
FOREIGN MILITARY SALES (FMS) SOLE-SOURCE PROCUREMENT:

A MEMORANDUM OF LAW

By

JEROME H. SILBER

Issue:

May procedures other than competitive procedures be used on the basis of the fourth exception of title 10 United States Code, § 2304(c), as amended by the Competition in Contracting Act of 1984, for a procurement pursuant to section 22(a) of the Arms Export Control Act (AECA) for defense articles or defense services for the use of a foreign government purchaser where part or all of the purchase price is financed either with credits extended under section 23 AECA that are not required by statute to be repaid to the United States Government or with military assistance funds granted to the purchaser and merged with purchaser funds pursuant to section 503(a)(3) of the Foreign Assistance Act of 1961 (FAA) solely to meet foreign military sales (FMS) obligations of the purchaser?

Conclusion:

If the criteria of the fourth exception are otherwise met, title 10 United States Code, § 2304(c)(4), justifies the use of procedures other than competitive procedures for the procurement specifically at issue, even though part or all of the purchase price is financed with nonrepayable credits or grant funds made available by law to the foreign government purchaser.

Statute at Issue:

(c) The head of any agency may use procedures other than competitive procedures only when

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(4) the terms of an international agreement or a treaty between the United States and a foreign government or international organization, or the written directions of a foreign government reimbursing the agency for the cost of the procurement of the property or services for such government, have the effect of requiring the use of procedures other than competitive procedures. (10 USC 2304(c), as amended by Public Law 98-369, July 18, 1984, section 2723.)

Foreign Military Sales (FMS) Background:

Sales to eligible foreign governments and international organizations of defense articles and defense services that are procured by the United States Government for such sales are authorized by section 22 of the Arms Export

Control Act (AECA), first enacted in 1968 by P.L. 90-629. Credits extended under section 23 AECA may be used by the borrowing foreign government to pay for defense articles and services procured under FMS from the United States Government (section 21 AECA stock sales or section 22 AECA sales from procurement) or under direct commercial contracts with private firms. (See the Congressional reports accompanying H.R. 15681, 90th Congress, prior to the enactment of P.L. 90-629.) As the Department of Defense told the General Accounting Office, there is no such thing as a section 23 "sale":

Contrary to popular misconception, we do not make credit sales under section 23. A credit 'transaction' under section 23 is in fact a separate agreement involving a credit or loan agreement substantially identical in form to those used by commercial banks. This agreement is separate and apart from the purchase arrangement which may be an FMS sale under section 21 [purchase from DOD stock] or section 22 or a direct sales contract between the borrowing country and the United States supplier. When the borrowing country is billed for payments due as a result of such sales, it is that country's option either to request a disbursement from the section 23 credit arrangement or to provide its own funds or a mix of both. [Procurements Involving Foreign Military Sales, 58 Comp. Gen. 81 (1978), 78 CPD 349.]

Credits or other financing made available by law to the foreign government purchaser are, in fact, treated as financial resources of the purchaser, and are husbanded or utilized by the purchaser as any other available budgetary resource for military procurements. The choice of using credits or cash is largely one made by the foreign government that is the borrower-purchaser.

U.S. Government FMS transactions are subject to the same rules and conditions whether they are paid for by the purchaser's cash or other U.S. Government financing. In either case, the funds with which the purchaser-borrower chooses to pay FMS obligations are deposited in its FMS Trust Fund that is managed by DSAA. The U.S. Comptroller General noted in this regard that "amounts deposited into the FMS Trust Fund are, in reality, foreign customer's funds that are administered by the United States Government only in a fiduciary capacity." (Procurements Involving Foreign Military Sales, *op. cit. supra.*) Yet, the U.S. Comptroller General noted that, in a technical sense, amounts in the FMS Trust Fund are "appropriated funds, even though they are not annually appropriated by Congress and not subject to direct Congressional control." (*ibid.*)

Commencing in 1973 the Congress has annually enacted specific legislation to release first Israel, and later Egypt, from their contractual liability to pay for defense items financed by the U.S. Government. See section 4 of the Emergency Security Assistance Act of 1973, P.L. 93-199, December 26, 1973; such "forgiven credits" were, when appropriated by P.L. 93-240 on January 2, 1974, treated by the Congress as tantamount to "grant military assistance." See also section 31(c) AECA, as amended since FY 1975, for the amounts on nonrepayable credits made available for Israel, and section 31(b)(6) AECA, as amended since 1981, for amounts of nonrepayable credits made available for Egypt. In 1980, the Congress enacted a new source of FMS financing: funds appropriated for grants to foreign governments under

the military assistance program (MAP). See section 112(a), P.L. 96-533, enacting section 503(a)(3) of the Foreign Assistance Act of 1961 (FAA). Just as section 23 AECA credit funds, repayable as well as nonrepayable, are deposited into the FMS Trust Fund to pay FMS obligations, so, too, are MAP funds under the 1980 authority. Section 503(a)(3) FAA currently authorizes the President to furnish military assistance by:

(3) transferring such of the funds appropriated or otherwise made available under this chapter as the President may determine for assistance to a recipient country, to the account in which funds for the procurement of defense articles and defense services under section 21 and section 22 of the Arms Export Control Act have been deposited for such recipient, to be merged with such deposited funds, and to be used solely to meet obligations of the recipient for payment for sales under that Act. (Emphasis added.)

Here, just as in the case of section 23 AECA credits, MAP funds are, in fact, treated as financial resources of the purchaser and husbanded or utilized by the purchaser as any other available budgetary resource for military procurements. Purchaser cash, cash provided by third-country donors, section 23 AECA credits, and grants under MAP are all merged into the FMS Trust Fund from whence payments are made to U.S. Government contractors and other suppliers of defense items sold to the purchaser. See section 37(a) AECA. A particular sales transaction may, depending largely on the purchaser's determination, be financed in varying proportions from all four sources or some combination of them. Analytically, a transaction authorized under section 22 AECA is a sale, substantively and procedurally, even though the purchase price is paid with funds that were derived initially from funds appropriated, in a separate Congressional decision, by the Congress to the President under the security assistance program.

Procurement Background:

The U.S. Comptroller General has held that procurements for sales authorized by section 22 AECA are not governed by the Armed Services Procurement Act of 1947, 10 USC 2301 et seq., and its competitive procurement requirements, but by the Defense Acquisition Regulation (DAR, formerly the ASPR) and only, presumably, because the Regulation so provides. In Allied Repair Service, Inc., B-207629, December 16, 1982, 82-2 CPD 541, the U.S. Comptroller General rejected a bid protest challenge to the legality of a sole-source procurement pursuant to section 22 AECA FMS transaction since the foreign government purchaser had designated a sole-source prime contractor to implement the FMS case, stating:

The Department of Defense (DOD) acts as an agent for a foreign government when it conducts procurements under the authority of the Arms Export Control Act, using the foreign government's funds that have been deposited in the Foreign Military Sales Trust Fund Account in the Treasury. While the funds are appropriated in a technical sense, they are administered by the United States in the capacity of a trustee; by law, these funds can only be disbursed in compliance with the terms of the trust. 31 USC § 1521 (formerly section 725s). DAR 6-1307(a), then, is no more than a reasonable implementation of the statutory requirement of 31

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U.S.C. § 1521. For that reason, the legal framework for our review of these procurements is the DAR and not the procurement statutes that govern purchases made by the military department on their own behalf using U.S. funds appropriated by the Congress for that purpose. See Procurements Involving Foreign Military Sales, 58 Comp. Gen 81 (1978), 78-2 CPD 349, Saudi Maintenance Company, Ltd., B0205021, June 8, 1982, 82-1 CPD 522. (Emphasis in the original.)

In his decision to hear bid protests against procurements under section 22 AECA, the U.S. Comptroller General in 1978 confronted the problem that the foreign government purchaser could defeat a challenge to a sole-source award simply by having made an appropriate request to that effect. Nevertheless, he decided that he had the authority to review such awards to determine whether they had been made in conformance with the regulations since the regulations themselves provided that they were applicable to FMS procurements and contained "uniform standards." (Procurements Involving Foreign Military Sales, op. cit. supra.)

These decisions were made at a time when the ASPR, and later the DAR, as well as the Military Assistance and Sales Manual (DOD 5105.38M, Part III, Chapter C, para. 12), issued by the cognizant agency within DOD, permitted sole-source designations by the FMS customer that is to "reimburse" the proposed procurement, but made no distinction between reimbursement by purchaser cash, cash provided by third-country donors, repayable AECA credits, nonrepayable AECA credits, and grants under MAP. In the absence of any challenge to a sole-source FMS procurement reimbursed by nonrepayable AECA credits or grants under MAP, the conclusion seems reasonably well-founded that the term "reimbursement" in the DOD regulations means nothing more than the term "FMS customer" in the Manual, i.e., a general reference to a sales transaction under the AECA as distinguished from a grant transaction under the obsolescent MAP procedures (authorized under section 503(a)(1) FAA) that were in use through FY 1981.

Legislative History of the Fourth Exception:

ASPR 3-210.2 (xviii) provided the following illustrative illustrative when noncompetitive procurement authority may be used:

(xviii) when the contemplated procurement is to be reimbursed by a foreign country which requires that the product be obtained from a particular firm as specified in the Letter of Agreement or other written direction by the Military Sales Organization [see 6-1307(a)].

ASPR 3-210.3 indicated that this authority described "procurements for foreign military sales." ASPR 6-1307 employed the term "FMS customer" and made no reference to "reimbursement" and no distinction between purchaser cash, etc., on the one hand, and nonrepayable AECA credits and grants under MAP, on the other.

On February 27, 1984, the Reagan Administration established its own policies regarding the use of noncompetitive procurement procedures in Policy Letter No. 84-2 issued by the Office of Federal Procurement Policy, Office of

Management and Budget. Paragraph 3.a.(5) of that Policy Letter permitted the use of noncompetitive procedures when:

A specific source is required by international agreement or for directed procurements for foreign governments.

This portion of the Policy Letter was implemented by the following amendment to FAR 15.105-2(a)(5), permitting the use of noncompetitive procedures when:

A specific source is required by the terms of an international agreement or treaty between the United States Government and a foreign government or for the directed acquisition for a foreign government that is reimbursing the U.S. Government for the cost of the acquisition. [Federal Register, vol. 49, no. 127, p. 26741 (June 29, 1984).]

The Policy Letter and the FAR amendment were rescinded on August 15, 1984, due to the intervening enactment on July 18, 1984, of the Competition in Contracting Act of 1984. However, the DOD issued two general messages on the subject of FMS sole-source procurement, the first on March 15, 1984, and the second on April 13, 1984, calling specific attention to the provisions of the DAR and Policy Letter No. 84-2. The latter message addressed the procedures whereby FMS sole-source procurements may be approved for FMS cases funded with grants under MAP.

Currently, FAR 15.210(b)(18) permits noncompetitive procurements --

(18) When the contemplated acquisition is to be reimbursed by a foreign country and requires that the product be obtained from a particular firm as specified in a Letter of Agreement or other written direction.

The FAR provision is implemented by DOD FAR Supplement 25.7307 which is identical to DAR 6-1307 which it replaced on April 1, 1984. On the same date, the Security Assistance Management Manual (DOD5105.38M, Chapter 8, Section II, para. B) superseded similar instructions in the Military Assistance and Sales Manual (DOD 5105.38M, Part III, Chapter C, para. 12), see supra, p. 4.

Section 2723 of the Competition in Contracting Act of 1984 (CICA) derived from two principal bills, S. 338, 98th Congress, and HR 2545, 98th Congress. Senate Report No. 98-50, March 31, 1983, of the Senate Governmental Affairs Committee on S. 338 explains the fourth exception as follows:

The fourth exception allows noncompetitive procedures to be used when required by international agreement or treaty or directed procurements for foreign governments when the cost is to be reimbursed by the foreign government. This exception deals with two separate situations. The first situation in which noncompetitive procurements are justified is when an international agreement is made, e.g., between NATO countries, to purchase a particular weapon system from one source. The second situation involves U.S. procurement of property or services to be sold to another

country. In this case, the foreign government chooses the contractor. (p. 22, emphasis added.)

On June 7, 1983, at a hearing on S. 338 before the Senate Armed Services Committee, the Deputy USDR&E (Acquisition Management) testified that a change should be made in the fourth exception as follows:

This subsection provides for the use of noncompetitive procedures when required by international agreement or at the direction of a foreign government. As written, the bill could be interpreted to include foreign military sales transactions within Chapter 137 of Title 10. Such transactions are currently covered by the Arms Export Control Act and should not be included in the procurement statute which applies only to purchases using appropriated funds.

We recommend: Deletion of this subsection and substitution of the following new subsection:

"(4) the terms of an agreement with a foreign government (or international organization) have the effect of requiring the use of procedures other than competitive procedures." (Hearings, p. 58.)

The recommended substitute may be found in H.R. 2545, 98th Congress. The Conference Committee, however, chose to recommend language very similar to that reported out by the Senate Governmental Affairs Committee on March 31, 1983.

Testimony against the inclusion of the fourth exception was presented by Messrs. Hann and Seidman, representing the National Tooling and Machining Association (NTMA), to the Senate Armed Services Committee on June 9, 1983, and to the House Armed Services Committee on September 29, 1983. The witnesses simply described the fourth exception as one "at the direction of a foreign government buyer." No distinction was made as to whether purchaser cash, etc., or nonrepayable credits or grants under MAP were to be used for the purchase. Rather, the NTMA testimony criticized the fourth exception as follows before the House Armed Services Committee (Hearings, p. 140):

H.R. 2545 would amend 10 U.S.C. §2304(a)(4) to permit noncompetitive procurements where "the terms of an agreement with a foreign government (or international organization) have the effect of requiring the use of procedures other than competitive procedures." Although there is no statutory exception at this time, noncompetitive procurements at the direction of a foreign government buyer are presently permitted by regulation, DAR 6-1307. NTMA recommends that rather than elevating this regulatory language to a statute, statutory language should instead be enacted, prohibiting foreign government buyers from directing the use of noncompetitive procurements. There is no reason for the United States to make a noncompetitive procurement because a foreign buyer directs it to do so. Such an exception is particularly inappropriate in light of the abuses which led to the enactment of the Foreign Corrupt Practices Act. Furthermore, the rationale that appropriated funds are not used in foreign military sales is a weak argument, because

appropriated funds have ended up being used in foreign military sales in the past. For instance, a recent decision of the United States Court of Appeals for the Federal Circuit held that obligations under Foreign Military Sales contracts may be satisfied out of appropriated funds. [Citing United States v. Federal Electric Corp., No. 83-571 (Fed. Cir. July 18, 1983).] (Emphasis added.)

A clearer presentation of the real objections of the NTMA may be found in the following colloquy between Senator Cohen and Mr. Seidman during the Hearings before the Senate Armed Services Committee (pp. 350-351):

Mr. SEIDMAN:

The next exemption would be for sole-source procurements made at the direction of a foreign government buyer. This exemption is directed at foreign military sales where DOD procures for a foreign government buyer. We had legislation enacted several years ago, the Foreign Corrupt Practices Act. Business overseas is not always conducted in the same manner that it is conducted here. It is likely that if we allow foreign government buyers to direct sole-source procurement, this will encourage such abuses. . . .

Senator COHEN. What you are suggesting is that we amend the other laws to prohibit foreign governments from selecting any contractor under our system? Otherwise what we are trying to do is say where existing law permits a foreign government to select a contractor that this act is not designed to contravene that.

Are you suggesting we ought to change the underlying law which allows a foreign government to select a contractor?

Mr. SEIDMAN. For one of two types of foreign military sales. One type of foreign military sale is the direct type, where a foreign country with a proper licensing agreement can contract with whomever they want, directly. The other method is to use DOD as a middleman.

If a foreign government elects to use the Department of Defense as a middleman, it should abide by our rules concerning competitive procurement. . . .

The Committees rejected the NTMA objections presumably because it is unclear that violations of the Foreign Corrupt Practices Act occur more frequently in FMS transactions, as Mr. Seidman implied, than in direct commercial sales of military items by U.S. private firms to foreign governments. Indeed, one might suppose that the contrary is more probable. Moreover, since credits extended under the AECA may be authorized to finance direct commercial sales as well as FMS government-to-government transactions, the Armed Services Committees might well have concluded that a foreign government purchaser-borrower should have the same opportunity with those credits to designate sole-source suppliers regardless of the type of transaction and that a role requiring competitive procedures only in FMS transactions would cripple the government's role as compared with the availability of sole-source procurements in direct commercial sales transactions. In any event, the issue before the Congress was clearly not whether competitive procedures should or should not be required in FMS government-to-government transactions depending upon the source of sales

financing or whether any financing from the United States or a third country was repayable.

ABOUT THE AUTHOR

Mr. Jerome H. Silber has served as the General Counsel for the Defense Security Assistance Agency since 1977. He previously was General Counsel for the Office of the Secretary of Defense (1966-1977) and also in the Department of State (1960-1966). Mr. Silber holds an L.L.B from the University of Wisconsin Law School and is a Member of the Bar in Wisconsin and the District of Columbia.