Arbitration of Disputes in the Aerospace Industry

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Abstract: According to Merriam Webster, the term "aerospace" first appeared in 1958, the year after the first satellite was launched into space and commercial jet transportation became mainstream with the introduction of Boeing 707 flights by Pan American World Airways. Today the aerospace industry may be defined as "the industry that deals with travel in and above the Earth's atmosphere and with the production of vehicles used in such travel." The worldwide aerospace industry, including both civilian and military components now accounts for nearly US $700 billion in annual sales, with slightly over 50 percent coming from the government/military side, which frequently include special contractual and security features. Virtually all the significant advantages of arbitration, e.g. confidentiality, cost effectiveness, quicker resolution, flexibility, ability to choose arbitrators with technical and subject matter expertise, limited discovery and document production, finality and cross border enforceability apply to disputes among aerospace industry participants and between those participants and their customers. However, as discussed below, many of those advantages have particular applicability to disputes involving aerospace companies. The following discussion reviews discuss some of those situations.

CHARACTERISTICS OF THE AEROSPACE INDUSTRY

According to Merriam Webster, the term "aerospace" first appeared in 1958, the year after the first satellite was launched into space and commercial jet transportation became mainstream with the introduction of Boeing 707 flights by Pan American World Airways. Today the aerospace industry may be defined as "the industry that deals with travel in and above the Earth's atmosphere and with the production of vehicles used in such travel."[1] The worldwide aerospace industry, including both civilian and military components now accounts for nearly US $700 billion in annual sales, with slightly over 50 percent coming from the government/military side.

[1] http://www.merriam-webster.com/dictionary/aerospace

Of the top ten aerospace companies worldwide, eight are US based. Boeing and Airbus Group (formerly known as the European Aeronautic Defense and Space Company) lead the industry group and have a virtual duopoly in the worldwide market for large commercial aircraft. Each has large military components as well.

Since the mid 1990's there has been a high degree of consolidation among companies in the industry, with the larger players absorbing both formerly major players and many of their first and second tier suppliers. For example today's Northrop Grumman and General Dynamics each consist of over 30 formerly independent companies while Lockheed Martin and Boeing each include over 20 formerly separate entities. Continued defense budget cutbacks are expected to prompt further consolidations in the years to come. Despite these consolidations, the larger companies still rely heavily on thousands of suppliers whose failures to deliver on time can cause major delays and revenue losses for the larger companies;[2] thus supplier issues are likely to be a major source for disputes.

Apart from commercial aircraft, major products and services provided by aerospace industry players include military aircraft, missiles, civil (i.e. government-non military) commercial and military satellites and the rockets used to place them in space. To varying extents all the major industry players buy cyber related products and services, and many furnish such products and services. And, as discussed below, insurance companies are also sometimes involved in disputes involving aerospace firms and their customers.

Virtually all the significant advantages of arbitration, *e.g.* confidentiality, cost effectiveness, quicker resolution, flexibility, ability to choose arbitrators with technical and subject matter expertise, limited discovery and document production, finality and cross border enforceability[3] apply to disputes among aerospace industry participants and between those participants and their customers. However, as discussed below, many of those advantages have particular applicability to disputes involving aerospace companies. The following sections discuss some of those situations.

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[2] *See* Financial Times, July 26, 2016, "Airbus and Boeing put pressure on supply chain" https://www.ft.com/content/e0d51872-516c-11e6-9664-e0bdc13c3bef

[3] *See* http://www.americanbar.org/content/dam/aba/publications/dispute_resolution_magazine/March_2012_Sussman_Wilkinson_March_5.authcheckdam.pdf

CONFIDENTIALITY AND HANDLING OF GOVERNMENT CONTROLLED AND CLASSIFIED INFORMATION

Confidentiality considerations arise when highly proprietary and sensitive information are involved in a dispute. Given the very nature of the products and services offered by the aerospace industry, most disputes with significant sums of money or intellectual property rights at issue involve such information. Many such disputes also involve information, which governments regulate, sometimes including classified information. For example, the United States government under the Arms Export Control Act[4] regulates and limits disclosure of many of the technologies utilized by the aerospace industry. Both the US Department of State and the Commerce Department have extensive regulations that specify how "exports" of controlled technology may be conducted. Importantly, the term "export" is not limited to physically sending such products or information outside of United States. Rather it covers transfers, physical or otherwise, to any person regardless of their location. It also includes "defense services" which involve discussions of controlled information. The confidentiality features of arbitration can greatly simplify the process of disclosing and using such information in arbitrations. If arbitrators are "non-US persons" experienced in the aerospace industry, the parties should generally be able to obtain necessary permissions to disclose such information.[5]

Classified information is also sometimes involved in disputes in the aerospace industry. In such cases, the "state secrets doctrine" frequently comes into play. Virtually every national government has a state secrets doctrine. The doctrine is best defined as a government's ability to prevent disclosure of any information that, if disclosed publicly, would be reasonably likely to cause significant harm to the national defense or foreign relations of a government.

Companies and governments spend huge sums of money to get satellites into space, but an average of one in 20 launches will fail. A hypothetical dispute involving a failed launch of commercial and government satellites is illustrative. Assume that an unmanned commercial rocket with both a commercial and a government classified satellite aboard explodes seconds after takeoff destroying both the rocket and the satellites, collectively valued at over $500 million. Many such launches are insured, usually by consortia consisting of US and non-US insurers. The rocket insurer refuses to pay under the insurance policy since the government has asserted the state secrets doctrine on the accident investigation report and refuses to allow the insured rocket and satellite manufacturers to provide information their insurers demand.

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[4] 22 U.S.C. §§39 *et seq.*

[5] Generally, US persons include US citizens, permanent residents and Green Card holders.

The rocket manufacturer commences an arbitration against the insurers and there is a tension between the state secrets doctrine and the insurer's ability to evaluate and defend the claim. Without the accident report, the how or why of the rocket explosion cannot be completely known or understood. There is also a tension for the arbitration panel. Dealing with state secrets is not familiar territory and there are civil and criminal sanctions for violations.

So what guidelines can an arbitration panel look to for guidance? Article 9(2)(f) of the International Bar Association rules on the Taking of Evidence in International Arbitration (2010) ("IBA Rules")[6] provides that an arbitration tribunal may exclude from evidence or production any document, statement or oral testimony on "grounds of special political or institutional sensitivity (including evidence that has been classified as secret by a government or a public international institution) that the arbitral tribunal determines to be compelling".

Application of the IBA Rules would permit the arbitration panel to exclude the state secrets material from the arbitration. However, this approach could also deprive the respondent insurance companies of the due process they are entitled to, thereby potentially imperiling enforceability of an award against them.

An alternative approach is to be creative, nibble at the edges, and if the facts permit, side step or otherwise satisfy the states secrets concerns. In the hypothetical explosion the classified satellite most likely was not the cause of the explosion. The rocket engine sits at the base of the rocket. The classified satellite sits 14 building stories above the rocket engine. The explosion was just seconds after lift-off and a standard analysis used by an aerospace company would likely find the explosion was due to a rocket engine anomaly. Perhaps most simply, state secrets information could be redacted from the accident investigation report, thereby removing a procedural constraint to the resolution of the insurance coverage dispute. However this quite likely would not satisfy the insurers. Other creative solutions would include:

1. Arbitrators and other key people in the case could be granted limited security clearances for purposes of the arbitration. Choosing arbitrators experienced in the industry that hold or have held security clearances, or who are quickly "clearable", can greatly expedite the process. This could also involve the government granting access to sensitive information in a secure location that only designated persons could have access to.

2. It may be possible to craft confidentiality agreements or orders that limit the people, approved by the government, who can see certain pieces of evidence.

[6] https://www.scribd.com/document/134332470/IBA-Rules-on-Taking-Evidence-2010

3. A moot arbitration may be particularly useful for claimant. If state secrets information would likely be excluded from the arbitration, the mock arbitration could help claimant determine if it could prove its claim without that information.

A dialogue and possible solutions to procedural constraints in state secret matters take time. Arbitrators can start the discussion early, and involve the parties, their counsel and the government in the discussion. Obviously, collective solutions meeting all the interested entities needs are best.

The bottom line is that the confidentiality and procedural flexibility of arbitration arguably makes it particularly well suited to address state secret and related challenges.

DISPUTES BETWEEN US GOVERNMENT CONTRACTORS AND THEIR SUBCONTRACTORS

In the United States, the contractual relationships between most US government agencies[7] and their prime contractors (meaning a contractor in direct privity with the government) are generally conducted under provisions and procedures set forth in the Federal Acquisition Regulation (FAR).[8] The US Department of Defense and its individual military services, which account for a very high percentage of dollars spent on aerospace systems, issue their own supplements to the FAR.

Companies wishing to do business with the US government are required to accept the large number of contract terms and conditions set forth in the FAR and FAR Supplements. While some of these provisions are required to be "flowed down" to subcontractors,[9] which are not in privity with the government, the governing law of such contracts is typically not, or at least not exclusively, the law pertaining to US government contracts. Thus a choice of law provision between a major prime aerospace contactor and a large supplier might read, in part, "this contract shall be interpreted under the laws of New York, and the federal law of government contracts, where applicable".

Disputes between prime contractors and their subcontractors/suppliers are usually handled in either civil courts or arbitration, depending upon the dispute resolution mechanisms set forth in the subcontract.[10] In such cases, the advantages of arbitration

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[7] The Federal Aviation Administration is exempt, and issues its own procurement rules.
[8] 48 C.F.R §§ 1 *et seq.*
[9] For example, where subcontracts are "cost reimbursement" rather than fixed price, subcontractors may be required to maintain specific types of cost allocation systems and must agree not to charge certain types of expenses (e.g. lobbying, entertainment, alcohol and many more) to those subcontracts.
[10] Generally disputes between US government agencies and their prime contractors are handled in government-established fora with little if any opportunity for arbitration.

discussed above frequently apply. The ability to appoint arbitrators with experience in both commercial law and US government contract law can be quite important for several reasons. Such arbitration professionals understand the interplay between commercial and government contract law. Appointing experienced arbitrators can avoid not only a substantial learning curve that might be the case with judges not well grounded in such cases, but can allow such cases to be resolved much more expeditiously than in courts.

With the expansion of international business by the major aerospace companies, the supply chain for those companies has become worldwide. Arbitration can be a particularly appropriate dispute resolution mechanism for disputes between parties of different nationalities. For example, a recent international arbitration case involved claims between a US government prime contractor performing services for the US Army in the Middle East and its Middle Eastern subcontractor which actually did much of the "hands on" work. Certain clauses in the prime contract were imported into the subcontract and Texas law governed the subcontract. The US prime contractor claimed that the subcontractor was not entitled to be paid until and unless the prime contractor was paid by the government. A panel of arbitrators with deep experience in US government contracts and commercial law was able to resolve the case expeditiously in the claimant's favor, and gave little weight to expert opinions on application of the law that, not surprisingly, were weighted heavily in favor of the parties who had retained them. Thus, the non-US claimant was able to obtain fair treatment of its claim in an efficient, expeditious manner.

COMMERCIAL HUMAN SPACEFLIGHT DISPUTES

Commercial human spaceflight has long been promised but most recently delayed when Richard Branson's Virgin Galactic Spaceship Two, an eight seat craft, failed a test flight in 2014 killing the pilot. Test flights resumed in September 2016 after completion of a new spaceship.

When the ticket line forms with people willing to pay $250,000 for a brief, suborbital flight,[11] adventurous space tourists as well as spacecraft manufactures, spacecraft operators, suppliers and insurers will focus on many issues including liability in the event of injury or death.

Arbitration will be the best choice for dispute resolution in such circumstances. Contracts for civilian space travel contain law and policy preferences that risk-taking international citizens and corporations have bargained for. Dispute resolution will focus on many issues of first impression in aerospace and aviation, which the parties will mandate be resolved in a private arbitration. Arbitrators well known for both legal expertise and

[11] A recent media article states that Virgin Galactic, the leading commercial space company offering such flights, has deposits from over 700 people. *See* http://www.space.com/18993-virgin-galactic.html

practical knowledge of products, services and attendant risk in human space flight would be ideal decision makers.

CYBER RELATED DISPUTES

The new normal is the hacking of national security technology and technology products. United States intelligence officials are centered on the impact that hacker data thefts can have on national security and global politics. James R. Clapper, the US Director of National Intelligence warned in his annual worldwide threat briefing in February 2016 that Russia was escalating its espionage campaigns against United States targets. Recent news reports bear this out.

Today in Silicon Valley, Washington DC and other high technology centers there are hundreds of commercial contracts where technology companies, law firms and consultants are provided technology and technology products developed at private expense, some of which have national security applications. The context of these contracts for technology companies is often to further the research and development of state of the art technology and for law firms to develop intellectual property protection or to be a depository of the technology in the context of disputes. This is a target rich environment for hackers and some technology companies and most law firms do not have the same secure computers systems as government agencies that deal in highly sensitive material.

When there is a hack of technology which has a national security application the immediate questions are--who, what, when, where, why and how. In these contacts the recipient technology company or law firm has the responsibility to provide a secure information technology system and they may be responsible for data breaches to include theft. In the examination of who, what, when, where, why and how, a charge of contract breach is often made and the dispute not surprisingly is increasingly heard by arbitrators. Arbitration can offer absolute confidentiality. Further, arbitration permits a singular and necessary advantage – availability of a group of neutrals with industry experience and who hold or are eligible to hold security clearances. Those arbitrators could be permitted access to information concerning a data breach and to technology and technology products destined for national security use.

ARBITRATION OF COMMERCIAL AIRCRAFT AND AVIATION DISPUTES

Disputes in the commercial aviation sector can arise from a wide variety of business relationships. A few examples are illustrative:

- disputes arising out of aircraft leasing relationships
- delays in delivery of manufactured airplane parts causing significant consequential liquidated damages
- defective manufacture of airplane parts requiring additional rework and repair prior to use

- disputes arising out of arrangements for layover accommodations for airline staff, many of which are unusual arrangements tailored to the pilots' and stewardesses' schedules
- disputes arising out of the servicing of aircraft
- claims for commissions owing for the sale of aircraft
- intellectual property disputes relating to equipment or other products for aircraft and airlines
- information technology disputes relating to an airlines' complex reservation systems

All of these disputes and many others that arise can benefit from utilizing the flexibility that arbitration affords to craft a bespoke dispute resolution process. Time and cost savings can easily be achieved by able counsel and capable arbitrators. Confidentiality, if important, can be preserved. Cross border enforceability of arbitration awards under the New York Convention in this inherently international business is a significant advantage. Arbitrators knowledgeable about some of the unique requirements of the airlines and the aerospace industry can manage the process most effectively. And in cases of continuing relationships, an arbitration is generally less damaging than the more litigious atmosphere of a court proceeding.

CONCLUSION

The above examples of the types of issues faced by aerospace industry companies in disputes are illustrative of the many advantages arbitration can provide to industry participants as compared with other dispute mechanisms.[12] As the industry continues to consolidate, and information protection issues grow in importance, the advantages of arbitration are likely to become even more apparent.

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[12] In recognition of this, the American Arbitration Association/ International Centre for Dispute Resolution recently created a specialized panel of arbitrators and mediators having extensive experience in aerospace, aviation and national security issues. *See:* *https://www.adr.org/aaa/ShowPDF?doc=ADRSTAGE2044890*

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