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Arbitration of Disputes in the Aerospace Industry

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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 $700 billion in annual sales, with slightly over 50 percent coming from the government/military side.

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Since the mid 1990s 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. 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.

Major products and services provided by aerospace industry players include commercial and 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.

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Confidentiality and Handling of Government-Controlled and Classified Information

Confidentiality considerations arise when highly proprietary and sensitive information is 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 that governments regulate, sometimes including export controlled and/or classified information. The confidentiality features of arbitration can greatly simplify the process of disclosing and using such information in arbitrations.

Where classified information is involved in disputes in the aerospace industry, 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 U.S. and non-U.S. 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.

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")[5] 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.

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An alternative approach is to be creative, nibble at the edges, and if the facts permit, sidestep 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:

- 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.
- 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.
- A mock 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 make it particularly well suited to address state secret and related challenges.

Disputes Between U.S. Government Contractors and Their Subcontractors

In the United States, the contractual relationships between most U.S. government agencies 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).[6] The U.S. 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.

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Companies wishing to do business with the U.S. 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 that 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 U.S. government contracts.

In such cases, the advantages of arbitration discussed above frequently apply. The ability to appoint arbitrators with experience in both commercial law and U.S. 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 al-

low such cases to be resolved much more expeditiously than in courts.

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 outgoing Director of National Intelligence, warned in his annual worldwide threat briefing in February 2016 that Russia was escalating its espionage campaigns against U.S. targets. Recent news reports bear this out.

Given the nature of the technologies they use and develop, aerospace companies are a target-rich environment for hackers and others seeking to exploit information systems weaknesses. When there is a hack of technology that has a national security application, the immediate questions are—who, what, when, where, why and how? In the examination of those issues, a charge of contract breach can be made and the dispute not surprisingly is most appropriately heard by arbitrators. 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. These could include disputes arising out of aircraft purchase or leasing agreements, delays in delivery of parts or delivery of defective parts, IT disputes arising from airline reservations systems, commissions relating to sales of aircraft and many others. Any of these scenarios could cause significant losses. All of these disputes can benefit from utilizing the flexibility that arbitration affords to craft a bespoke dispute resolution process.

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. As the industry continues to consolidate, and information protection issues grow in importance, the advantages of arbitration are likely to become even more apparent.

Endnotes

1. http://www.merriam-webster.com/dictionary/aerospace.
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.
4. 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:* ICDR-AAA Aerospace, Aviation and National Security Panel, available at https://www.adr.org/aaa/ShowPDF?doc=ADRSTAGE2044890. The authors are charter members and serve on the Steering Committee for this specialized panel.
5. https://www.scribd.com/document/134332470/IBA-Rules-on-Taking-Evidence-2010 .
6. 48 C.F.R. §§ 1 *et seq.*

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