



Legal Evaluation of Parts Transactions

Workshop F

3:30 pm – 5:00 pm

June 6, 2022



Plan for the Workshop

- Our purpose today is to look at some legal cases whose decisions may illustrate the law as it applies to aircraft parts transactions
- We will present fact patterns and ask you to consider them and identify what you think is “the answer” to each fact pattern
- Please do not rely on what you learn in this course as a full statement of the law - the actual facts of a case can lead to differing results



Security Interests

- Liens, encumbrances and similar rights are also known as “security interests”
- Security Interests *typically* have two parts:
 - A security agreement that explains the terms of the security interest
 - A financing statement that summarizes the security interest and is intended to be filed in a searchable repository
 - This provides notice to the world of the security interest
 - Proper filing of the financing statement is called “perfection” of the interest



Does Seller Sam Have a Valid Security Interest for Bankruptcy Purposes?

- Seller Sam sold an APU to Air Carrier Charlie on credit. Seller Sam retained a security interest in the APU. The UCC-1 financing statement was filed with the state. Sam did not file his security interest with the FAA.
- Air Carrier Charlie files for bankruptcy. The trustee challenges the security interest.
- 49 U.S.C. § 44107(a)(2)(D): The FAA “shall establish a system for recording ... instruments executed for security purposes ... that affect an interest in ... [an] appliance maintained for installation or use ... by or for ... an air carrier ... and spare parts maintained by or for an air carrier.”
- 49 U.S.C. § 44108(a): If a security interest that could be filed under section 44107 is not filed, then it is only valid against the parties and those with actual knowledge



What Happened in the Actual Case?

- Seller Sam admitted that the APU was an aircraft part within the scope of the filing requirements, so it was subject to the filing requirements
- The court said that the failure to file with the FAA meant that the security interest was not perfected
- *In re Air Specialties Corp.*, 56 F.3d 70 (9th Cir. 1995).
- Note that this means that the lien was valid against Air Carrier Charlie but not against the bankruptcy estate as represented by the trustee (because of the lack of perfection)



Was This Security Interest Perfected?

- TIMCO performed a heavy check on an air carrier aircraft
- State law says you can retain an “artisan’s lien” on an aircraft when you perform work and retain the aircraft
- TIMCO still had the aircraft
- Air carrier files voluntary bankruptcy
- Bankruptcy trustee says that the “artisan’s lien” was not perfected because it was not filed with the FAA



What Did the Court Decide?

- Court explained that the Federal Aviation Act intended only to preempt state law requirements for the filing of transfers and liens against aircraft, replacing them with a federal repository.
 - It did not replace non-filing means of perfection
 - "the possession of goods by a creditor is an effective means of putting future creditors or purchasers on notice that the property is encumbered."
- Retaining the aircraft was adequate perfection under state law (North Carolina), and state law did not require FAA filing, so state law perfection-by-retention was valid
- *In re Southern Air Transport, Inc.*, 511 F.3d 526 (6th Cir. 2007)



State Law Remains Important

- The state-law artisan's lien in this case requires possession, rather than filing, to be valid and retain priority.
- The FAA itself has indicated that under the circumstances it would have refused any attempted filing of such a lien
 - FAA Legal advised the FAA Registry to accept for recordation only mechanic's (artisan's) liens from those states that have statutes that require filing.
 - *Legal Opinion as to the Recordability of Artisan's Liens*, 46 F.R. 61528 (Dec. 17, 1981).
- Where a state law does not require the filing of a document in support of the possessory artisan's lien (as an element of perfection), the failure to file a document evidencing the lien with the FAA registry does not invalidate the lien.
- *In re Southern Air Transport, Inc.*, 511 F.3d 526 (6th Cir. 2007)



And Then, One Year Later

- AAR performed maintenance on an aircraft
- AAR retained possession of the aircraft
- AAR filed a claim of lien with the state (Florida) for labor, materials and services
- AAR did not file with the FAA
- The court found that Florida law requires both possession and filing of notice, so the FAA filing was still required
- The lien was valid, but not perfected against third parties
- *In re Tradewinds Airlines, Inc.*, 394 B.R. 614 (Bkrtcy. S. D. Fla. 2008)



Lessons

- Perfected liens can be valuable tools for protecting your right to get paid, especially in a customer bankruptcy
- Know your state's law
- Work with an attorney to be sure that you have the right process for perfecting liens in your state
- If you need to file a lien in another state (where the asset is found) then that state's law may apply, and you may need to determine perfection protocol based on that state's laws



Is this Aircraft Fraud?



- Harper owned and controlled a business known as Apple Helicopter International; Apple was engaged in purchasing, refurbishing, and selling used helicopters and helicopter parts
- Harper obtained a helicopter with significant damage to its underbelly
- Harper moved the data plate from the first helicopter to the fuselage of another helicopter that had crashed in New Jersey, but was less costly to fix
- Harper actively marketed and tried to sell the resulting helicopter with the moved data plates



The Situation

- Harper attempted to sell the helicopter to an undercover agent posing as an aircraft broker. During the attempt, Harper concealed the true history of the aircraft and coordinated the provision of fraudulent maintenance records to the undercover agent.
- The data plate switch caused the true history of the helicopter to be concealed.
- Following the filing of a criminal complaint and the issuance of an arrest warrant, agents arrested Harper when he entered the United States in Los Angeles, California on January 24, 2020, on his way to Heli-Expo.



The Result

- He plead guilty to aircraft parts fraud under 18 U.S.C. § 38
 - Sentenced to 8 months (time served), plus 3 years supervised release
 - Was deported back to Great Britain
 - *U.S. v. Richard Paul Harper* (E.D. Tenn. 2020)
- Note that FAA regulations also set a standard for identification data:

14 C.F.R. § 45.13(b): Except as provided in [*maintenance provisions*], no person may remove, change, or place identification information required [*for aircraft, engines, or propellers*], on any aircraft, aircraft engine, propeller, propeller blade, or propeller hub, without the approval of the FAA



The Fact Pattern

- Alpha told the FAA (during certification) that a software feature in their autopilot that *assumes control in emergencies* only activates at 0.7g or above
- In fact, the software feature that *assumes control in emergencies* had been changed to activate at lower g forces. Alpha learned this after the revelation to the FAA, but did not update the FAA
- The government claims that this was a false statement about an aircraft part, in violation of 18 U.S.C. § 38, because (it claims) there was a change that was not fully disclosed



Some Law

- 18 U.S.C. § 38 criminalizes fraud “concerning any aircraft or space vehicle part”
- “Part” is defined as “a frame, assembly, component, appliance, engine, propeller, material, part, spare part, piece, section, or related integral or auxiliary equipment.” 18 U.S.C. § 31(a)(7)



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What Did the Court Say?

- Section 38 criminalizes fraud “concerning any aircraft or space vehicle part”
- The statute defines “part” as “a frame, assembly, component, appliance, engine, propeller, material, part, spare part, piece, section, or related integral or auxiliary equipment.” 18 U.S.C. § 31(a)(7)
- **Terms in a list are presumed to have a similar meaning; the terms defining “part” are all physical tangible things**



This is from the Boeing MCAS case

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- The statute defines “part” as “a frame, assembly, component, appliance, engine, propeller, material, part, spare part, piece, section, or related integral or auxiliary equipment.” 18 U.S.C. § 31(a)(7)
- Terms in a list are presumed to have a similar meaning; the terms defining “part” are all physical tangible things
- **"One might reasonably say that computer code is part of an aircraft, but it stretches ordinary usage to say that computer code is an aircraft part."**
- **MCAS is not a part; also, jet fuel is not a part**
- ***United States v. Forkner* (N.D. Tex. 2022)**



What Does this Tell Us?

- You must CAREFULLY read statutes and regulations
- Courts can interpret statutes and regulations different from the way that you might think
 - What we might think of as a part, might not be a part for *certain statutes and regulations*
 - Terms can be different based on usage, *e.g.* an 18 U.S.C. § 38 part may be different from a 14 C.F.R. § 21.1 part
 - In tricky situations, you should get a lawyer's advice about what a court might think



Facts in a Parts Dispute

- Air Carrier X has a fleet of aircraft, B-7A7, and is the last major operator flying the B-7A7
- Air Carrier X offers an inventory of B-7A7 parts. The book value is about \$200 million. Air Carrier X sells this inventory for \$4 million to Distributor Dee. The contract of sale says that the parts are sold on an as-is where-is basis
- Distributor D takes possession of the inventory. Shortly thereafter, Air Carrier X announces it is retiring the B-7A7 fleet.



What Documents are Required?

- The contract of sale says that the parts are sold on an as-is where-is basis
- The contract disclaimed all express and implied warranties
- The contract provided that Air Carrier X would provide Distributor Dee with FAA Form 8130-3 certification for all components
- The 8130-3 forms were not accompanied by either manufacturer's original packing slips nor traceability documents.
- Distributor Dee refuses to pay the \$2 million balance, because it is an industry norm to provide manufacturer's original packing slips and back-to-birth traceability documents.



The Documentation Issue

- The air carrier could have argued that the contract was specific about the required documentation, and it was limited to the 8130-3 tags
- The claim that “it is an industry norm to provide manufacturer's original packing slips and back-to-birth traceability documents” has two flaws
 - That was not the industry norm for these parts
 - That was contrary to the limits in the plain language of the contract
- **BUT THE REAL CASE WAS DECIDED ON OTHER GROUNDS**



What Actually Happened?

- In the real case, the distributor had a ten business day period for inspection and rejection
- The first communication that could arguably be called a rejection was sent more than ten business days after the last delivery
- The rejection was untimely, so the parts were considered to have been accepted, and there was no grounds for revocation of acceptance
- *Northwest Airlines, Inc. v. Aeroservice*, 168 F. Supp. 2d 1052 (2001).



Lessons

- Make sure you are specific in your contracts about what you expect
- Make sure you are well-informed about the inventories that you purchase
- Make sure you meet ALL of the terms of your contracts – and pay attention to deadlines
- And if you have a dispute then don't forget to look at ALL of the options for prevailing in the dispute



Can We Export the Needed Part to Hungary?



- Sanctioned Airlines (SA) is currently named as a Specially Designated National (SDN) under the OFAC regulations. SA is located in Minsk, Belarus.
- SA opens a wholly owned airline in Hungary, known as Hungarian Unsanctioned Airlines (HUA). They register their aircraft in Hungary, and hold an operating certificate issued in Hungary.
- HUA has an aircraft that is AOG in Budapest. They need an airframe part controlled under ECCN 9A991.
- Can we export the needed part?



BIS Legal Standard

- Sanctioned Airlines (SA) is currently named as a Specially Designated National (SDN) under the OFAC regulations. SA is located in Minsk, Belarus.
- SA opens a wholly owned airline in Hungary, known as Hungarian Unsanctioned Airlines (HUA). They register their aircraft in Hungary, and hold an operating certificate issued in Hungary.
- The 9A991 aircraft part is subject to the EAR and it is for use on a foreign aircraft, so we must make the § 744.7 analysis:
 - The aircraft is located in Hungary, and
 - The aircraft is registered in Hungary, and
 - If the aircraft is controlled by a Hungarian airline.
- **BUT WAIT**



OFAC Analysis

- Hungarian Unsanctioned Airlines (HUA) is wholly owned by Sanctioned Airlines (SA)
- SA is currently named as a Specially Designated National (SDN) under the OFAC regulations.
- The sanctions against SA flow down to SA's controlled subsidiaries (control is assumed if the sanctioned entity owns at least 50%)
- OFAC regulations will forbid this transaction, unless you first obtain an OFAC license



Can We Export the Needed Part to Russia?



- Random Foreign Airlines (RFA) is not currently subject to sanctions as a named party. RFA is located in Turkey and owns all of its own aircraft. RFA has an aircraft that is AOG in Moscow. They own and operate the AOG aircraft and it is registered in Turkey.



Legal Standard

- Random Foreign Airlines (RFA) is not currently subject to sanctions as a named party. RFA is located in Turkey and owns all of its own aircraft. RFA has an aircraft that is AOG in Moscow. They own and operate the AOG aircraft and it is registered in Turkey.
- Can we export the needed part?
- The aircraft part is subject to the EAR and it is for use on a foreign aircraft, so we must make the § 744.7 analysis:
 - The aircraft is located in Russia, and
 - The aircraft is NOT registered in Russia, and
 - If the aircraft is NOT controlled, leased, or chartered by Russia or a national of Russia.



Two Different Analyses

- Random Foreign Airlines (RFA) is not currently subject to sanctions as a named party. RFA is located in Turkey and owns all of its own aircraft. RFA has an aircraft that is AOG in Moscow. They own and operate the AOG aircraft and it is registered in Turkey.
- Can we export the needed part?
 - Under the § 744.7 analysis, we need a license or a license exception because the aircraft is located in Russia
 - Under the § 746.8 analysis we need a license or a license exception because the destination for the export is in Russia
 - We cannot export the part unless we can identify a license or license exception that applies to each restriction



A License Exception

- Random Foreign Airlines (RFA) is not currently subject to sanctions as a named party. RFA is located in Turkey and owns all of its own aircraft. RFA has an aircraft that is AOG in Moscow. They own and operate the AOG aircraft and it is registered in Turkey.
- Can we export the needed part?
- The AVS license exception is available for exporting aircraft parts if:
 - The aircraft is NOT registered in, owned, or controlled by, or under charter or lease by Russia or a national of Russia
 - In this case we do not run afoul of the limits on AVS, and it is one of the few permitted license exceptions for Russian transactions subject to § 746.8



Practical Advice

- Perform adequate due diligence on all of the parties
 - Russian ownership (50% +) can cause a party to be subject to the same sanctions as those that are applied to the owner
- Get an end-use statement from the customer, and make sure it describes a legitimate transaction (when this is not legally required, the purpose is to mitigate risk)
- Confirm that the part actually gets installed on the aircraft that was used as the basis of the license exception analysis, or at least get a signed statement confirming such an intent



Can they Sue in Colorado?

- Continental Motors is incorporated in Delaware, with its principal place of business in Alabama; it produces engines, and makes its manuals and service bulletins available on its website (for a fee)
- Arapahoe Aero (MRO in Colorado) obtained the manuals, and repaired an engine pursuant to the manuals; the airplane later crashed in Idaho (on a flight from Colorado)
- Arapahoe's insurance company was Old Republic [incorporated in Pennsylvania; principal place of business in Illinois]; Old Republic brought a suit against Continental Motors claiming that the manuals contained defective information



Jurisdiction Rules

- Due process requires
 - The defendant must purposefully establish minimum contacts within the forum State
 - The assertion of personal jurisdiction must comport with ‘fair play and substantial justice’
- General jurisdiction over foreign corporations arises when their affiliations with the State are so ‘continuous and systematic’ as to render them essentially at home in the forum State.
- Specific jurisdiction over foreign corporations arises when the cause of action relates to the party’s contacts with the forum state
- Jurisdiction can also arise from harmful effects purposefully directed into the state



What Did the Court Find?

- The only contacts Old Republic relied upon for specific personal jurisdiction were those relating to Continental Motors' website, its online service manuals, and Arapahoe Aero's ongoing participation in the FBO Program
- There was no evidence that Continental Motors and Arapahoe Aero negotiated any agreements - Arapahoe Aero merely signed up for the online manuals and paid an annual fee
- Minimal contacts and minimal obligations: so there was not enough to assert personal jurisdiction over Continental Motors in Colorado
- Old Republic could not sue Continental Motors in Colorado
- *Old Republic Ins. Co. v. Cont'l Motors, Inc.*, 877 F.3d 895 (10th Cir. 2017)



How Can You Control Jurisdiction?

- Be careful about where you do business
 - You can be sued where you have significant and/or regular business contacts
 - You can be sued where the harm happens (*e.g.*, if you sign a contract in Alabama with an Alabama company, and then you breach that contract, then you can probably be used in Alabama because that is where the harm is)
- Add a clause to your contacts that identifies the jurisdiction for both choice of law and location of litigation (personal jurisdiction) purposes



Thank You

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