Chapter 1

Introduction

Ivan W. Bilaniuk and Nathaniel E. Castellano

I. International Procurement

Declines in US federal spending force US government contractors to compete for fewer domestic opportunities and provide an additional incentive to look abroad. US contractor interest in international procurement remains high, in part, because of the recent period of decline in US federal spending. Growing foreign procurement markets offer significant potential opportunities but also increased risks that US contractors are well advised to identify and manage.

The trend of increased opportunities in foreign procurement markets seems likely to continue for some time, driven in part by the momentum of geopolitical developments such as: a) the continued threat of the Islamic State of Iraq and Syria (ISIS) in the Middle East and the activities of other terrorist organizations; b) Russia’s disturbing of the post-WWII European security order with its invasion of Ukraine and attempted annexation of Crimea; c) Russia’s use of hybrid warfare strategies in Ukraine and the West; d) continued instability in the Middle East; e) uncertainty as to the stability of the European Union (EU); f) territorial disputes and shifting alliances in the South China Sea; and g) tensions on the Korean peninsula.

The US policy in recent years of avoiding deployment of traditional military force abroad is likely to encourage other countries to invest more in their own national security. These national security threats will fuel global demand for defense products and services as well as a wide range of information technology (IT) products, services, and physical infrastructure with national security implications.
Opportunities in foreign procurement markets extend beyond the traditional defense sector. Civilian agencies look to the private sector for a wide range of goods and services to fulfill their mandates. Furthermore, foreign governments increasingly seek to computerize operations and provide e-government capabilities. Countries with relatively underdeveloped commercial markets may be particularly interested in doing business with US contractors.

International government contractors also have an opportunity to provide basic infrastructure, utilities, and humanitarian support, particularly in developing countries. Development banks, most notably the World Bank, and institutions like the US Agency for International Development (USAID) finance such projects around the world. Recent reforms in the World Bank’s procurement guidelines prioritize building the capacity of borrower countries to engage in and administer procurements on their own. Such reforms may result in more government customers and increase international procurement opportunities. In addition, the nascent Asian Infrastructure and Investment Bank (AIIB) holds the promise of increasing the number of development bank-funded procurement opportunities available.

Another relevant global trend is the proliferation of free trade agreements that are opening up government procurement markets to US suppliers, but also creating more competition in the US government procurement market. Most prominent among these free trade agreements is the World Trade Organization (WTO) Agreement on Government Procurement (GPA), under which members accede to open certain procurements to competitors from other member countries. Recent US policy has hindered this trend. Before the Transatlantic Trade and Investment Partnership (T-TIP) talks stalled, the United States and the European Union (EU) had been negotiating which procurements they would open to each other’s contractors. Similarly, before the United States withdrew from the Trans-Pacific Partnership (TPP) Agreement, the TPP
held promise to open certain procurement markets to competition in the United States and twelve Pacific Rim countries.

In evaluating whether to pursue opportunities abroad, companies must balance the significant potential for reward in foreign procurement markets with the inherent risks. This book aims to provide a practical tool for companies considering such international opportunities by identifying the potential unique risks associated with international procurements and ways to mitigate and manage these risks.

II. Sources of Risk

Contracting with the US government is a complex, idiosyncratic, and sometimes counterintuitive process. Government contractors incur significant overhead costs in maintaining staff to manage contracts and remain in compliance with the Federal Acquisition Regulations (FAR) and its agency-specific supplements, federal labor and safety laws, specific accounting standards for federal contractors, and other regulatory requirements. Contracting with foreign governments introduces new dimensions of complexity.

Contracting with foreign governments most likely means working in foreign countries on contracts that may be governed by foreign law. There is an increased risk of misunderstandings about legal rights and obligations. The contractor may be subject to local regulatory requirements, and there will likely be transaction costs that arise from differences in culture and business practices. Furthermore, political instability may lead to flux with the government customer.

A. Doing Business in a Foreign Country

International procurement, like any business in another country, involves transaction costs associated with different cultural, business, and political norms. US contractors need to be
prepared to invest considerable time and resources into developing relationships with the customer and other market participants, and they must be vigilant in complying with the Foreign Corrupt Practices Act (FCPA) and Anti-Kickback Act when doing so.

US contractors typically will need to find a local partner or partners to compete effectively for business in foreign procurement markets. Foreign government customers may expect or even require US contractors to team with or subcontract to local firms. These requirements may be memorialized as legal obligations in the form of offsets or may be communicated informally. Such governments use procurements to serve their policy goals of developing domestic industry.

US contractors’ search for and negotiations with a qualified local partner may be complicated if the market is small. During negotiations over a representative agreement, teaming agreement, subcontract, or joint venture, local partners may drive a hard bargain in negotiations over knowledge transfer, training, rights in intellectual property, compensation, and so on. US contractors must remain vigilant in their anti-corruption compliance.

Political instability can further complicate doing business in a foreign country. A change in regime or government can endanger a contract if it becomes a politicized issue, or it can alter a government customer’s contracting priorities.

B. Foreign Law

US procurement law usually will not govern contracts with foreign governments, with the primary exception of contracts awarded pursuant to the U.S. Foreign Military Sales program. Foreign procurement laws may not be as developed as US procurement law, creating general uncertainty as to legal rights and obligations. Furthermore, with foreign procurements, the contractor is often left with significantly higher cost and performance risk compared to US
procurements because foreign systems tend not to have as wide a spectrum of available contract vehicles (e.g., single award contracts, multiple award contracts, variable and indefinite delivery/indefinite quantity contracts, blanket purchasing agreements, etc.) and pricing structures (e.g., fixed price, cost reimbursement, time and materials, etc.) through which the contractor may share or avoid these risks. Another common difference between US and foreign procurement law is that the FAR and its agency supplements provide government contracting-specific clauses and rules that govern contract performance, whereas in many countries, contract performance is governed by the same contract law that applies to contracts between private parties.

US contractors may encounter difficulties in competing for foreign procurements. Simply determining a US contractor’s eligibility to compete in a tender may be challenging. Furthermore, even if a trade agreement does provide US contractors with a clear legal right to participate in a foreign procurement, asserting the right to participate may also be difficult.

The nature of the purchasing government entity and the goods or services being procured also impacts the legal framework that governs procurement. In many countries, including the United States, defense procurement is conducted under entirely different laws and regulations than non-defense procurement. There is often additional legal complexity for procurements during contingency operations. In the international development industry, donors such as the World Bank and USAID usually flow down their own regulations and guidelines that operate in parallel with domestic requirements.

For example, a US contractor may be familiar with the United States and local laws that apply when using Foreign Military Financing (FMF) to sell defense supplies and services to Egypt under a direct commercial contract. If Egypt is purchasing those same goods and services to support a contingency operation, however, the contractor may have to learn and navigate a
different set of local laws and regulations than those that usually apply. Alternatively, if the same contractor were to seek an Egyptian construction contract that is partially funded by a World Bank loan, the contractor would also need to understand and comply with the World Bank’s procurement rules.

In addition to the significant compliance obligations of doing business in the United States, international government contracting requires compliance with the Foreign Corrupt Practices Act (FCPA); US export controls; as well as trade sanctions on foreign countries, entities, and nationals. US contractors will also have the burdens of operating in a foreign country and needing to comply with local laws that may conflict with US laws, such as local laws requiring the boycott of Israel that conflict with US anti-boycott laws. US anti-trafficking laws may prohibit employment practices that are common or even encouraged among local partners. US labor laws and the foreign government customer’s labor laws likewise may impose conflicting requirements that are difficult or even impossible to comply with simultaneously.

III. Risk Mitigation

Companies can mitigate risk in several ways. While many of mitigation practices are not unique to international procurement, the heightened risks in this environment increase the importance of implementing these practices when contracting with a foreign customer.

Working with a trusted local partner is one of the most significant ways a contractor can mitigate the risks of working in a foreign country with a different cultural, business, and political environment. Such a local partner should be intimately familiar with the local business and political environments and assist the contractor to forge relationships with the government.

Finding a local partner who can be trusted may take significant effort. Meaningful due diligence of the partner’s capabilities, references, and other bona fides pursuant to the company’s
anti-corruption compliance policies and procedures is essential. Companies should utilize US
government resources where possible, such as the US Commercial Service and the US Embassy.
The local partner must have its own anti-corruption compliance policy and relevant personnel
should receive the contractor's anti-corruption training. Contractors must be vigilant in
monitoring compliance.

Contractors may find limited, if any, ability to negotiate standard contractual terms and
conditions. Like the US government, foreign government customers will often insist on their
own standard terms and conditions. Contractors need to assess the risks of pursuing the
opportunity with the offered terms and conditions. If negotiation is possible, contractors should
prioritize certain provisions such as dispute resolution. For example, US contractors generally
should not rely on resolving disputes with the foreign government in the sovereign’s courts, as
they may be subject to “hometown justice.” At a minimum, companies should insist on a neutral
and balanced dispute resolution clause that provides for international arbitration outside the
sovereign’s territory. Companies should also be aware of investment protections that may exist
under various bilateral investment treaties and permit them to pursue relief through investor-state
arbitration.

Once performance begins, effective contract management is key for managing disputes
and avoiding international arbitration. Commonly, foreign government customers seek
deviations that increase the scope of work. Contractors must devote sufficient resources to
contract management to adequately address such requests, and appropriately negotiate contract
modifications that involve increased compensation, descoping, or other requirements as
appropriate.
IV. Conclusion

Given the current geopolitical environment, contractors may be attracted by opportunities to contract with foreign governments. Doing business in a foreign country, under foreign law, and with a foreign sovereign creates significant challenges for even the most sophisticated contractors. In contemplating whether to pursue international public procurements, contractors should understand and manage the risks in doing so. This book aims to provide the reader a practical guide to assessing, mitigating, and managing these risks.