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UNITED STATES BANKRUPTCY COURT  
SOUTHERN DISTRICT OF NEW YORK

Case No. 12-11873-smb

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In the Matter of:

HAWKER BEECHCRAFT, INC., et al.,

Debtors.

-----x

United States Bankruptcy Court  
One Bowling Green  
New York, New York

August 14, 2012

10:21 AM

**B E F O R E:**  
HON. STUART M. BERNSTEIN  
U.S. BANKRUPTCY JUDGE

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Pilatus Aircraft Ltd.'s Motion for Payment of Administrative  
Expenses

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HAWKER BEECHCRAFT, INC., ET AL.  
P R O C E E D I N G S

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THE COURT: Hawker Beechcraft?

MR. CHANTAYAN: Good morning, Judge. Franck --

THE COURT: Good morning.

MR. CHANTAYAN: Franck Chantayan from Carlton Fields on behalf of Pilatus Aircraft Ltd. With me I have my partner, Bruce Berman.

THE COURT: How do you do?

MR. CHANTAYAN: Judge, we're here on the motion of Pilatus Aircraft for allowance and payment of an administrative claim and for an accounting.

Pilatus Aircraft has licensed technology to -- originally to Raytheon. And then when Raytheon to Beech Aircraft, and subsequently through merger, now the debtors Hawker -- actually Hawker Beechcraft Corporation. The genesis of this is that at the time the debtors' predecessors were trying to develop -- seek to enter into the government aircraft business. And they went looking for a plane and for technology that they could take, modify for the JPATS program -- the government program.

The debtors' predecessor came to Pilatus because Pilatus had the PC-9, which was one of the top military aircrafts around the world. And ultimately we entered into a licensing agreement where Pilatus agreed to license its technology to the debtors -- or the debtors' predecessors. And

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1 under that agreement they acknowledged that the aircraft would  
2 have been modified to meet the requirements of the government's  
3 JPATS program. And they shared technology and it became known  
4 as the Beech-Pilatus trainer.

5 The rights given to the debtor are now under section  
6 6.1 of the agreement, which was attached to our motion, that  
7 provides for the use of Pilatus' intellectual property, and the  
8 debtors have continued to use that intellectual property. And  
9 as proof of that --

10 THE COURT: Well, they say they haven't.

11 MR. CHANTAYAN: Well, they say they haven't, but --  
12 and that's really the crux of the issue that we're getting to  
13 now. And really the issue becomes this: to show that they  
14 continued to use it, the T-6 and all derivative aircraft means  
15 any modification to the original BT trainer -- are under the  
16 same type certificate. And the significance of a type  
17 certificate, Judge, is that the type certification is a complex  
18 aircraft certification process that requires detailed  
19 compliance with federal regulations. And the current version  
20 of the debtors' aircraft is being manufactured under the same  
21 type certificate -- under Revision 17 of that type certificate.

22 So if the debtors were no longer using Pilatus'  
23 intellectual property, they would have had to have gotten a new  
24 type certificate for their plane. They never did; they're  
25 using the same type certificate because they're -- it's the

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1 same plane. It's the same technology, only based under  
2 modifications, and those modifications are called for and  
3 acknowledged under the agreement. Because the agreement says  
4 the BT trainer and all derivative aircrafts.

5 The other support for the fact that they're using  
6 Pilatus' intellectual property is they've paid royalties to  
7 Pilatus all these years, up through just before the filing of  
8 the petition date. And in fact, the pre-petition claim that  
9 the debtors have scheduled on Hawker Defense Company's  
10 schedules is a pre-petition claim for approximately 1.1  
11 million. And that claim is scheduled without being disputed,  
12 contingent or unliquidated. If the debtors weren't using our  
13 intellectual property, two things you would think would have  
14 occurred: one, they wouldn't have scheduled the claim; or two,  
15 they would have scheduled it as disputed or contingent, at  
16 least.

17 The other support is --

18 THE COURT: I suppose they'll tell me they woke up on  
19 the petition date and realized they didn't owe you the money.

20 MR. CHANTAYAN: Well, that's what it seems that  
21 we're -- the direction we seem to be heading from the debtors'  
22 papers.

23 THE COURT: Right.

24 MR. CHANTAYAN: The other support for it is in 2011,  
25 the debtors requested that Pilatus agree to an assignment of

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1 the agreement from Hawker Beechcraft Corporation -- which is  
2 the counterparty -- to Hawker Beechcraft Defense Co. That  
3 assignment was never authorized because the parties were  
4 negotiating additional modifications to the agreement which  
5 would have provided as well for that assignment. And then at  
6 some point in 2011 all communications on that issue stopped,  
7 presumably because the debtors were then contemplating their  
8 bankruptcy filing and they weren't going to go through with  
9 that and had other issues.

10           Additionally, if you look at their web site, their own  
11 web site says that the T-6C and the AT-6 are manufactured as  
12 modifications of the original aircraft. So by the debtors'  
13 current own web site they're acknowledging that the aircraft is  
14 using our intellectual property.

15           As you point out, the debtors say that they may not be  
16 using -- possibly not using, but all of that has come up as a  
17 post-petition claim, that they're potentially not using it.  
18 And to us that is unconvincing because the government's  
19 business -- the government aspect of the business is one their  
20 most significant and important aspects of the debtors'  
21 business. They've said so in their papers. And you would  
22 believe that if this were such an important business, they  
23 would know what technology are in those planes, what they're  
24 using.

25           Furthermore, under the agreement it says that if they



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1 cease to use our intellectual property, they have -- because  
2 there was a sharing of information, and they actually shared  
3 that with some of their subcontractors and some of their  
4 servicers -- they would have to provide a termination letter  
5 and a cease and desist letter to anybody who has that  
6 information, and they never issued that letter.

7 THE COURT: Does Pilatus have any remaining duties  
8 under the licensing agreement?

9 MR. CHANTAYAN: Yes, Judge.

10 THE COURT: What duties does it have?

11 MR. CHANTAYAN: We have duties that -- we have mutual  
12 duties of indemnification so that if there is any claim of an  
13 infringement, that we have a duty to indemnify the debtor. We  
14 have auditing rights under the agreement.

15 THE COURT: Well, that's not a duty, that's a right.

16 MR. CHANTAYAN: True. We have a continued grant of  
17 the license; if they cease to use the license then we would --  
18 that license would terminate. If they have -- if there's any  
19 infringement we would have --

20 THE COURT: What my questions are really aimed at is  
21 whether this is an executory contract?

22 MR. CHANTAYAN: Yes, Judge.

23 THE COURT: And maybe it should just shorten the time  
24 for the debtor to assume or reject the contract and make the  
25 debtor put its money -- its mouth -- its money where its mouth

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1 is.

2 MR. CHANTAYAN: And to that --

3 THE COURT: If it doesn't need it, it doesn't need it,  
4 and then just reject it.

5 MR. CHANTAYAN: Right. And that's exactly right,  
6 Judge. And to that point, yesterday -- and which we  
7 delivered a copy -- hand-delivered a copy to your chambers, we  
8 filed a motion for exactly that.

9 THE COURT: Okay.

10 MR. CHANTAYAN: And it's set for the hearing on August  
11 the 30th.

12 THE COURT: Okay. I got it.

13 MR. CHANTAYAN: Thank you, Judge.

14 MR. MCELLOWNEY: Your Honor, Sean McEldowney from  
15 Kirkland & Ellis here on behalf of the debtors-in-possession.

16 Pilatus' motion is premature at this time to rule on.  
17 A lot of what you just heard was about facts about what --

18 THE COURT: I haven't heard any facts from the debtor.  
19 Why'd you continue to pay them if you weren't using their  
20 technology?

21 MR. MCELLOWNEY: So the agreement isn't set up as a  
22 straightforward royalty in exchange for the use of IP; it was  
23 in fact a settlement agreement that arose out of an arbitration  
24 that had several different claims in it. The license  
25 Provision, which is section 6 of the agreement, speaks to a

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1 fully paid-up license, which suggests that at the time of the  
2 agreement the IP license was fully paid for. The payment  
3 provision is in section 4 and talks about manufacturing rights,  
4 and was the resolution of all of the claims that were part of  
5 that arbitration. So the payments, in our view, it appears may  
6 be in fact for ongoing sort of structured settlement payments  
7 and not payments --

8 THE COURT: But I thought you have to pay them for  
9 every aircraft, a fixed amount for every aircraft you sell?

10 MR. MCELLOWNEY: That's right. That is how the  
11 agreement is structured, but that doesn't necessarily mean that  
12 it's an exchange for the use of the IP rights, I would submit.  
13 It's just that that's how the settlement agreement was  
14 structured --

15 THE COURT: So why don't you just reject the  
16 agreement? If you both --

17 MR. MCELLOWNEY: So that's an issue that we're looking  
18 at now, Your Honor, and if in fact we're not --

19 THE COURT: Is there any reason I shouldn't just fix  
20 the time to assume or reject the agreement?

21 MR. MCELLOWNEY: I haven't yet had an opportunity --

22 THE COURT: You seem to be telling me you don't need  
23 the agreement.

24 MR. MCELLOWNEY: So we're currently evaluating that  
25 issue, and whether in fact we are using the IP. For purposes

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1 of the present motion, we would suggest a scheduling order  
2 where we can explore that issue with Pilatus and get some  
3 discovery to see what intellectual property they say they have,  
4 which, to date, they have not yet pointed to a single patent, a  
5 single trade secret that we're supposedly using. If it's so  
6 straightforward an issue, they should point us to a patent --

7 THE COURT: It's a contractual right, isn't it?

8 MR. MCELLOWNEY: The payments, Your Honor?

9 THE COURT: You took their plane; you got the right to  
10 manufacture it with modifications. Isn't that what you're  
11 doing? You're doing whatever you were doing.

12 MR. MCELLOWNEY: Yes, that's right that we're  
13 manufacturing an airplane.

14 THE COURT: I got it.

15 MR. MCELLOWNEY: The question is whether we're  
16 continuing to use their IP rights, and that's the issue we're  
17 looking at. And if in fact we conclude that we're not, then  
18 that will certainly inform our decision about whether to reject  
19 the agreement, Your Honor. But as part of this particular  
20 motion, in order to address this motion, we would need  
21 discovery to look at whether the payments under this agreement  
22 are, in fact, royalty payments in exchange for ongoing use of  
23 IP rights.

24 THE COURT: Can't you determine that by reading the  
25 agreement? What are you going to ask for in discovery?

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1 MR. MCELLOWNEY: On the face of this agreement, Your  
2 Honor --

3 THE COURT: Right.

4 MR. MCELLOWNEY: -- it appears to me that this is not,  
5 in fact, a royalty payment that's being made in exchange for IP  
6 rights.

7 THE COURT: But the agreement says you've got to pay  
8 them -- what is it, 100 -- 78,000 dollars for every plane  
9 that's sold. If it's unrelated to the use of IP and you're  
10 selling planes, why do your papers talk about use of their IP?

11 MR. MCELLOWNEY: Why do our papers, Your Honor?

12 THE COURT: Yeah. Your opposition talks about that  
13 you're not using their IP, but now you're telling me that the  
14 payments are unrelated to the use of the IP.

15 MR. MCELLOWNEY: So two separate questions, Your  
16 Honor. The first is whether the agreement is set up such that  
17 the payments are being made in exchange for the use of IP.

18 THE COURT: What is the debtors' position?

19 MR. MCELLOWNEY: Excuse me, Your Honor?

20 THE COURT: What is the debtors' position on that?

21 MR. MCELLOWNEY: On that question? At this time it  
22 appears to us on the face of the agreement, Your Honor, that  
23 the payments are in fact not in exchange for the ongoing use of  
24 IP --

25 THE COURT: Okay.

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1 MR. MCELLOWNEY: -- because it's called a lump sum  
2 or --

3 THE COURT: All right. But if that's the case then we  
4 are you arguing in your response that you don't have to pay  
5 them because you're not using their IP?

6 MR. MCELLOWNEY: Sure. So that's one issue, which in  
7 our view is a threshold question, whether the payments are, in  
8 fact --

9 THE COURT: But if they're not --

10 MR. MCELLOWNEY: -- in exchange for IP. But second --

11 THE COURT: But if they're not -- if you're right,  
12 then don't you just have to pay them 78,000 dollars every time  
13 you sell a plane?

14 MR. MCELLOWNEY: Under the agreement that's correct.

15 THE COURT: So why don't you just pay them?

16 MR. MCELLOWNEY: Because our view, Your Honor, is that  
17 that would not then be an administrative priority claim.

18 THE COURT: Then it would be a --

19 MR. MCELLOWNEY: That's the issue here.

20 THE COURT: -- claim arising under a pre-petition  
21 contract. Because you didn't make that argument, which is what  
22 I thought you would make in your papers.

23 MR. MCELLOWNEY: I'm not sure I followed that, Your  
24 Honor.

25 THE COURT: Yes, sir.

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1 MR. GUERRIERI: Will Guerrieri on behalf of the  
2 debtors from Kirkland & Ellis. That's right.

3 THE COURT: You're going to translate my question to  
4 him.

5 MR. GUERRIERI: Yeah. So, I mean, this is more of a  
6 bankruptcy issue. And --

7 MR. MCELDFOWNEY: Not a bankruptcy attorney, Your  
8 Honor.

9 THE COURT: Well, this is a bankruptcy court.

10 MR. GUERRIERI: Exactly.

11 THE COURT: That's an amazing coincidence.

12 MR. GUERRIERI: And not a litigation issue. So I  
13 think --

14 MR. MCELDFOWNEY: The IP attorney will sit down, Your  
15 Honor.

16 THE COURT: Yeah. That's fine. Thank you.

17 MR. GUERRIERI: I mean, the point here is that the  
18 debtors are now analyzing whether or not it's in the best  
19 interest of debtors' estate to reject this contract.

20 THE COURT: So you agree it's executory also?

21 MR. GUERRIERI: At this point we think it probably is  
22 executory.

23 THE COURT: Okay. Well, maybe that'll bring the whole  
24 issue to a head.

25 MR. GUERRIERI: And so as soon as we can complete our

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1 analysis and make the decision that's in the best interest of  
2 all the creditors, because to the extent we can reject this  
3 contract and not have to pay 80,000 or 200,000 dollars for each  
4 plane that the debtors produce, that's just going to maximize  
5 the value, maximize the sale value of the defense business.

6 THE COURT: Well, they may still have a pre-petition  
7 claim for that, no?

8 MR. GUERRIERI: Very true.

9 THE COURT: If you reject it. Okay.

10 MR. GUERRIERI: And that's what we think they have.

11 THE COURT: All right. It sounds to me like -- thank  
12 you. It sounds to me like this may be a rejection issue more  
13 than anything else. But in any event, look, this is  
14 essentially a status conference. It's the first pre-trial  
15 conference, and I could not rule as a matter of law on your  
16 motion.

17 You have the right to make a motion for summary  
18 judgment if you follow the procedure. This could conceivably  
19 have to be tried. But my suggestion is that I adjourn it to  
20 August 30th. You're telling me that's the return date. If  
21 they assume your contract -- if they decide they really have to  
22 assume it, they're going to have to pay all the pre-petition  
23 and post-petition defaults anyway to do that. If they reject  
24 it and they're correct that it's simply rights arising under a  
25 pre-petition contract, you'll have a claim but it'll be paid



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1 under a plan, presumably.

2 MR. CHANTAYAN: Judge, I would agree with that.

3 Although if they reject our agreement and they want to continue  
4 using that aircraft under the same type certificate, we're  
5 actually going to seek stay relief and bring an IP litigation  
6 lawsuit because --

7 THE COURT: Yeah. I understand that. I know that  
8 there was a Seventh Circuit case recently about whether or not  
9 you had to return -- if you're a licensee, I think, that  
10 rejects, whether or not you have to return the --

11 MR. CHANTAYAN: That's right.

12 THE COURT: -- license. And they may have to do that.

13 MR. CHANTAYAN: They would have to cease  
14 manufacturing.

15 THE COURT: All right.

16 MR. CHANTAYAN: It completely throws their government  
17 process into a --

18 THE COURT: That's their assump --

19 MR. GUERRIERI: This is all part of our analysis, Your  
20 Honor.

21 THE COURT: That's their assumption/rejection  
22 decision. I don't mean to make light of it.

23 MR. CHANTAYAN: I don't either, Judge.

24 THE COURT: I realize it's a difficult decision, but  
25 it sounds to me like if they do reject it you may have to bring

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1 an IP litigation --

2 MR. CHANTAYAN: Right.

3 THE COURT: -- in district court.

4 MR. CHANTAYAN: That's right.

5 THE COURT: Okay.

6 MR. CHANTAYAN: And just so that -- for a history, we  
7 signed this license agreement originally under the original  
8 agreement in '96; they delivered the first plane in 2001. So  
9 there was a ramp-up period from the time that they got the  
10 information to the time they were able to deliver. I think  
11 that's something that they need to consider. If now they're  
12 telling us they're not using it -- our plane, then the question  
13 is what plane are they using? How is it different from our  
14 plane? And I think that's going to be an issue for them.

15 THE COURT: All right. I'll adjourn this to August  
16 30th, which is the return date of the assumption/rejection --  
17 motion to compel the assumption or rejection.

18 MR. CHANTAYAN: Thank you, Judge.

19 THE COURT: Okay. Thank you.

20 MR. MCELDFOWNEY: Thank you, Your Honor.

21 THE COURT: Thank you.

22 (Whereupon these proceedings were concluded at 10:37 AM)

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C E R T I F I C A T I O N

I, Avigayil Roth, certify that the foregoing transcript is a true and accurate record of the proceedings.



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AVIGAYIL ROTH

AAERT Certified Electronic Transcriber CET\*\*D-640

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Date: August 14, 2012