

ADVISORY | International Trade

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U.S.-INDIA DEFENSE TRADE EXPECTED TO INCREASE

Significant increases in India's defense budget, together with frequent state-to-state defense trade dialogue and a new U.S.-India agreement on end-use monitoring, offer tremendous export opportunities for U.S. defense companies.

U.S.-INDIA DEFENSE TRADE DIALOGUE

The meeting of the U.S.-India High Technology Cooperation Group in Washington, D.C. two weeks ago is the most recent in a series of important bilateral trade discussions between the United States and India on high technology and defense trade issues. Indian Foreign Secretary Nirupama Rao chaired the meeting which involved industry-to-industry discussions on March 15 followed by government-level meetings on March 16 concerning promotion of high technology trade between India and the United States. Acting Under Secretary of Commerce, Daniel Hill, Deputy National Security Adviser, Michael Froman, and Assistant Secretary of Commerce, Kevin Wolf, all participated in the meeting, which focused on defense and strategic trade in addition to other "dual use" goods and technologies such as biotechnology and nanotechnology. During the meeting, Foreign Secretary Rao applauded the Administration's current export control reform efforts and said that she hopes the efforts will result in an enhancement of high technology trade between the United States and India that reaffirms the strategic nature of the U.S.-India partnership.

In January, U.S. Defense Secretary Robert Gates made his second visit to India as Secretary of Defense, where he spoke with Indian leaders about deepening the long-term defense relationship between the United States and India and continued negotiations concerning defense-security related agreements that, if concluded, would allow for further expansion of defense trade with India. In November 2009, President Obama welcomed Prime Minister Singh to the White House for the first state visit of his administration. White House press secretary Robert Gibbs stated that the visit would "highlight the strong and growing strategic partnership between the United States and India." Last July, Secretary Clinton traveled to India for a series of meetings that included key defense trade discussions.

U.S.-INDIA END-USE MONITORING AGREEMENT

During Secretary Clinton's visit to India, the United States and India finally reached agreement on an important bilateral defense trade arrangement that removes a significant hurdle to the sale of U.S. defense articles and services to India. The agreement pertains to the "end-use monitoring" ("EUM") commitments that U.S. law requires from foreign purchasers of U.S. defense articles and services. In the past, the Indian Government was reluctant to agree to standard EUM verification commitments in military sales contracts. The breakthrough achieved last July marks a change in the U.S.-India defense relationship that should allow for more military-to-military cooperation and make U.S. defense companies more competitive in the expanding Indian defense market.

Section 505 of the Foreign Assistance Act of 1961 and section 40A of the Arms Export Control Act require that foreign purchasers commit to allow the U.S. Government to verify the “use, transfer and security” of U.S. defense articles and defense services provided under security assistance programs (including International Military Education and Training programs and Foreign Military Sales (“FMS”)). The U.S. Department of Defense monitors the end-use of such defense articles and services through a program known as “Golden Sentry.” The required commitments take the form of EUM clauses included in contracts for military sales. Standard EUM verification commitments include agreements to permit scheduled inspections or physical inventories upon the request of the U.S. Government. The U.S.-India EUM agreement will streamline defense sales that heretofore had been negotiated on a case-by-base due to the absence of an agreed formulation for the required EUM clause.

The EUM agreement is controversial in India. For years the Indian Government objected to the United States’ standard language in the end-user monitoring clauses. Members of the opposition in India’s parliament criticized the EUM agreement citing concerns that allowing inspections of Indian military installations will compromise India’s national sovereignty. However, Prime Minister Singh is standing behind the agreement and has emphasized the need to diversify India’s sources for military equipment in order to obtain the best technology. The Prime Minister assured critics that the agreement does not provide for unilateral inspections of Indian military installations; rather, any verification inspections must be requested and conducted on a date and in a location that is mutually acceptable.

Assistant Secretary of State for South and Central Asian Affairs, Robert Blake, noted that “India already holds more military exercises with the United States than with any other country,” and “the EUM agreement should help facilitate the Indian Government’s increasing shift toward U.S. defense equipment.”

EXPANSIVE INDIAN DEFENSE BUDGET IS OPPORTUNITY FOR INCREASED U.S. DEFENSE SALES

U.S. defense exports to India have exceeded \$3.1 billion since 2008, but there is substantial room to grow. India’s defense budget is expected to be robust over the next few years as India seeks to modernize its aging, Soviet era military equipment and technology. India’s defense budget is approximately \$30 billion for the year ending March 31, which represents a 25 percent increase over last year and 70 percent increase from five years ago. Moreover, as part of its modernization program, India estimates that it will spend roughly \$100 billion on defense over ten years.

India already has several major defense procurements in the works from U.S. defense suppliers. On January 22, the Department of Defense notified Congress of a possible Foreign Military Sale to India of 145 U.S.-made Howitzers worth approximately \$647 million. Earlier in January, India submitted a letter of intent to purchase 10 cargo transport aircraft from Boeing.

U.S. companies Lockheed Martin and Boeing also are positioned to benefit from the EUM agreement. The aerospace companies are bidding to supply India’s Medium-Multi-Role Combat Aircraft, a deal worth more than \$10 billion. The contract would include 126 fighter aircraft and ongoing training and maintenance for the Indian Air Force. Other contenders for the contract include French, Russian and Swedish companies and a European consortium.

Defense acquisitions expected by India in the near future include a broad array of military equipment and technology, such as warships, fighter jets, tanks and other weapons.

With the increasing defense trade with India signaled by India’s modernization program and the finalization of the EUM agreement, U.S. defense companies should position themselves to take

advantage of new opportunities for sales to India. It will be important to develop an understanding of the requirements for negotiating military sales in India, and to monitor India's expansive military modernization program to identify opportunities for sales. As always, U.S. defense companies seeking to make sales abroad should also implement and maintain healthy export controls and Foreign Corrupt Practices Act ("FCPA") compliance programs.

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Covington & Burling LLP has extensive experience with U.S. Foreign Trade Controls, FCPA, government contracting and trade policy issues. We would be happy to assist our clients as they seek to navigate the intricacies of defense trade with India and other countries.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our International Trade, FCPA and Government Contracts practice groups:

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