Published on *The National Law Review* https://natlawreview.com

Fourth Circuit Further Defines Scope of Contractor Risks in the FMS Sales Context

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The Court of Appeals for the Fourth Circuit recently published a decision that expanded on its prior *Trimble* ruling that a foreign government customer cannot sue a U.S. contractor in the Foreign Military Sales ("FMS") context (at least in U.S. courts). In *BAE Sys. Tech. Solution & Servs., Inc. v. Republic of Korea's Def. Acq. Program Admin.*, 884 F.3d 463 (4th Cir. 2018), the Korean government claimed that BAE Systems Technology Solutions & Services, Inc. ("BAE") breached a side agreement that BAE executed with Korea (the "BAE-Korea Agreement"). The BAE-Korea Agreement, which was separate from the FMS agreement between the U.S. and Korea (the "U.S.-Korea Agreement"), required BAE to use its best efforts to negotiate favorable pricing terms in the FMS transaction between the U.S. Government and Korea, and permitted the courts in Korea to hear disputes arising under the agreement.

BAE secured a favorable declaratory judgment from a U.S. district court to the effect that it had complied with the best efforts undertaking, and the Fourth Circuit affirmed on the broader ground that enforcing the BAE-Korea agreement would be contrary to the policy of the Arms Export Control Act ("AECA") and the principles laid down by the Fourth Circuit in the 2007 *Trimble* decision, which held that foreign customers in an FMS transaction cannot sue U.S. contractors under a third-party beneficiary theory. However, both courts declined to enjoin Korea's lawsuit in the Korean courts.

The Fourth Circuit's decision suggests some guidance for U.S. contractors about entering into similar FMS side agreements in light of both U.S. and foreign litigation risks.

A. The Arms Export Control Act and Foreign Transaction Structures

The AECA allows foreign governments to purchase national security goods and services from U.S. Government contractors. The program requires U.S. Government oversight of these sales, but frequently allows the foreign government to choose between two types of transaction structures — Direct Commercial Sales ("DCS") transactions and FMS transactions.

Each structure has its advantages. Under the DCS structure, subject to the U.S. Government's oversight, the foreign government negotiates directly with the U.S. contractor the specific contract terms, such as pricing and the provision of post-sale support services.

Under the FMS structure, the U.S. Government retains a role as an indispensable middleman, and the foreign government never has privity of contract with the U.S. contractors. The foreign government enters into a Letter of Offer and Acceptance with the U.S. Government relating to the procurement of the desired goods or services. The U.S. Government, in turn, will typically compete and award a contract to procure the desired items from the U.S. contractor, through a process that closely resembles a standard U.S. Government acquisition. Then the U.S. Government furnishes the items to the foreign customer pursuant to the Letter of Offer and Acceptance. In an FMS transaction, the U.S. Government has final say over the terms of the procurement, including price. In some cases, U.S. Government's control over the acquisition process can be to the benefit of the foreign government, such as where the U.S. Government appropriately leverages its ability to combine multiple orders for items, resulting in lower per-unit pricing for foreign end-customers.

Occasionally, the foreign government customer has no choice between the DCS and FMS route — it is required to enter into an FMS transaction. This can occur when heightened national security interests surround the product or service, and the U.S. Government finds it necessary to use the FMS structure to ensure greater oversight of the transaction. This happened to be the case in the *BAE* litigation — i.e., the U.S. Government required Korea to purchase certain F-16 aircraft upgrades from the U.S. Government under an FMS transaction, and forbade Korea from buying directly from U.S. Government contractors under a DCS transaction.

B. BAE's Agreement with Korea and the Dispute Between the Parties

In August 2012, BAE and Korea entered into the BAE-Korea Agreement, which dealt with how the parties would approach their respective FMS negotiations with the United States. The BAE-Korea Agreement listed desired contract terms and pricing that the parties would seek to incorporate into the separate U.S.-Korea Agreement. The BAE-Korea Agreement specified in part that BAE would use its "best efforts" to achieve these terms and have them passed on to Korea under the U.S.-Korea Agreement. The BAE-Korea Agreement also provided that, if BAE did not use such best efforts, BAE would owe $43.25 million to Korea, and that disputes under the agreement could be heard in the Korean courts.

For reasons apparently attributable to the U.S. Government's "historical experience with previous F-16 upgrade programs," the U.S. Government was unable to offer the same pricing under the U.S.-Korea Agreement that BAE and Korea had listed as the desired or goal pricing in the BAE-Korea Agreement. When Korea claimed that BAE did not use best efforts to secure favorable pricing, BAE sought a declaratory judgment from the U.S. District Court for the District of Maryland stating that it had complied with its best efforts undertaking. In a parallel proceeding, Korea brought suit against BAE in a Korean court, seeking the $43.25 million based on its contention that BAE had not used its best efforts.

The district court issued a declaratory judgment in BAE's favor. However, the district court declined to enjoin Korea's lawsuit against BAE in the Korean courts, finding that the MOA allowed such a lawsuit. The parties cross-appealed the district court's ruling, and the Fourth Circuit weighed in.

C. The Fourth Circuit's Consideration of the Facts

The Fourth Circuit first addressed the issue of whether BAE could seek declaratory judgment regarding the "best efforts" obligation imposed by the BAE-Korea Agreement in a U.S. court. The Fourth Circuit first considered the terms of the forum selection clause in the agreement. The clause specified, in relevant part, that disputes between the parties "shall be resolved through litigation and the Seoul Central Court shall hold jurisdiction." The court found that the use of the word "shall" was not dispositive, and viewed the clause as permissive rather than giving the Korean courts exclusive jurisdiction. Additionally, Korea never attempted to claim that litigation in the U.S. district court raised *forum non conveniens* issues. For these reasons, the Fourth Circuit affirmed the district court's finding that the forum selection clause in the agreement provided "no basis for dismissing the action" in the United States.[1]

The court next considered whether Korea should be immune from domestic suit under the Foreign Sovereign Immunities Act ("FSIA") and found it significant that Korea had not asserted a sovereign immunity defense in over a year of litigation, and even filed a motion to dismiss and a responsive pleading without raising the argument. The court took this to be an implicit waiver of any possible immunity defense.

Having determined its jurisdiction over questions arising under the BAE-Korea Agreement, the Fourth Circuit then considered the merits of the district court's declaratory judgment to BAE. Importantly for FMS contractors, the court stated that "[t]he principal issue for declaratory judgment purposes, however, is not whether BAE failed to use its best efforts to advocate for a certain price, but rather whether Korea can enforce its agreement with BAE (including this 'best effort' obligation) in light of U.S. national security interests." In reaching its conclusions, the court considered the principles of *U.K. Sec'y of State For Defence v. Trimble Navigation Ltd.*, 484 F.3d 700, 704 (4th Cir. 2007), which it characterized as a ruling that "teaches that a foreign state cannot sue a U.S. contractor if doing so would undermine the FMS structure and afford the foreign state advantages only available in a direct purchase DCS transaction between a foreign state and a U.S. contractor."[2]

Applying the *Trimble* framework, the Fourth Circuit first affirmed the district court's ruling that the BAE-Korea Agreement and the U.S.-Korea Agreement were "inextricably intertwined." The Fourth Circuit reached this conclusion because BAE would be subjected to "punishment" if it did not secure favorable terms in the U.S.-Korea Agreement, and because the BAE-Korea Agreement would terminate once the U.S. and Korea reached final agreement on terms.

The Fourth Circuit next considered how the litigation related to domestic policy considerations. It found that because the agreements were intertwined, allowing Korea to enforce the BAE-Korea Agreement would both undermine the *Trimble* ruling and the control, conveyed by statute, that the United States retains over pricing and contractor negotiations in FMS transactions.

The Fourth Circuit reached these conclusions despite claims in an amicus brief filed by the U.S. Government that "Korea was not seeking to reorder the FMS structure." It stated that it found the U.S. Government's contention to be "overly simplistic," and reasoned that permitting Korea to enforce the BAE-Korea Agreement would create an "unworkable approach" that would suggest "that courts must consider the distinct national security implications of each and every contract that . . . relates to (but is technically separate from) an FMS transaction."

Finally, the Fourth Circuit affirmed the district court's refusal to bar Korea from pursuing suit against BAE in a Korean court. The court reasoned that in this instance international "comity concerns are near their peak." The court further reasoned that "an anti-suit injunction here would impinge on the sovereignty of the Korean courts (to hear the case) and the Korean government (to litigate it). And it

would do so on a permanent basis. . . .” The court left unresolved how the court’s declaratory rulings — to the effect that the damages provision of the BAE-Korea Agreement should not be enforced as a matter of U.S. law and policy — would be applied by the Korean courts, although it implied that a reciprocal exercise of comity by the Korean courts should result in dismissal of the action. Indeed, the court quoted the district court’s conclusion that if Korea “proceed[ed] with its claims against BAE in its own courts, BAE may defend against the claims by asserting any claim or issue preclusion that this judgment may afford it under Korean law.”

While it declined to issue an anti-suit injunction, the Fourth Circuit did leave open a possibility that a domestic court may later consider the impact of an adverse Korean court ruling on national security interests, if such a ruling were issued. The Fourth Circuit’s ruling was heavily influenced by the fact that Korean courts had not yet been afforded the opportunity to even consider these issues at the time of the appeal, and the court made its view clear that “enforcement of the BAE-Korea agreement runs counter to U.S. national security concerns, and. . . enforcement by a Korean court may threaten those same concerns.”

D. Takeaways

Although the Fourth Circuit’s findings are generally favorable to Government contractors engaging in FMS transactions, there are important lessons that contractors should take away from the dispute.

1. **Carefully Consider the Wording of Forum Selection Clauses.** When entering into agreements with foreign governments, contractors should be cautious about the wording of any forum selection clause. Depending on the context, contractors should consider whether the language regarding suit in the customer country’s courts could be construed as permissive as opposed to mandatory and exclusive, to avoid a possible bar on the ability to bring suit domestically. Contractors should also consider whether it might be preferable to provide for arbitration in an international tribunal rather than litigating in U.S. or customer-country courts.
2. **Seek a Waiver of FSIA Immunity Where Possible.** Here, Korea’s implicit waiver of FSIA immunity appeared to be inadvertent — other contractors may not be so fortunate. To the extent possible during negotiations, to successfully preserve the ability to pursue actions in U.S. courts, contractors should consider at least proposing some language to the foreign counter-party that might constitute an express or implied waiver of FSIA immunity by the customer country.
3. **Do Not Dismiss the Risk of Litigation.** Although the Fourth Circuit expressed a clear distaste for an analytical framework that would require courts to review the national security implications of every side agreement that relates to an FMS transaction, it did not provide significant guidance on how closely “intertwined” these agreements must be to an FMS transaction to warrant contractor immunity on national security grounds. The decision also leaves some uncertainty about the continuation of litigation about the BAE-Korea Agreement in the Korean courts, where the degree of deference to the U.S. court’s views will presumably have to be litigated before a domestic court might consider whether it will weigh in again. Thus, although a U.S. contractor’s willingness to enter into such side agreements may be key to a foreign government’s willingness to enter into an FMS arrangement where that contractor is the preferred provider, the litigation risks presented by such agreements should be carefully weighed.

[1] Although the Fourth Circuit only stated that if the clause were mandatory, “BAE bears the burden of proving why it should not be enforced,” the district court opined that “even if the clause were mandatory, this would be the ‘exceptional case’ in which I should not exercise my discretion to

dismiss this case based on the forum-selection clause under *forum non conveniens*." Thus, it is possible that BAE might have prevailed on this point either way.

[2] Alan Pemberton and Jennifer Plitsch served as counsel for Trimble Inc. in this appeal.

National Law Review, Volume VIII, Number 116