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Air Force

F-16 Fallout Clouds Future Foreign Deals, May Alter National Security

BY DANIEL SEIDEN

South Korea and defense contractor BAE's failure to finalize a deal to upgrade the F-16 jet didn't just allow rival Lockheed Martin to step in and take the business. It also raises several prickly questions regarding U.S. national security and the \$33.6 billion Foreign Military Sales (FMS) program:

- Could refusing to enforce FMS-related contracts sour foreign countries on U.S. military purchases?
- If such agreements are enforceable, will foreign governments use them to protect their interests and weaken U.S. control over FMS?
- Could national security be harmed if military contractors are reluctant to participate in FMS over fear of foreign litigation?

The dispute is on appeal in the Fourth Circuit, where South Korea is due to respond by May 8 to BAE's assertion that the country's breach-of-contract suit in a Seoul court must be stopped.

Foreign Litigation "If [South Korea] is able to pursue a lawsuit against BAE in Republic of Korea courts and prevails, it would not only likely have a chilling effect on defense contractors participating in FMS, it would also likely undermine the FMS program itself," Derek Gilman, a partner with Nichols Liu LLP, Washington, who specializes in international legal matters for the aerospace and defense industries, told Bloomberg BNA.

Gilman is the former general counsel and principal director of the Defense Security Cooperation Agency, where he was the chief legal adviser on more than \$30 billion in military sales annually. Gilman said he is advising BAE, but isn't the counsel of record in this litigation.

FMS is "a form of security assistance" through which the U.S. "may sell defense articles, defense services, and military training to foreign countries and international organizations," according to the agency.

The U.S. government determines the price of a foreign military sale, and therefore contractors could be reticent to use the FMS program if a foreign court could hold them liable for a pricing decision over which they didn't have control, Gilman said.

"Perhaps more troubling is the potential adverse effect such a decision could have on U.S. national secu-

urity and foreign policy, given that certain defense articles and services are sold only through the FMS program," Gilman said.

If a foreign country could effectively control FMS pricing, Gilman said, "it could have significant adverse effects on U.S. acquisitions for the benefit of foreign countries."

Trump Could Continue Upward Trend This court fight comes at a time when tensions on the Korean Peninsula have ratcheted up — the U.S. recently deployed an aircraft carrier and warships in response to North Korea's missile tests.

Recent actions by North Korea, and President Donald Trump's willingness to take a confrontational approach, "could encourage further FMS purchases by South Korea, better ensuring modernization across its forces, and maintaining close cooperation and interoperability with the U.S.," Gilman said.

The Defense Security Cooperation Agency in February announced the possible sales of 60 Sidewinder missiles and 89 Maverick missiles to South Korea.

The U.S. has been the leading exporter of military equipment for decades, and that leadership increased with the Obama administration, which totaled \$278 billion in foreign military sales — more than doubling the George W. Bush administration, said Allen Green, senior counsel specializing in international government contracts with Dentons LLP, Washington.

How the Trump administration will affect the upward trend remains unclear, he said. "There was a lot of campaign talk about 'America First' in terms of trade and import tariffs that would affect foreign governments' purchases," Green said. "Those issues are still at play."

Talk during the campaign of NATO's obsolescence raised the possibility of decreasing military sales with alliance partners, but the president appears to have since changed his view of the North Atlantic Treaty Organization, Green added.

Trump's recent statements and actions indicate a return to a stronger U.S.-NATO relationship, which could result in an increase of FMS sales to NATO and its member states, Gilman said.

Clarity Can Prevent 'Messy Result' BAE and South Korea reached a "best-efforts" agreement, according to the parties' briefs, and BAE was tasked with getting the parties and the U.S. to agree on pricing. However, the F-16 upgrade deal fell apart in November 2014, when South Korea decided the \$1.7 billion price tag was too high.

South Korea then tried to recover \$43 million from BAE, but BAE convinced a district court that its agreement with South Korea wasn't enforceable under the

FMS program. The court ruled that the FMS program doesn't allow foreign countries to sue contractors when the U.S. and the foreign country can't reach an agreement.

However, the district court also opened the doors to South Korea's home-court lawsuit against BAE.

Amid this, South Korea got a better deal from Lockheed Martin, which announced in November 2016 that it would upgrade 134 aircraft for \$1.2 billion.

And the country continued its dispute with BAE, arguing March 7 that both a forum selection clause in their agreement and South Korea's status as a foreign sovereign should have kept this case out of the district court, but also that national security concerns didn't apply to bar review of its agreement with BAE.

There was no basis to find that the parties' "best efforts" agreement was "inextricably intertwined" with an FMS transaction and therefore shielded from court review, the country's brief asserted. "No term of the [agreement] purports to affect the U.S. government in any respect," South Korea said.

The Fourth Circuit might remand the case to the district court to provide some clarity as to the enforceability of side agreements related to FMS, Green said.

A U.S. court refusing to enforce this BAE-South Korea agreement may not deter foreign ministries from seeking U.S. military equipment, he said. However, clarifying the standard for ancillary agreements "would keep the FMS program clean," he said.

These agreements could become a "new tool for foreign governments to protest their interests when seeking a military purchase" if they are enforceable, but that "could also have a messy result that weakens the U.S. government's control over the FMS program," Green said.

Consistent With Expectations The contracting community would expect the Fourth Circuit not to enforce the BAE-South Korea agreement, said Peter Lichtenbaum, a partner with Covington & Burling LLP, Washington, who specializes in international regulatory compliance.

This understanding has existed since *Secretary of State for Defence v. Trimble Navigation Ltd.* in 2007, which denied third-party beneficiary rights to a foreign government under an FMS sale, said Lichtenbaum, a former BAE vice president and former assistant secretary for export administration with the Commerce Department.

"South Korea won't like the result, but a disruption to its relationship with the U.S. is unlikely," he said.

"South Korea probably has other priorities right now, given what's going on in that part of the world."

Cost of Doing Business BAE responded with an April 6 brief saying the FMS program doesn't allow foreign governments to sue contractors, and that national security interests require an order blocking South Korea's home-court suit.

That suit would dissuade military contractors from participating in FMS transactions, and the threat of foreign suits could make contractors vulnerable to pressure from foreign governments, BAE said.

Anti-foreign suit injunctions are rare and difficult to get, Green said, and the Fourth Circuit allowing the Seoul suit to go forward probably won't deter U.S. contractors from participating in the FMS program.

"Being sued is the cost of doing business," he said. "If a U.S. contractor is doing business in a foreign country, and, for example, hiring local nationals, there can always be a suit involving business in that country."

He added that "it's a little unique" for South Korea to be suing, and foreign governments usually use other kinds of leverage to get the concessions they seek.

'Very Chilling' Allowing the Seoul suit to proceed would likely affect defense contractor behavior, and hinder national security interests, Lichtenbaum said.

FMS provides important business opportunities for defense contractors, so some companies might try to continue FMS participation but avoid entering into side agreements such as the one at issue here, he said.

The Seoul suit "would be very chilling" for defense contractors' participation in FMS, said Frederic M. Levy, a partner with Covington & Burling in Washington and co-chair of the government contracts practice group.

"Where do you draw the line?" he asked. "Allowing this suit could open the possibility of foreign governments suing in their courts to enforce terms of a U.S. government FMS contract."

Because the U.S. government, not BAE, determined the price to which South Korea objected, contractors "would be deterred from choosing FMS in the future as they could be penalized for a determination over which they did not have control," Gilman said.

To contact the reporter on this story: Daniel Seiden in Washington at dseiden@bna.com

To contact the editor responsible for this story: Daniel Ennis at dennis@bna.com