

New Opportunities For US Defense Contractors In India



Jade Totman

Meena Sharman

Law360, New York (November 05, 2014, 10:25 AM ET) -- The prospects of increased U.S.-India defense trade were recently affirmed with the Indian prime minister's September 2014 visit to the United States. A U.S.-India joint statement, released after Prime Minister Narendra Modi's Sept. 30 meeting with President Obama, highlights a shared intention to expand defense cooperation and build an "enduring partnership," including through defense technology transfers, trade, co-production, and co-development.

In addition, the U.S.-India joint statement makes clear that the two countries desire more ambitious defense cooperation programs, including faster progress on selecting "unique projects and technologies which would have a transformative impact on bilateral defense relations and enhance India's defense industry and military capabilities." This bilateral commitment to increasing cooperation in defense and security can be expected to open more business opportunities and options to U.S. defense contractors.

Options for U.S. Defense Contractors

Although significant business opportunities already exist from U.S.-India defense and security cooperation, there is room for more. Over the past decade, the United States has sold approximately \$10 billion in defense articles to India; still, these sales have mostly occurred through the U.S. government's foreign military sales ("FMS") program, which involves direct sales by the U.S. government to the government of India. But, as the U.S.-India joint statement portends, this may soon change.

A U.S.-India security partnership that expands and endures means more than a greater number of FMS transactions. It also means that U.S. defense contractors and the Indian defense industry can and should explore other types of business transactions and arrangements, in at least three possible ways.

Direct Commercial Sales Transactions

First, direct commercial sales (“DCS”) could emerge as a viable and popular alternative to FMS. As a general rule, DCS transactions, like FMS, involve the transfer of U.S. defense articles and services to our international partners, but they do not directly involve the U.S. government. U.S. defense contractors act as the sellers, so they directly negotiate and execute DCS transactions with international partners. Of course, these transactions still are subject to U.S. government regulations and approval, and they may require congressional notification if the proposed sale meets or exceeds certain dollar thresholds. But even so, certain restrictions that apply to the U.S. government (and therefore to FMS) do not apply to DCS, often leaving the parties freer to negotiate different contract terms.

“Offset” requirements set by the Indian government might also lead to more DCS transactions. Offsets are quid pro quo arrangements whereby a U.S. contractor, as a condition of sale with a foreign purchaser, agrees to invest in the foreign purchaser or in a separate foreign entity. In that way, offsets can solidify partnerships between U.S. and Indian contractors, reinforcing U.S.-India security ties and strengthening India’s defense industry. But with FMS, although offsets are possible, they are complicated by a U.S. policy that bars the U.S. government from encouraging, committing to, or entering into offsets. Offsets can only occur in FMS transactions if they are part of a separately negotiated contract with a U.S. defense contractor — an important consideration in India, given a 30 percent offset obligation for deals of 300 crore rupees (around \$50 million) or more. DCS transactions can simplify the process by allowing the same parties to package their sales and offsets in the same transaction.

Hybrid FMS/DCS Transactions

Another alternative to FMS transactions is a combination of FMS and DCS arrangements — a “hybrid.” These frequently occur when the U.S. government has designated a defense article or service as “FMS only,” a designation used by the U.S. government to restrict sales of highly sensitive defense articles and technologies. The process for designating such items can be found in Section C4.5.9 of the U.S. government’s Security Assistance Management Manual.

Hybrid transactions can occur in a number of ways. For example, an “FMS only” item could be packaged with a defense article or service that has not been designated as “FMS only” (for example, training or follow-on sustainment support) thus allowing an FMS transaction and a DCS transaction to occur. Alternatively, “FMS only” sustainment support for an item sold through DCS can be carved out and purchased through an FMS deal. Of course, even in a hybrid case, any offset commitments must still be made by the U.S. defense contractor, not the U.S. government.

Focus on Co-Production and Co-Development

Finally, in addition to increased U.S. defense sales to Indian buyers, the United States and India are interested in increasing co-production and co-development projects. In fact, co-production and co-development are at the core of the Defense Trade and Technology Initiative (“DTTI”), which was launched by the United States and India in 2012 as a framework for advancing defense cooperation. The DTTI tasks each country with pushing beyond the status quo in key areas, including co-production and co-development. This includes working towards building an indigenous Indian industrial base by prescreening projects for co-production and, eventually, co-development.

The recent U.S.-India joint statement reaffirms the tenets of the DTTI, pronouncing that the United States and India intend to “build an enduring partnership in which both sides treat each other at the same level as their closest partners, including defense technology transfers, trade, research, co-production, and co-development.” And with the two countries serious about moving forward with co-production and co-development projects, the expectation here is that U.S. defense contractors will benefit — finding, perhaps, clearer paths to partner with Indian firms to, among other things, jointly produce defense articles, deliver technology and assistance, and share research and development costs.

Final Thoughts

We encourage U.S. defense contractors and the Indian industry to be optimistic and enthusiastic about the business opportunities and options that can emerge from stronger and deeper ties between the United States and India. That said, there will be challenges that come with these opportunities and options. The laws, regulations, guidelines and processes for DCS, hybrid transactions, and co-production and co-development are not all the same as they are for FMS transactions. There are complex and, in some cases, evolving laws and regulations in the United States and India.

Compliance challenges for U.S. defense contractors and their counterparts will vary depending on the nature of the transaction. In the end, the effective and successful business parties will be those with the preparedness, ability, and counsel to seize these opportunities and to deal with these challenges.

—By Jade C. Totman and Meena R. Sharma, Covington & Burling LLP

Jade Totman is an associate in Covington's government contracts practice in the Washington, D.C., office and a former active duty Army officer. Meena Sharma is an associate in the firm's international trade and CFIUS/national security practice groups in Washington.

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