duties and other charges of any kind levied on, or in connection with, the importation of products, . . . if such products are *for use in a civil aircraft, and incorporation therein*, in the course of its manufacture, repair, maintenance, rebuilding, modification or conversion.

CASE STUDY NUMBER ONE

- The court held that Article 1.1 must be read in context with the limiting language in article 2.1.1. While article 1.2 defines the term "civil aircraft" and its related parts as those not intended for military application, this distinction does not define the phrase "*for use in civil aircraft*" in article 2.1.1. The common meaning of "use" is "bring into service," and an "aircraft" is "a machine capable of flight," Thus covered parts include those civil aircraft parts that are brought into service on machines capable of flying, and **does not include parts for ground-fired test cells**. The phrase "for use in civil aircraft" coupled with "incorporation therein" indicates that the covered aircraft engine parts must be actually installed on civil aircraft. And article 2.1.1's enumerated uses for the covered parts: manufacture, repair, maintenance, rebuilding, modification and conversion, **do not include testing or development**. *United Techs. Corp. v. United States*, 315 F.3d 1320, 1323 (Fed. Cir. 2003).
- Based on the treaty language, should an aircraft part imported for repair be duty free? Incorporation into an assembly? Held in stock?

Current General Note 6(b)



(b) (i) For purposes of the tariff schedule, the term "civil aircraft" means any aircraft, aircraft engine, or ground flight simulator (including parts, components, and subassemblies thereof)–

(A) that is used as original or replacement equipment in the design, development, testing, evaluation, manufacture, repair, maintenance, rebuilding, modification, or conversion of aircraft; and

(B) (1) that is manufactured or operated pursuant to a certificate issued by the Administrator of the Federal Aviation Administration (hereafter referred to as the "FAA") under section 44704 of title 49, United States Code, or pursuant to the approval of the airworthiness authority in the country of exportation, if such approval is recognized by the FAA as an acceptable substitute for such an FAA certificate;

(2) for which an application for such certificate has been submitted to, and accepted by, the Administrator of the FAA by an existing type and production certificate holder pursuant to section 44702 of title 49, United States Code, and regulations promulgated thereunder; or

(3) for which an application for such approval or certificate will be submitted in the future by an existing type and production certificate holder, pending the completion of design or other technical requirements stipulated by the Administrator of the FAA.

CASE STUDY NUMBER TWO

Please read the one-page case study

CASE STUDY NUMBER TWO: Questions

- Should Aircraft Underwriters be limited by the economic loss doctrine to claims only for the value of damage to the specific products? Why or why not? What if the aircraft was able to land?
- Would your analysis change if Globetrotter had bought the aircraft and engine directly from the manufacturer?
- Do you think broad warranty language disclaiming tort liability, including liability for negligence, is a reasonable warranty term?

CASE STUDY NUMBER TWO

- Warranties did not bar Plaintiff's tort claims because Plaintiff aircraft operator did not directly bargain for the rights or obligations of either of the warranties.
- To the extent the warranties would have applied they would have only covered diminution in value of the products covered by the warranty, not the total harm caused; thus products liability is not barred
 - Plaintiff may assert a cause of action against Defendants for breaching duty not to inject defective products into the stream of commerce.
- When the loss extends beyond the economic risks allocated by contract to include the physical loss of the end product in which warranted components were installed, the economic loss rule does not limit a plaintiff's action to one under those warranties.
- General disclaimers of tort liability based on the sale, use, or manufacture of the products are disfavored and enforceable only if specifically agreed to in negotiations between a commercial seller and commercial buyer.
- *United States Aviation Underwriters, Inc. v. Pilatus Bus. Aircraft, Ltd.*, 358 F. Supp. 2d 1021 (D. Col. 2005).

What do your Warranties say?

- Make sure you know what you are and are not offering a warranty for; make sure you have the ability to actually back up what your warranty provides
- Warranty disclaimer language often has specific requirements, like **BEING CONSPICUOUS**, or using specific language to disclaim particular implied warranties
- Warranties are not a panacea! Product liability can still attach even though we have warranty language disclaiming everything.

CASE STUDY NUMBER THREE

Please read the one-page case study

CASE STUDY NUMBER THREE Questions

- Did Lender Lou take enough steps to perfect its lien? What other steps should it have taken?
- If this was a Chapter 11 (reorganization) case instead of a Chapter 7 (liquidation) case, do you think the outcome would be different?
- What if Sooner was a distributor instead of an air carrier?
- What other steps can Lender Lou take to protect against insolvent customers?

What did the Court decide?

- The Court held that:
 - Bankruptcy Trustees may void unperfected liens, but liens perfected prior to bankruptcy are valid against the Trustee
 - Federal Aviation Act governs perfection of security interests in aircraft and aircraft parts under 49 USC §§ 44107-08 and that the purpose is to create a central clearing house of recordations of liens against aircraft preempting state laws
 - Includes “spare parts maintained by or for an air carrier holding a certificate”
 - Spare parts not attributable to any particular aircraft may fall outside of the recording requirements of § 44107
- *Malloy v. Pub. Bldg. Com. of St. Clair Cty, Ill. (In re Ozark Air Lines, Inc.)*, 2007 Bankr. LEXIS 5119 (Bankr. N. Okla. 2007).

Practice Notes

- Whenever seeking to secure interest in collateral, including aircraft parts, make sure to file with the FAA in addition to UCC and state filings.
https://www.faa.gov/licenses_certificates/aircraft_certification/aircraft_registry/record_aircraft_lien/
- Be aware of financial condition of customers with growing accounts receivable if you have no collateral to secure the debt
- Parts inventory not deemed “spare parts” associated with particular aircraft may not be subject to FAA lien recording requirements, but Courts are not settled on this. Don’t risk it!

CASE STUDY NUMBER FOUR

Please read the one-page case study

CASE STUDY NUMBER FOUR: Questions

- What crimes have been committed? By who?
- What do you think the penalty was?
- What actions could be taken to sever the parties from the criminal activity (if any)?

CASE STUDY NUMBER FOUR: Results

- Mr. Big was found guilty of conspiracy to commit fraud in aircraft parts, false statement involving aircraft parts (three counts), and mail fraud.

18 USC § 38

(a) Offenses. Whoever, in or affecting interstate or foreign commerce, knowingly and with the intent to defraud—

(1) (A) falsifies or conceals a material fact concerning any aircraft or space vehicle part;

(B) makes any materially fraudulent representation concerning any aircraft or space vehicle part; or

(C) makes or uses any materially false writing, entry, certification, document, record, data plate, label, or electronic communication concerning any aircraft or space vehicle part;

(2) exports from or imports or introduces into the United States, sells, trades, installs on or in any aircraft or space vehicle any aircraft or space vehicle part using or by means of a fraudulent representation, document, record, certification, depiction, data plate, label, or electronic communication; or

(3) attempts or conspires to commit an offense described in paragraph (1) or (2), shall be punished as provided in subsection (b).

CASE STUDY NUMBER FOUR: Results

- Mr. Big was found guilty of conspiracy to commit fraud in aircraft parts, false statement involving aircraft parts (three counts), and mail fraud.

18 USC § 1341 Frauds and Swindles

Two elements to mail fraud:

- 1) Devised or intending to devise a scheme to defraud
- 2) Use of the mail for the purpose of executing, or attempting to execute, the scheme

CASE STUDY NUMBER FOUR: Results

- Mr. Big was sentenced to 72 months in prison and ordered to pay restitution of \$378,633
18 USC § 38
- **(b)** Penalties. The punishment for an offense under subsection (a) is as follows:
 - **(1)** Aviation quality. If the offense relates to the aviation quality of a part and the part is installed in an aircraft or space vehicle, a fine of not more than \$ 500,000, imprisonment for not more than 15 years, or both.
 - **(2)** Failure to operate as represented. If, by reason of the failure of the part to operate as represented, the part to which the offense is related is the proximate cause of a malfunction or failure that results in serious bodily injury (as defined in section 1365), a fine of not more than \$ 1,000,000, imprisonment for not more than 20 years, or both.
 - **(3)** Failure resulting in death. If, by reason of the failure of the part to operate as represented, the part to which the offense is related is the proximate cause of a malfunction or failure that results in the death of any person, a fine of not more than \$ 1,000,000, imprisonment for any term of years or life, or both.
 - **(4)** Other circumstances. In the case of an offense under subsection (a) not described in paragraph (1), (2), or (3) of this subsection, a fine under this title, imprisonment for not more than 10 years, or both.
 - **(5)** Organizations. If the offense is committed by an organization, a fine of not more than--**(A)** \$ 10,000,000 in the case of an offense described in paragraph (1) or (4); and
 - **(B)** \$ 20,000,000 in the case of an offense described in paragraph (2) or (3).

United States v. Parker, 553 F.3d 1309 (10th Cir. 2009).

CASE STUDY NUMBER FIVE

Please read the one-page case study

CASE STUDY NUMBER FIVE: Questions

- Who should win this case? What should the remedy be?
- What did ABC do wrong, if anything?
- What did GHI do wrong, if anything?

- What else should ABC have done to protect itself?
- What else should GHI have done to protect itself?

What did the court decide?

- The court found that:
 - GHI failed to meet its payment obligations under the contract
 - ABC's fraud in the inducement was waived by GHI when GHI continued to operate under the contract after it learned of the fraud
- GHI was ordered to pay the contract damages plus interest
- Later, the case was dismissed because the amount in controversy was not adequate for federal court (technical grounds)
- *SMR Techs., Inc. v. Aircraft Parts Int'l Combs, Inc.*, 141 F. Supp. 2d 923, 933 (W.D. Tenn. 2001), vacated on other grounds, 2004 U.S. Dist. LEXIS 4741, at *7 (W.D. Tenn. Mar. 23, 2004)

Some Legal Notes

- **ISSUE:** FAA certification might have been a fundamental assumption to the execution of the Distributor Agreement, and GHI claims that it was induced to enter into the agreement by fraud. Nevertheless, GHI continued to perform under the contract after it realized that the initial representations of FAA certification were false. Conduct, treating the contract as binding after full knowledge of a fraud, is a waiver of the right to avoid the contract on that basis.
- **LESSON:** If you have grounds for termination, then assert them unless the contract allows you to reserve them
- *Do not unwittingly waive your rights!*

Some Legal Notes

- **ISSUE:** By failing to allege a termination of the contract for material breach, GHI retained an obligation to perform under the contract. But purchasing goods under the contract GHI incurred an obligation to pay for them. Under the contract, there was no right to set-off for the GHI allegations.
- **LESSON:** If the contract specifies procedures for termination, then make use of them – do not merely assume that you have a right to ignore the contract due to the other side's apparent breach
- **NOTE:** *Quantum Meruit* provides a mechanism for recovery even if the contract fails
- *If you want to have rights that you think are common industry practices (like a contra or set-off right) then write them into the contract!*

Questions?



Please feel free to ask questions

Thank You

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