



LEGAL EVALUATION OF PARTS TRANSACTIONS GONE AWRY

2019 ASA Annual Conference

Workshop L

CASE STUDY NUMBER ONE

Please read the one-page case study

CASE STUDY NUMBER ONE: Questions

- How should the Court rule?
- Should double jeopardy apply?
- What do you think is an appropriate penalty?
- Would the analysis change if the blades had been repairable?

49 U.S.C. § 44726

- **(b) REVOCATION OF CERTIFICATE.—(1) IN GENERAL.—**Except as provided in subsections (f) and (g), the Administrator shall issue an order revoking a certificate issued under this chapter if the Administrator finds that the holder of the certificate or an individual who has a controlling or ownership interest in the holder—**(A)** was convicted in a court of law of a violation of a law of the United States relating to the installation, production, repair, or sale of a counterfeit or fraudulently-represented aviation part or material; or
- **(B)** knowingly, and with the intent to defraud, carried out or facilitated an activity punishable under a law described in paragraph (1)(A).

49 U.S.C. § 44709

- (a) Reinspection and Reexamination.—(1) In general.—The Administrator of the Federal Aviation Administration may reinspect at any time a civil aircraft, aircraft engine, propeller, appliance, design organization, production certificate holder, air navigation facility, or air agency, or reexamine an airman holding a certificate issued under section 44703 of this title.
- (b) Actions of the Administrator.—The Administrator may issue an order amending, modifying, suspending, or revoking—(1) any part of a certificate issued under this chapter if—(A) the Administrator decides after conducting a reinspection, reexamination, or other investigation that safety in air commerce or air transportation and the public interest require that action

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 ONE: Results

- FAA suspended mechanics certificate for one year based on a settlement with Mr. Suspect.
- Mr. Suspect was then convicted of criminal fraud under 18 U.S.C. § 38(a)(1)(C)
- FAA then revoked both certificates permanently

49 U.S.C. § 44726

- **(b) REVOCATION OF CERTIFICATE.—(1) IN GENERAL.—**Except as provided in subsections (f) and (g), the Administrator shall issue an order revoking a certificate issued under this chapter if the Administrator finds that the holder of the certificate or an individual who has a controlling or ownership interest in the holder—**(A) was convicted in a court of law of a violation of a law of the United States relating to the installation, production, repair, or sale of a counterfeit or fraudulently-represented aviation part or material**; or
- **(B) knowingly, and with the intent to defraud, carried out or facilitated an activity punishable under a law described in paragraph (1)(A).**

Res Judicata and Collateral Estoppel

- Mr. Suspect argue that permanently revoking his certificates was inappropriate because the case had already been settled
 - *Res judicata* – something that has already been competently adjudicated cannot be pursued further
 - Collateral estoppel – judgment in previous cases precludes further adjudication
 - Arising from “same nucleus of operative fact”
 - “a judgment on the merits in a prior suit bars a second suit involving the same parties or their privies based on the same cause of action”
Parklane Hosiery Co. v. Shore, 439 U.S. 322, 326 (1979).

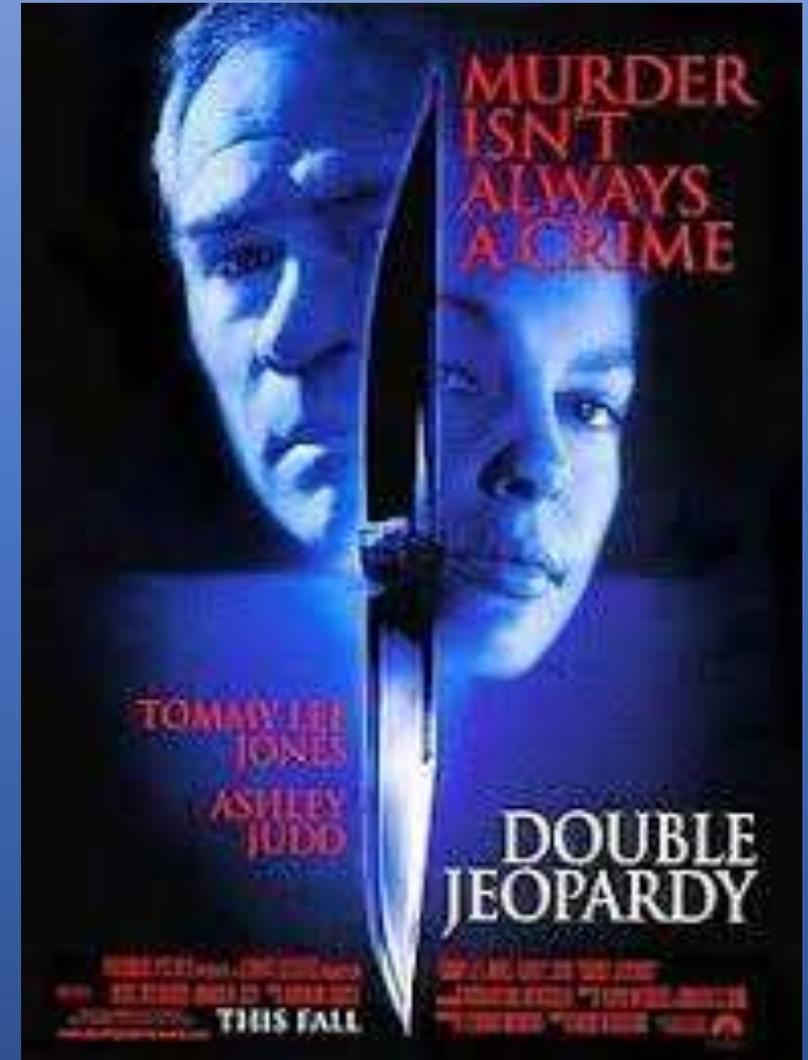
Res Judicata and Collateral Estoppel

- *Res judicata* in administrative cases doesn't apply when Congress has spoken on the matter
 - § 44726(1)(b) provided for an administrative action and finding leading to revocation
 - § 44726(1)(a) imposed a mandatory obligation upon the FAA to revoke ("shall issue an order revoking a certificate" upon conviction)
 - Because (a) and (b) are disjunctive, they are separate bases for revocation according to the Court
- Collateral estoppel (issue preclusion) doesn't arise from settlements unless specifically stated
 - No issues are litigated or otherwise adjudged

Double Jeopardy?

- Fifth Amendment protection against multiple criminal punishments
- But certificate revocation is a *civil administrative* punishment. Therefore Double Jeopardy does not apply.

Lauterbach v. Huerta, 817 F.3d 347 (D.C. Cir. 2016).



CASE STUDY NUMBER TWO

Please read the one-page case study

CASE STUDY NUMBER TWO: Questions

- Who do you think should prevail in this case?
- Would your analysis change if no modifications to the STC had been required?
- Would your analysis change if the contract specified a delivery date for the VCAC?

CASE STUDY NUMBER TWO

What happened in this case?

- Install Co. sued for breach of contract and rescission then moved for summary judgment
- Summary judgment standard: Summary judgment is proper "if the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(a).
 - Movant bears burden of establish absence of genuine issue of material fact
 - All facts viewed in light most favorable to non-movant

Reasonable Amount of Time?

- Install Co. motion for summary judgment **DENIED**
 - The contract was silent as to a delivery date
- Uniform Commercial Code (“UCC”)
 - Adopted in all 50 states (though only partial in a few)
 - When a time for delivery is not expressly provided for in a contract, the UCC provides a “gap filler” provision that states “a reasonable time.”
 - A “reasonable time” “depends upon what constitutes acceptable commercial conduct in view of the nature, purpose and circumstances of the action to be taken.”

Reasonable Amount of Time?

- What constitutes a “reasonable time” is a question of FACT
- Numerous material facts in dispute with respect to “reasonable time”
 - Install Co. only stated that three years was “patently unreasonable” and stated that Coolguys had been notified of the upcoming aircraft maintenance schedule. Coolguys responded with update on FAA contact
 - Coolguys told Install Co. deviation from STC would take time to get new/amended STC; never gave tentative deadline; explained “trade usage” of FAA approval process for STCs (no scheduled timeline, can take anywhere from 6 months to five years)

Outcome

- Within six months of denial of summary judgment motion the case was settled for:

\$33,049

Israel Aerospace Industries, Ltd. v. Airweld, Inc., No. CIV. 2:11-CV-00887-WBS-CKD (E.D. Cal. 2012).



CASE STUDY NUMBER THREE

Please read the one-page case study

CASE STUDY NUMBER THREE Questions

- Can Dr. J successfully allege a claim of fraud against Alabaster?
- Who is responsible for the engine warranty?
- Did Alabaster have a duty to disclose to Dr. J information it had about Emerald's financial status?

Fraud

- Must show:
 - Material representation to plaintiff
 - Representation was false
 - Knew the representation was false (or made recklessly)
 - Induced plaintiff to act upon misrepresentation
 - Plaintiff relied upon misrepresentation
 - Misrepresentation caused injury to plaintiff
- Heightened pleading standard
 - a plaintiff must specify 1) what the fraudulent statements were, 2) who made them, 3) when and where the statements were made, and 4) why the statements were fraudulent

Fraud

- In this jurisdiction:
 - Reliance must be reasonable
 - Misrepresentation must relate to past or present material fact; opinions and predictions are not sufficient

Puffery!

- Buyers must exercise common sense
 - “Puffing by sellers is universal, and every one buys knowing that he must exercise his own judgment on matters of opinion expressed by the seller.”
Vokes v. Eaton, 85 S.W. 174, 177 (Ky. 1905).
- Statements like “quality” and “reliability” are generally viewed as self-serving puffery
- “Best prices in the business!”
- “Top notch service and savings!”
- “Unparalleled excellence!”

Fraud or Puffery?

- No fraud: Alabaster accurately described the terms of the warranty
- Words like “reliable” and “quality” were used to describe the product, not the financial health of Emerald.
 - Even if describing the company’s financial status, such terms are “self-serving” opinion on which no buyer should reasonably rely.
- Concealing knowledge of true state of affairs?
 - Still not actionable: the buyer has a duty to perform due diligence and use common sense to verify readily obtainable facts

What about the Warranty?

- Unclear whether economic-loss doctrines would cover something more attenuated than goods (in this case, information about a warranty)
- Was there a duty to disclose?
 - Fiduciary
 - Statutory
 - Partial disclosure of material facts but giving the impression of full disclosure
 - One party to a contract has superior knowledge and is relied upon to disclose the same

What about the Warranty?

- No fiduciary or statutory duty
- Superior knowledge? Alabaster was not a party to Dr. J's purchase contract of the other aircraft
- Partial disclosure? Statements with respect to warranty are partial, but also do not appear to create the impression of a full disclosure with respect to the finances of a company or numerous other matters
 - "Mere silence does not constitute fraud where it relates to facts open to common observation or discoverable by the exercise of ordinary diligence."

Ultimately: Buyer beware!

Morris Aviation, LLC v. Diamond Aircraft Indus., Inc., No.12-6021 (6th Cir., 2013)

CASE STUDY NUMBER FOUR

Please read the one-page case study

CASE STUDY NUMBER FOUR: Questions

- Should Awesome Aero return the payments in response to the Trustee's letter?
- Will the Court require Awesome Aero to return the payments?
- What factors do you think the Court will consider in determining whether to allow Awesome Aero to keep the payments?
 - What if Weekly Wings paid all outstanding debts in one lump-sum wire?
- What steps can Awesome Aero take to protect itself against insolvent customers?

What did the court decide?

- The court found that:
 - The payments were within the ordinary course of business and were not subject to avoidance by the Trustee (the payments did not have to be returned to the bankruptcy estate)
 - In reaching this decision the Court weighed five factors to find that the “ordinary course of business” defense applied:
 1. Length of Engagement: the companies had a significant history that predated financial trouble
 2. Similarity of Transfers: The nine payments in question followed the same pattern as prior payments
 3. Manner of Tender: The manner of tender was largely the same, and where the manner of tender differed it was not at the request of the creditor (the supplier who was owed money)
 4. Collection Efforts: The creditor did not take any unusual or aggressive action to suggest that the payments were outside of the ordinary course of business
 5. Advantage in Light of Debtor’s Condition: Creditor did not demand any additional collateral, impose late fees, or pressure for payment in light of Debtor’s financial difficulty
- *Burtch v. Texstars, Inc. (In re AE Liquidation)*, 2013 Bankr. LEXIS 4144 (Bankr. Del. 2013)

Practice Note

- Make sure to keep accounts receivable up to date; once a company files for bankruptcy it can be very difficult (or impossible) to recover what is owed.
- Do not try to take advantage of a company in financial difficulty to “get ahead” of other creditors (i.e., other suppliers). This could cause an “ordinary course of business” defense to fail, and require you to return payments in the Preference period (usually the 90 days preceding the filing).
- Distinguish between letters from the Trustee or collection professionals and actual court orders. Consult with an attorney specializing in bankruptcy to determine your rights.
- Move quickly! Bankruptcy actions may have very short deadlines to submit a claim.



CASE STUDY NUMBER FIVE

Please read the two-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

Ryan Aggergaard, ASA Counsel
Jason Dickstein, ASA Counsel
Washington Aviation Group, PC
2233 Wisconsin Avenue, Suite 503
Washington, DC 20007

Tel: (202) 628-8947 – Fax: (202) 628-8948
Ryan@WashingtonAviation.com