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Contributing Attorney Authors

Kevin Cosgrove
Norfolk
757.640.5342
kcosgrove@hunton.com

Patricia Epps
Richmond
804.788.8249
pepps@hunton.com

Ryan Glasgow
Richmond
804.788.8791
rglasgow@hunton.com

Christy Kiely
Richmond
804.788.8677
ckiely@hunton.com

Patrick McDermott
McLean
703.714.7422
pmcdermott@hunton.com

Glen Sturtevant
Richmond
804.788.8260
gsturtevant@hunton.com

Syed Ahmad
McLean
703.714.7676
sahmad@hunton.com

In This Issue

Case Spotlight

Pitfalls Of Doing Business With Foreign Sovereigns:

Wye Oak Technology, Inc. v. Republic Of Iraq

By Kevin J. Cosgrove

On December 29, 2011, the U.S. Court of Appeals for the Fourth Circuit released its decision in *Wye Oak Technology, Inc. v. Republic of Iraq*, 2011 WL 6825271 (4th Cir. 2011). *Wye Oak* is the latest — but by no means the only — case in which a foreign government attempted to evade its commercial obligations by invoking the Foreign Sovereign Immunities Act, 28 U.S.C. Sections 1602-11 ("FSIA"). This article will report on the *Wye Oak* case and thereafter will discuss how a private company can protect against the possible pitfalls of doing business with foreign governments.

In 2004, Wye Oak and the Iraqi Ministry of Defense ("IMOD") entered into a contract for the refurbishment and disposal of Iraqi military equipment. The contract identified Wye Oak as IMOD's broker for inventorying military equipment, determining which equipment could be salvaged and selling the remainder for scrap. Wye Oak claimed that it performed as required under the contract but received no payment. Therefore in July 2009, Wye Oak sued the Republic of Iraq, but not IMOD, in the United States District Court for the Eastern District of Virginia for breach of contract. Iraq responded with a motion to dismiss pursuant to Fed. R. Civ. P. 12(b)(1). The basis for Iraq's motion was its claim that because it was a sovereign nation it was immune from suit pursuant to the FSIA.

Iraq argued that it was not a party to the contract between Wye Oak and IMOD. It asserted that IMOD "was and continues to be a separate and independent legal person from … the Republic of Iraq … with separate legal identity, including … liability under any contracts entered into by [IMOD]." *Wye Oak* at *4. The district court denied Iraq's motion and ruled that under the FSIA, Iraq and IMOD "are treated one and the same." The district court also found that this case fell within the commercial activities exception to the FSIA, but did transfer the case to the United States District Court for the District of Columbia. An appeal was taken to the Fourth Circuit Court of Appeals.

The FSIA provides that "a foreign state shall be immune from the jurisdiction of the courts of the United States and of the states except as provided in sections 1605 to 1607 of this chapter." 28 U.S.C. § 1604. The main exception to FSIA immunity is the "commercial activities" exception found in 28 U.S.C. § 1605. Therefore, there were two separate questions before the court of appeals. First, are Iraq and IMOD legally separate persons under FSIA jurisprudence? If so, Iraq's motion to dismiss would be sustained, because it was not a party to the original

contract and, therefore, could not be liable for IMOD's breach. Second, were the activities that were performed pursuant to the contract sufficient to bring the contract within the commercial activities exception, which would result in Iraq being subject to personal jurisdiction?

The Fourth Circuit answered the first question by holding that Iraq and IMOD are *not* legally separate entities under the FSIA. The FSIA applies not only to a foreign state, but also to that state's components. The component at issue here was Iraq's armed forces under the umbrella of IMOD. "Armed forces are as a rule so closely bound up with the structure of the state that they must in all cases be considered as the 'foreign state' itself, rather than a separate 'agency or instrumentality' of the state." *Wye Oak* at *8. As a result, Iraq was a proper defendant in this lawsuit.

Turning to the second question, the Fourth Circuit ruled that "Wye Oak has presented sufficient facts to support a reasonable inference that Iraq, through IMOD, engaged — pursuant to the contract — in the preparation for sale and sale of scrap metal in Iraq — a commercial activity." *Wye Oak* at *8. This holding relied in part on the Supreme Court's holding that "a foreign state engages in commercial activity where it acts 'in the manner of a private player' within a market." *Saudi Arabia v. Nelson*, 507 U.S. 349, 360 (1993) (quoting *Republic of Argentina v. Weltover, Inc.*, 504 U.S. 607, 614 (1992)). The Fourth Circuit found that Wye Oak had performed sufficient work in the United States for the commercial benefit of Iraq so as to fall within the FSIA's commercial activities exception. As a result, the judgment of the district court was affirmed and Wye Oak's lawsuit was permitted to proceed.

When Wye Oak entered into its contract with IMOD, it probably did not anticipate the legal nightmare that has ensued. Eighteen months after having filed its lawsuit — and presumably after paying significant legal bills — Wye Oak has not yet even begun discovery on the merits of its claim. Even assuming that it is successful in obtaining a judgment, enforcing it could be problematic. Companies that are considering doing business with foreign governments need to understand the unique risks that accompany such transactions. Here are a few of those risks, along with some suggestions for mitigating them.

I. Foreign Sovereigns are More Than Just Governments

28 U.S.C. § 1603 defines a "foreign state" as including both political subdivisions of the foreign state and "agencies or instrumentalities of a foreign state." In order to be deemed an agency or instrumentality of a foreign state, the entity must be a separate legal person, corporate or otherwise; it must either be an organ of the foreign state or the foreign state must be the majority owner; and it cannot be a United States' citizen or created under the laws of any third country. 28 U.S.C. § 1603(b). Many large companies, such as airlines, energy companies, banks and shipping lines, are owned by foreign governments. Therefore those companies fall within the definition of "agency or instrumentality" set forth above. The first question to be determined, therefore, is the ownership structure of the entity with which you are contemplating doing business. You might be dealing with a foreign state and not even know it.

II. Can You Defeat the Foreign State's Immunity From Lawsuits in the United States Pursuant to the FSIA?

The default position of the FSIA is that foreign states are immune from lawsuits in United States' courts. 28 U.S.C. § 1604. To overcome that position, a plaintiff must be able to demonstrate that its case falls within the exceptions provided in 28 U.S.C. §§ 1605-07. The exception most commonly claimed is the "commercial activities" exception codified at § 1605(a)(2). There are three different ways in which actions by foreign states can be deemed "commercial activities." The lawsuit must be based upon:

- a commercial activity carried on in the United States by the foreign state;
- an act performed in the United States in connection with a commercial activity of the foreign state elsewhere; or
- an act performed outside the United States in connection with a commercial activity of the foreign state elsewhere and that act causes a direct effect in the United States.

The best and most effective method of obtaining the benefits of the commercial activities exceptions to the FSIA is to build that concept into the contract itself. To the extent possible, a private company should always insist that the contract with a foreign sovereign include a statement that the subject matter of the contract will be deemed a commercial activity as defined by the FSIA.

III. Remember the "Golden Rule"

It is one thing to be able to sue and obtain a judgment against a foreign sovereign. It is quite another to be able to enforce it, especially outside the United States. There is no uniform international body of law (such as a United Nations Convention) regarding the enforcement of foreign judgments.[1] The prudent private entity will negotiate appropriate security measures, such as letters of credit, that are held by reputable third parties that are subject to U.S. law.

[1] In contrast, the 1958 New York Convention requires the courts of contracting nations to recognize arbitration agreements and enforce arbitration awards made in other contracting nations. Most of the world's major nations are party to the New York Convention, but many smaller nations are not.

IV. Carefully Research and Draft the "Disputes" Clause of Your Contract

It is very important that an entity proposing to contract with a foreign sovereign research how disputes can be resolved. You, of course, will want to have all disputes resolved in United States courts and based upon the law of the United States. Some foreign sovereigns are not permitted to enter into contracts that are subject to foreign laws. Others cannot agree to submit to the jurisdiction of courts in the United States. Still others will *say* these things during negotiations in an effort to obtain a "home court" advantage. There is no substitute for doing one's homework on these issues. Entering into contracts with foreign sovereigns can result in unpleasant surprises for their contractual partners. The time to learn about these possible surprises is before one signs the contract. Afterward is far too late.

Rules

New DoD Rule Makes Contractors Responsible for Compliance with Revolving-Door Laws

By Glen H. Sturtevant

The Department of Defense (DoD) has issued a final rule requiring defense contractors bidding for contracts to represent that certain former DoD officials employed by the contractor are in compliance with post-employment restrictions, known as federal revolving-door laws. The final rule, issued on November 18, 2011, creates Defense Federal Acquisition Regulation Supplement (DFARS) 252.203-7005, which contains an affirmative representation that must now be included in all contract bids made on or after that date. *See* 76 Fed. Reg. 71,826 (Nov. 18, 2011).

The revolving-door laws at issue — primarily 18 U.S.C. § 207 (criminal restrictions on post-employment conflicts of interest), 41 U.S.C. § 2104 (restrictions on former officials' acceptance of compensation from contractors) and DFARS 203.171-3 (requiring former officials to have received or requested an ethics opinion on post-government employment restrictions) — have been in place for some time, but the new rule now puts the onus on contractors to monitor and ensure their employees' compliance. Violations of the rule can result in not just rejected invoices and cancelled contracts, but also potential False Claims Act suits, bid protests and suspension or debarment proceedings.

The New Representation — DFARS 252.203-7005

The final rule is based on a proposed rule issued by DoD in June 2011, which was developed in response to a 2008 GAO report finding that "major defense contractors are not currently ensuring that former DoD senior officials and acquisition executives working on contracts are complying with post-employment restrictions" and that greater transparency is needed to ensure compliance with post-employment restrictions.

DoD implemented the recommendations of the GAO report and included much of the proposed rule in the final rule, which now requires offerors to complete and provide a new representation as part of each contract proposal certifying that all of the offeror's employees who are former DoD officials are in compliance with the post-employment restrictions. Importantly, the new representation need only be made once at the time of the initial offer and applies only to certain former DoD officials that the contractor expects to perform work on the contract.

The representation specifically states:

> By submission of this offer, the offeror represents, to the best of its knowledge and belief, that all covered DoD officials employed by or otherwise receiving compensation from the offeror, and who are expected to undertake activities on behalf of the offeror for any resulting contract, are presently in compliance with all post-employment restrictions covered by 18 U.S.C. § 207, 41 U.S.C. §§ 2101-2107, and 5 CFR parts 2637 and 2641, including Federal Acquisition Regulation 3.104.2.

See DFARS 252.203-7005.

"Covered DoD Officials"

By its terms, the new representation applies only to "covered DoD officials" "who are expected to undertake activities on behalf of the offeror for any resulting contract." "Covered DoD officials" are those officials who left DoD service on or after January 28, 2008, and either (1) participated personally and substantially in an acquisition for more than $10 million while serving in an Executive Schedule position, in the Senior Executive Service or in a general or flag officer position; or (2) served as a program or deputy program manager, contracting officer, source selection authority, source selection evaluation board member or chief of a financial or technical evaluation team for a contract of more than $10 million. *See* DFARS 252.203-7000.

"To the Best of Its Knowledge and Belief"

The final rule further requires that the representation be made by the contractor "to the best of its knowledge and belief." The rule fails to define this phrase, stating in response to the public comments on the proposed rule only that it "is a recognized legal term of art, and one that has been used in numerous statutes over the decades." Because of the lack of clear guidance, it is unclear whether this phrase will be interpreted only to require that contractors not willfully ignore information in their possession or whether contractors will have an affirmative duty to investigate compliance before making the representation.

The DoD's responses to the public comments, however, tend to indicate that the latter interpretation will apply and that contractors will have an affirmative duty to monitor and confirm their employees' compliance. *See* 76 Fed. Reg. 71,826, at 71,826–827 ("[C]ontractors, as employers of covered officials, have an affirmative compliance responsibility regarding employees' post-Government employment restrictions."); ("Hiring contractors have a duty to interview their new hires who formerly worked for DoD and screen their work experiences for relevant particular matters."); ("Contractors should know on what particular matters covered officials worked and already ensure employees are not assigned to work on those matters because there are current requirements to maintain and track this information."); ("Contractors need to seek clarification with job applicants and employees as to whether the applicant meets the DFARS definition in order to ensure employees are in compliance with DoD post-employment restrictions.").

Applicable to All Solicitations

The DoD also made clear in the final rule that the new representation applies to all DoD solicitations, "including solicitations for task and delivery orders" as well as "commercial item acquisitions." Thus, no contractor, regardless of the size or subject matter of the contract, can avoid complying with the new representation.

The Revolving-Door Laws

Generally, the revolving-door laws covered by the new representation are designed to limit conflicts of interest that can arise when DoD officials work on matters involving contractors they may eventually work for in the private sector and when former DoD officials use their government contacts after leaving DoD.

The revolving-door laws at issue are as follows:

- 18 U.S.C. § 207 prohibits individuals from representing contractors to their former agencies on certain matters they handled for defined cooling-off periods.
- 41 U.S.C. §§ 2101–2107, specifically 41 U.S.C. § 2104, prohibits former officials from receiving compensation from contractors during a one-year cooling-off period if the official worked on contracts, held or bid on by the contractors, valued at more than $10 million.[1]
- Although not specifically referenced in the language of the new representation, one of the post-employment restrictions covered by 41 U.S.C. §§ 2101-2107 is DFARS 252.203-7000, *Requirements Relating to Compensation of Former DoD Officials*, which prohibits contractors from providing compensation to covered DoD officials within two years of leaving the DoD, without first determining that the official has received, or has asked for and not received within 30 days, a written ethics opinion from DoD regarding applicable post-employment restrictions.

Potential Consequences and Recommendations

DoD's new representation is now mandatory for all solicitations submitted by contractors on or after November 18, 2011. Given the arsenal of enforcement mechanisms DoD has at its disposal, noncompliance has the potential to result in unpaid invoices, cancelled contracts, bid protests, debarment proceedings and False Claims Act suits. Any question of whether the employee bears sole responsibility for compliance with post-employment restrictions has been answered with a resounding "No." Rather, DoD's final rule appears to place the lion's share of responsibility on the contractor for monitoring and ensuring their employees' compliance with federal revolving-door laws.

- Because of the significant consequences of noncompliance, contractors should assess whether their current compliance systems need improvement:
- Are all applicable post-government restrictions accounted for under the current compliance system?
- Are proper determinations made as to whether job applicants and employees fall within the definition of "Covered DoD Officials"?
- Are work experiences of new hires and existing employees being properly identified and monitored?
- Are employees adequately trained in the details necessary for their own compliance?
- Have required cooling-off periods been correctly calculated and monitored?
- And, perhaps most importantly, is the current compliance system defendable in a potential bid protest, False Claims Act lawsuit or debarment proceeding?

These are difficult questions to face when you are focused on running your business. We are always available to assist you in decoding these complex rules and regulations to ensure your compliance systems protect you, your employees and your company.

[1] The other post-employment restrictions referenced in the new representation are 5 CFR parts 2637 and 2641 and Federal Acquisition Regulation (FAR) 3.104.2. 5 CFR parts 2637 and 2641 implement 18 U.S.C. § 207 and FAR 3.104 implements 41 U.S.C. § 2104.

Current Events

OFCCP Proposes Increased Affirmative Action Obligations Related To Disabled Workers

By Christy E. Kiely and Ryan A. Glasgow

Office of Federal Contract Compliance Programs ("OFCCP") Director Patricia A. Shiu has repeatedly said she wants to make the OFCCP the "premier civil rights agency in the federal government." Under her direction over the last three years, the OFCCP has increased its staff by 35% and has made significant regulatory and procedural changes that will dramatically increase federal contractors' affirmative action obligations and lead to a much more aggressive OFCCP enforcement process.

Most recently, on December 9, 2011, the OFCCP published proposed revisions to its regulations for Section 503 of the Rehabilitation Act of 1973. Section 503 requires federal contractors and subcontractors to take affirmative action to employ and advance in employment qualified individuals with disabilities. The OFCCP's current Section 503 regulations are limited in scope and primarily provide suggestions for increasing the number of disabled individuals in a contractor's workforce. The proposed revised regulations go well beyond mere suggestions. They instead impose mandatory obligations that, if approved, will require contractors and subcontractors to conduct substantive analyses of their personnel decisions, to set placement goals for individuals with disabilities, and to enter into formal recruitment agreements with organizations that promote employment of disabled individuals.

The OFCCP's proposals contain dozens of changes. Some of the more critical changes are briefly discussed below.

Nationwide Placement Goal

The proposed regulations require contractors to set a 7% placement goal for disabled individuals. Contractors must then conduct a utilization analysis based on that goal to see if they are under-represented at any level of the organization. The proposed placement goal and utilization analysis are similar to those that contractors undertake for women and minorities. The key distinction, however, is that, unlike placement goals for women and minorities, the 7% placement goal for disabled individuals will be the same for all contractors and subcontractors, regardless of their geographic recruiting areas, their industries, and the type of positions at issue.

A contractor's failure to meet the 7% placement goal will not be deemed a violation of Section 503. However, the OFCCP will use such failure as an indicator of noncompliance and may conduct a more in-depth analysis of the contractor's compliance with its Section 503 obligations.

Modified Process for Extending Invitations to Self-Identify

Under current Section 503 regulations, contractors must invite applicants to self-identify as disabled to benefit under the contractor's affirmative action program. However, the invitation can only be extended after the contractor makes an offer of employment to the applicant in order to comply with the Americans With Disabilities Act ("ADA"). The ADA has been interpreted to prohibit employers from asking about an applicant's disability, except to determine whether the applicant can perform the minimum qualifications of the job.

The OFCCP's December 9 proposals seek to change the timing of the invitation and will require the contractor to invite all applicants to self-identify as disabled during the application process. This pre-offer invitation will be limited to identifying the existence of a disability and not the nature and extent of the disability. The contractor must extend a second, more thorough invitation to self-identify to any applicant who receives an offer of employment.

The OFCCP believes that eliciting disability information during the application process is not inconsistent with the ADA. However, it may make ADA failure-to-hire claims tougher to defend because the contractor will have a tougher time arguing it was not aware of the disabled status of the plaintiff-applicant.

Annual Survey of Current Employees

The proposed revised regulations also require contractors to conduct an annual survey of current employees to allow employees to anonymously identify as disabled. The OFCCP argues that, unlike a status as female, minority, or veteran, which are immutable characteristics, a disability can arise at any time, including after an individual starts work. Thus, annual surveys are ostensibly needed to gather more complete data and prevent under-reporting of disabilities.

Linkage Agreements

The current regulations merely suggest that contractors establish relationships with groups that serve disabled individuals in order to increase the number of disabled employees. The OFCCP's December 9 proposals seek to make this a mandatory obligation by requiring contractors to enter into written "linkage agreements" with at least three disability-focused recruitment and training sources. These agreements must specify (a) the nature of the relationship

between the contractor and the recruitment/training source and (b) the steps each intends to take to increase the number of disabled individuals employed by the contractor.

Written Reasonable Accommodation Procedures

The proposed revised regulations require contractors to publish written reasonable accommodation procedures that include: (a) the procedures for requesting an accommodation; (b) a requirement that the contractor provide written confirmation that a request has been received; (c) a timeframe for processing and responding to the request; (d) the circumstances under which medical documentation will be sought; (e) the requirement that denials of requests for accommodation be made in writing with a detailed explanation of the basis for the denial; and (f) the identification and contact information of a responsible company official.

Though most contractors likely already have some form of reasonable accommodation policy, contractors will need to revise and expand their policies to address these new elements.

Verbatim Inclusion of EEO Clause in Covered Subcontracts

A contractor must include the EEO clause for disabled individuals in every subcontract for $10,000 or more. Under the current regulations, the contractor can incorporate the EEO clause by reference (i.e., by citing to the regulation). The OFCCP's proposed revisions will change this rule and require that the six-paragraph EEO clause be recited verbatim in each covered subcontract. This will noticeably increase the length of subcontracts.

Increased Data Tracking and Reporting Requirements

The changes also include increased data tracking obligations. Among other data, the contractor will be required to track the number of referrals it receives for disabled and non-disabled individuals from state and local employment delivery services. The contractor must also maintain data on the number of disabled individuals who apply and who are hired and calculate the ratio comparing these figures to the total number of applicants and hires. The OFCCP is also considering adding a reporting requirement where contractors would be required to report this data to the OFCCP on an annual basis regardless of whether the contractor has been selected for a compliance audit. This would be a significant change to current procedures, which involve no annual reports to the OFCCP.

The 60-day public comment period on the proposals expired on February 21, 2012. The OFCCP is now reviewing the comments submitted. The OFCCP will likely try to publish a final rule before the end of 2012 so that, if President Obama is unsuccessful in his re-election bid, the revised regulations can take effect before his Republican successor takes office.

Did You Know

Risk Management & General Liability Insurance

By Patrick M. McDermott and Syed S. Ahmad

Government contractors, like all businesses, continue to face evolving liability risks. Examples include claims arising out of alleged losses or injuries due to global warming and patent infringement claims. Liability insurance allows a government contractor to manage its exposures. Although the insurance policy language will guide a government contractor's strategy with respect to specific claims, the considerations reviewed below often apply and should generally be considered for each risk.

First, government contractors should know that most courts will interpret insurance policies in favor of coverage, notwithstanding that government contractors and their insurers are often sophisticated parties. However, each policy's specific provisions require due consideration, because apparently minor differences in policy language can significantly increase or decrease available insurance coverage.

Following receipt of a claim (or knowledge of an event possibly giving rise to a claim), government contractors should identify all potentially relevant insurance assets and alternate sources of insurance recovery. Sources of coverage that may be overlooked include a corporate predecessor's insurance policies, an affiliated company's insurance policies, and coverage purchased by other third parties, such as suppliers, distributors, contractors, or retailers. Although these options may not readily appear applicable, these alternative sources of recovery may prove to be an important asset to government contractors.[1]

Other considerations related to identifying all available insurance coverage are the so-called "trigger" and "allocation" issues. Claims may involve circumstances spanning many years. Such claims can implicate policies in different years as well as different types of coverages. Accordingly, to maximize insurance coverage, government contractors should be aware that, in addition to their current policies, their prior policies can also be valuable sources of recovery.

After identifying available insurance coverage, another important issue concerns providing notice to the insurers. A policyholder's failure to provide timely and effective notice could negate otherwise applicable coverage. Providing notice and timely updates to insurers can benefit government contractors by encouraging the meaningful participation of insurers in resolving claims and avoiding "late notice" defenses. However, government contractors should also consider whether notice under a particular policy is actually required, because providing notice could have a negative impact on a contractor's relationship with its insurer as well as on premiums for subsequent renewals. Therefore, when faced with a claim, these competing considerations regarding notice will need to be carefully weighed in light of the specifics of the claim, the policy provisions, and the applicable law.

One important factor for government contractors to evaluate concerning whether to involve insurers in a claim is the estimated legal fees to be incurred in the defense of a claim. As government contractors are well aware, legal fees will often amount to hundreds of thousands, if not millions, of dollars. Liability policies can be important sources of funds for these legal fees. Under many policies, most courts require only a "potentiality" of coverage to find an insurer liable for its policyholder's defense costs. That is, an insurer must pay legal fees incurred by its policyholder in defending a claim when the insurance policy possibly provides coverage. Thus, the insurer's "duty to defend" is broader than its duty to indemnify a policyholder for amounts paid in settlement of a claim. In addition to being an important consideration in determining whether to provide notice of a claim, this "potentiality" of coverage standard is also another reason government contractors should be careful not to ignore insurance policies that may not immediately appear applicable to a claim.

The issues discussed above are only a few of the many considerations that a government contractor may encounter in dealing with potential insurance disputes. Government contractors should be proactive in managing their relationships with insurers, particularly in light of the many opportunities for disputes due to the variety of specific claims and policy provisions, as well as the differing laws that may govern any such disputes. Liability insurance remains a critical tool in helping manage the many risks facing government contractors. The considerations discussed above demonstrate the importance of properly handling insurance issues to minimize risks and potential exposures.

[1] In patent claims, government contractors may also seek protection under 28 U.S.C. § 1498, which provides that when a patented invention is used or manufactured by or for the United States, a patent owner's sole remedy is against the United States in the United States Court of Federal Claims.

Pentagon Releases "Guidance Document" that Discusses Military Plans for the Next Decade

By Kevin J. Cosgrove

On January 3, 2012, the Defense Department ("DoD") issued a "Guidance Document" explaining how it intends to revise its priorities, given significant impending budget cuts. It is difficult to draw specific conclusions. Nevertheless, several changes appear to be in the works.

- The focus of DoD efforts will shift away from Europe and toward the Middle East and South Asia. The document stated that the United States "was investing in a long-term strategic partnership with India" in an effort to promote security in the Indian Ocean region.
- The document pointed out that while China's military power is increasing, that nation needed to provide "greater clarity of its strategic intention in order to avoid causing friction in the region."
- DoD intends to work with other Middle Eastern nations "to prevent Iran's development of a nuclear weapon capability and counter its destabilizing policies."
- Significant investments are expected to be made to "sustain our undersea capacities, develop a new stealth bomber, improve missile defenses and improve our space-based capabilities."
- United States military manpower will be reduced over the coming decade. The size of the reduction was not specified.

This strategic document offers little in the way of concrete details. Some of those details will begin to emerge when the proposed budget for fiscal year 2012/13 is unveiled later this year.

We will continue to follow and report on these issues in our next edition.