Pushing Allied Integration - Governments Can Ease Path for NATO Contractors

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Senior U.S. Defense Department officials recently have promoted the view that the United States and its NATO allies should pull down the barriers to international integration of military contractors. The effort is fueled by the increasingly integrated nature of NATO interventions, and the belief that there will be cost efficiencies from contractor integration. These views, in speeches by Jacques Gansler, U.S. undersecretary of defense, last November, and U.S. Defense Secretary William Cohen at the NATO conference in March, included proposals to establish a government-industry committee to investigate easing regulations that constrain integration and issuing guidelines for government approvals.

So far, no committee has been formed and no guidelines have been issued. Part of the delay may stem from the tension between preventing the unauthorized distribution of controlled information while allowing more foreign parties to participate in projects that require having that information.

There is inherent tension in allowing the integration of foreign and domestic contractors while keeping information safe. But, the Defense Department and related agencies can help smooth the way for business integration, and create an environment that generates active experimentation on information and product integration.

American defense companies are often sought out by foreign contractors because they best know the defense business, and have the channels and customers to sell the ultimate products and services. Therefore, there can be significant opportunities even if there is no initial assurance of access to classified or controlled information.

These acquisitions would allow, initially, the integration of nonclassified parts of the business. Then as companies start moving into how information could be exchanged, business and

government will come up with the practical borders. Rules for e-mails, visits, computer access and telephone calls among different groups within the parent and the subsidiary all could be developed in a real context.

DoD then could substantially advance the cause of integration without resolving ultimate information access questions by allowing foreign companies to participate in running those businesses, while keeping independent committees of directors who assure the foreign parent does not have access to controlled information.

Currently, the Defense Department allows foreign acquisition of U.S. companies that do classified work through variations of two models:

- A proxy agreement or a Special Security Agreement. Under the proxy agreement, the acquirer appoints a wholly independent proxy board to govern the company. The parent company is entitled only to the barest rights in its investment: approving buying or selling major assets or declaring bankruptcy.
- Other ties between the owner and the subsidiary, such as the use of the owner's administrative services, must be spelled out in explicit documents subject to Defense Security Service review and acceptance. In essence, the proxy agreement makes the owner closer to a passive investor than to an operating manager.

This model severely limits business integration and does next to nothing to allow information integration for the development of new products.

The other method, the Special Security Agreement, still requires outside directors whose primary function is to assure the confidence of classified or other controlled information. However, the owning company can appoint inside directors who are also officers of the parent company and officer-directors.

Of course, foreign persons (as well as Americans) who do not hold clearances cannot have access to classified or controlled information, or influence participation in classified contracts. But the parent can participate actively in running the business.

When foreign owners are allowed to substantially control their investment, there will be more transnational acquisitions allowing experiments in information integration.

I am unaware of substantial problems in the use of Special Security Agreements. Indeed, the Defense Department has become substantially more liberal in approving them in the last 10 years.

However, the government imposes a huge obstacle on the use of these agreements. It requires a National Interest Determination (NID) that there is a need for a company under an Special Security Agreement to be able to compete for classified contracts before a request for a

proposal is issued to it.

This is a contract-by-contract or specific product requirement. Most agencies take a long time, often several months, to make an NID, and agencies tend to be sparing with it. The administrative burden, delay, and uncertainty does not provide an attractive alternative to the proxy agreement and can dissuade acquirers from buying an American company.

But this cumbersome NID requirement is unnecessary. It is hard to think of a safer way of testing new defense company alliances than one that has independent American board members overseeing the confidentiality of classified information. Simple measures, such as allowing Special Security Agreement-like agreements without contract-by-contract NIDs, would accelerate corporate integration and experiments on information integration.

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