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BY JASON DICKSTEIN
AEA GENERAL COUNSEL

The New False and Misleading Rule—More than Just Anti-Fraud

Anyone dealing with aircraft parts had better be careful what they say—or don't say. That's the message of the FAA's new false and misleading statement rule (FAR 3), whose fuzzy boundaries and grant of substantial discretion to enforcement personnel make it a rule to watch out for. This law makes it a civil offense under FAA regulations to make certain types of fraud, false statements, misleading statements and misleading omissions concerning aircraft and aircraft parts.

Summary of the Rule

First, the rule makes it unlawful to commit fraud or make an intentional false statement. This aspect of the rule is generally consistent with existing state-level commercial fraud laws, although narrower in scope. The regulation applies only to (1) records concerning the airworthiness of a type-certificated product (aircraft/airframe, aircraft engine or aircraft propeller), or (2) records concerning the acceptability of any product, part, appliance or material for installation on a type-certificated product.

The fraud/false statement portion of the rule also applies to those who either reproduce or omit a record.

The rule also goes on to prohibit misleading statements, and as the full analysis in this article shows, the scope of this provision is likely to be confusing to many people in the aviation industry.

The rule also provides several definitions of terms that are important to the industry. In the case of the term "airworthy," for example, the FAA for the first time codifies the airworthiness definition that has long been considered the norm in the aviation industry (the definition based on the conditions for issuing an export 8130-3 taken from 14 CFR 21.333(a)).

False Statements and Fraud

The FAA explains the elements of false statements and fraud by establishing the individual elements that make up each offense:

"An intentionally false statement consists of (1) a false representation, (2) in reference to a material fact, (3) made with knowledge of its falsity. A fraudulent statement consists of these three elements, plus (4) it was made with the intent to deceive, and (5) action was taken in reliance upon the representation."

For purposes of compliance, the separate elements of fraud can be ignored. This is because the elements of a false statements offense are a subset of the elements of fraud, and both fraud and false statements are comparable offenses under the new regulation (although it is possible that they may be treated differently for purposes of assigning a penalty in an enforcement action). Furthermore, it may be possible to ignore element No. 3—knowledge—because the FAA has stated its intent to assume knowledge

whenever a case is of such a category that it would be brought as a civil penalty (the issue of knowledge is further discussed below under the Enforcement section of this article).

Thus, the FAA may be able to successfully claim an offense of FAR 3 whenever they can demonstrate a false representation concerning one of the following material facts:

- 1) the airworthiness of a type-certificated product (meaning an airframe, engine or propeller), or
- 2) the acceptability of any product, part, appliance or material for installation on a type-certificated product.

The fraud/false statement prohibition does not apply to records made under 14 CFR § 43.9. This is good for repair stations but it does not mean that we are 'off-the-hook!' The rule will apply to all other records that pass between the repair station and its customer as well as the records that pass between the repair station and its suppliers or other business partners. This will include documents like quotes, requests for quotes, purchase orders, and invoices. It could also include some internal records that might be shared with customers in a sales transaction, like travelers, tear-down reports, or other records of work performed that are not 43.9 records.

The new rule also makes it an offense to make an intentionally false or fraudulent reproduction or alteration of any record related to airworthiness of a product or acceptability of a

part for installation on a product. A perfectly valid record that is photocopied and applied to a different part ('the wrong part') could reflect a violation under this clause. An example of such actions would be copying the cert papers for a lot of fasteners and using them to pass off an unrelated lot of non-conforming fasteners as if they were in compliance with the standards described in the documentation. In this case, the non-conforming fasteners would be unacceptable for installation because they are not in the condition verified by the fraudulent paperwork.

This provision likely encompasses a wide variety of frauds. One type of alteration the prohibition covers is whitening out one set of target data and replacing it with another—for example, whitening out the eligibility statement in block nine of an 8130-3 tag, and replacing it with a different eligibility statement that is incorrect. However, the fraud section of this rule probably would not apply to the whitening out and replacement of the company name listed in block four, because that fraud does not address the airworthiness of an aircraft or the acceptability for installation of a part (although other laws would likely forbid such a fraud).

Misleading Statements

While the fraud/false statement rules are based on very clear-cut legal standards, the misleading statements provisions unfortunately don't quite rise to this level.

As originally proposed, the misleading statement prohibitions would have required "appropriate" records without ever defining what records were considered "appropriate" and would have established a very subjective standard for what was considered misleading.

The final rule is much better than the original proposal in this regard. While the term "airworthy" has been defined

in a way that is not 100 percent clear, it is at least now grounded firmly in language that follows standard industry patterns. More importantly, the scope of the misrepresentations that are covered under this rule has been curtailed drastically. While the subjective desires of FAA inspectors can still potentially influence the handling of matters that fall within the scope of the rule, the issues on which they can assert those desires have been narrowed.

The "misleading" section of the rule forbids making, or causing to be made:

(1) a representation reflected by a record or an omission of material fact that leads to the creation of a misrepresenting record;

(2) that (a) a type-certificated product is airworthy, or, (b) a product, part, appliance or material is acceptable for installation on a type-certificated product;

(3) if that representation is likely to mislead a consumer acting reasonably under the circumstances; and

(4) when the representation is made in the context of an advertisement of a transaction.

It is crucial to note that both material misrepresentations and omissions of material fact can give rise to a violation. The potential for violations based not just on making statements but on omitting a statement is what makes this provision of the rule so fraught with uncertainty.

It isn't always clear what might constitute a material fact for purposes of this rule, especially in areas where the importance of particular issues is open to debate. Many in the industry have felt that historical installation on an incident- or accident-related aircraft is a material fact. There are others who dispute whether this broad category is per se material, especially in situations where the historical installation does

not appear to be relevant to the airworthiness of the part. For example, while a hard landing will often generate concern over the landing gear, what is its real effect on the avionics? If there is a small fire in the aft galley of a transport category aircraft, is there any reasonable potential for damage to the avionics in the cockpit? And what about the situation where a part has been subjected to a full hidden damage analysis that shows that the incident- or accident had no reasonable effect on the airworthiness of the part? In each of these hypotheticals, is the fact that the part was installed on an incident- or accident-related aircraft really a material fact? The fact is that reasonable people in the industry have disagreed about that question. And that disagreement over what is considered to be material in a parts transaction is exactly what makes this new rule dangerous.

The FAA's pledge to interpret the material misrepresentation rule in a manner consistent with existing Federal Trade Commission (FTC) advertising guidelines suggests that it plans to take a limited and reasonable approach to determining what is material. The FTC has the authority to prevent "unfair or deceptive acts or practices," which it does by examining the target audience for the communication, taking into account the knowledge and sophistication of that group of consumers. This is good news, as it means that most aviation advertising and other communications in the transport category aircraft market should be assessed according to the likely effect on sophisticated purchasers from the industry, rather than on the inexperienced layman.

The FTC has defined a material misrepresentation as "one which is likely to affect a consumer's choice of

Continued on following page

NEWS FROM THE HILL

Continued from page 29

or conduct regarding a product.” The FTC has also suggested that “injury and materiality are different names for the same concept,” suggesting that a misrepresentation that is unlikely to cause injury is equally unlikely to be material.

The FTC has also made it clear that “no statement or illustration should be used in any advertisement which creates a false impression of the grade, quality, make, value, currency of model, size, color, usability, or origin of the product offered, or which may otherwise misrepresent the product in such a manner that later, on disclosure of the true facts, the purchaser may be switched from the advertised product to another.” Thus, when offering items that comply with a TSO it is important to be clear about the make and model of the TSOA-compliant item.

It is important to remember that the misleading statement prohibitions apply to all types of records, including 43.9 records as well as those discussed in the fraud/false statement section (quotes, requests for quotes, purchase orders, invoices, etc.). Therefore, AEA members should be intensely aware as they perform their record-keeping functions that, if any record states or fails to state something that misleads someone, that statement may be actionable.

Enforcement

In the preamble to the rule, the FAA has established the enforcement pattern that it intends to use for enforcing the new regulation. The first step in the process would generally be to contact the person who made the representation, record, or omission, and discuss why the statement in question appears to be misleading.

The preamble goes on to state: “If the person who made the statement in question can show a mistake was

made, and such mistake was honest or legitimate, the FAA will not take enforcement action. However, if the statement is not corrected so as to remove its misleading character, or the mistake is one in a series of such mistakes, the FAA will presume knowledge on the part of the person sufficient to take enforcement action.”

While, at first glance, this approach seems to reflect a reasonable and cooperative approach to enforcement, there are numerous problems with it. First and foremost, it assumes that the FAA inspector’s decision that a statement is misleading is conclusive. This sets a dangerous precedent because an FAA inspector’s conclusions about the law may not always be accurate (many AEA members can attest to this). For example, FAA inspectors have on occasion issued statements contending that a repair station is out of compliance with a regulation when the station is, in fact, properly compliant and it is the inspector’s interpretation that is out of alignment with the regulation as interpreted by FAA headquarters.

The problems are compounded by the difficulty of challenging an inspector’s conclusion—often, the only way to contest an assessment by an inspector is to insist on a formal adjudication through a proposed civil penalty action. Only during this process does the inspector seek legal advice from FAA attorneys in a position to inform the inspector that his or her assessment of the law is incorrect. This can be quite expensive—so expensive that it may be significantly easier to acquiesce to the FAA inspector (thus permitting a chilling effect on the business’ first amendment commercial expression rights). It can also mean challenging the same FAA inspector who is your primary contact for field approvals and other important FAA feedback, which makes it even less likely that repair stations will assert their first amendment rights.

Assume, for example, that an FAA inspector (not necessarily the PAI!) contacts a repair station and informs the business that an advertisement on a website is misleading. Upon examination (and perhaps upon consultation with others in the industry), the repair station concludes that the advertisement is not misleading and therefore does not correct it. Under the language of the preamble, the repair station’s reasonable belief that the statement is not misleading is, in and of itself, tantamount to a knowledgeable violation (willfulness or knowledge generally makes the penalty for any violation greater). AEA Members can expect to see the FAA bootstrap its civil penalty arguments with the proposition that because the repair station contested the declaration of ‘misleading,’ a knowledgeable violation will be imputed.

Advice and Conclusion

In a recent AEA Regional Meeting presentation, I provided sample disclaimers that might be useful in some circumstances to help demonstrate lack of knowledge about a particular transaction. These disclaimers and other information are available in the Resource One portion of AEA’s website, www.aea.net. AEA Members who do not yet have access to Resource One should contact Association headquarters for access information.

It is especially important for AEA members to scrutinize their documentation and record patterns to be sure they do not inadvertently create misleading statements. They should also be careful not to leave out facts in a way that suggests an acceptability for installation that is not correct. This can be particularly important for TSOA products that are advertised as being acceptable for installation in a product despite the fact that installation eligibility have not yet been confirmed. Advertising is another medium by which infringements can be made so it

bears additional scrutiny, as well.

Despite the FAA's efforts to tighten up the new rule, the fact is that it still remains quite vague. The scope of this rule as it is properly enforced will only be understood through the actual enforcement actions undertaken by the FAA. The problems with the enforcement process suggest that much of the 'enforcement' of this rule will be informal, through FAA employees who insist that a representation, record or omission is misleading, and repair stations and others in the industry who change their practice (even when they do not concur in the FAA's judgment) in an effort to avoid the expenses associated with civil penalty action. Therefore, it becomes especially important that those in the industry remain vigilant regarding behavior that might trigger this rule. AEA stands ready to provide support and advice if it is needed! □