

"No Profit, No Loss"--Not Always: Application of the Uniform Commercial Code to Reports of Discrepancy for Foreign Military Sales from Department of Defense Stocks

By

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SUMMARY

Foreign military sales of defense articles and services from Department of Defense stocks are governed by the Arms Export Control Act and the provisions of the contract with the foreign purchaser, contained in the Letter of Offer and Acceptance. As the federal law of sales transactions, article 2 of the Uniform Commercial Codes [UCC] guides the interpretation of sales contract provisions and the allocation of risk between the contracting parties. Thus, when Reports of Discrepancy under foreign military sales arise, the UCC augments the Letter of Offer and Acceptance and the Arms Export Control Act in specifying the rights accorded to and the constraints placed upon the parties. In particular, application of the UCC may, in a given case, achieve results that at first appear contrary to the foreign military sales adage of "no profit, no loss" to the U.S. government. In fact, the UCC reinforces this principle. Two recent cases illustrate this result.

FOREIGN MILITARY SALES

The Arms Export Control Act (AECA) permits sales of defense articles and services to foreign governments, consistent with U.S. foreign policy interests.[1] Sales may be either from "stocks"[2] or from "procurement." [3] Sales from stocks include both "defense articles and defense services" sold by, or performed by members of, the Department of Defense (DOD). Sales from procurement include only those defense articles or defense services which the U.S. Government (USG) procures for and on behalf of the foreign government by means of a procurement contract. The Letter of Offer and Acceptance (LOA)[4] is the vehicle for conducting both types of foreign military sales (FMS). In addition to the detailed bargained-for provisions of the sale and the financial schedules, the LOA contains a "boilerplate" statement of general conditions of the sale.[5] Among these, General Condition C broadly exonerates the USG from liability under the LOA; it requires FMS purchasers to indemnify and hold the USG harmless for loss or liability in tort or contract in connection with FMS sales.[6] As an exception to General Condition C, paragraph A.3.a. of the General Conditions requires the USG to "repair or replace at no extra cost defense articles supplied from DOD stocks which are . . . found to be defective. The defect may be one of manufacturing--material or workmanship--or one of specification or design. The USG is liable to correct such defects if they "existed prior to passage of title." Paragraph B.6. of the General Conditions specifies that claims for such defects must be made by way of a Report of Discrepancy (ROD).[7]

This article examines two countries' RODs for manufacturing defects to illustrate the application of the general law of sales to FMS contracts and to alert those involved in conducting or overseeing foreign military sales to the potential adverse consequences defective performance holds

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for their organizations. The countries will be referred to as Country X and Country Y. Country X's difficulties with improper painting of its FMS-purchased aircraft illustrate the general application of the Uniform Commercial Code (UCC) to FMS contracts, provide a laboratory for reviewing USG liability to repair or reimburse for defective products, and highlight the need for thorough analysis of the underlying circumstances of each ROD. Country Y's experience with defective gun pods reveals the intricacies of delivery of defective goods, subsequent rejection and return by the purchaser, and responsibility for returned property. Together, the cases show why good faith performance is not always enough to sustain the "no profit, no loss" goal of the FMS program and how application of the UCC refines the meaning of this oft-quoted principle.

COUNTRY X: OFF-COLOR AIRCRAFT

This case presented the question to what extent, if any, the USG is liable to reimburse the Air Force of Country X (XAF) for two RODs pertaining to defective paint conditions on certain aircraft purchased under FMS by the XAF: peeling paint on fourteen and a color mismatch on six of the fifteen aircraft purchased.

Under the aircraft purchase LOA, a Naval Air Rework Facility (NARF) reworked all fifteen aircraft and painted them by the same standards and procedures used in repainting U.S. Navy aircraft. The XAF supplied special painting instructions regarding camouflage color and paint scheme to supplement NARF standard repainting procedures. After completion of painting, each aircraft was delivered to the XAF. The XAF took delivery of all fifteen aircraft within a four-month period.

Neither paint problem manifested itself until after the aircraft started arriving in Country X. Although the color mismatch came to light shortly prior to delivery of or departure for X of the last one or two mismatched aircraft, the XAF elected to accept delivery of these aircraft and to submit a ROD at a later date. Shortly after delivery of the last aircraft, a NARF quality control engineer inspected twelve of the fifteen aircraft in Country X.[8] He found the most prominent peeling and flaking of new paint on the center leading edge of eleven of the twelve aircraft inspected. In addition, he noted that six of the twelve aircraft examined had the wrong paint scheme on the radome; that is, the light gray bottom color on the fuselage was carried over to the radome. Thus, there were actually three defects: peeling and flaking, mismatched color, and mismatched patterns. Six aircraft displayed all three problems. Only one aircraft was free of painting defects.

The aircraft came from U.S. Navy stock and were subsequently modified to the desired configuration by Navy employees. No procurement contract was involved. Accordingly, for the purposes of interpreting the AECA as it applies to the provisions of the LOA, sale of the fifteen aircraft, as modified (including painting), was sale from "DOD stocks."

Peeling and Flaking

While there was initial speculation that the peeling and flaking problem may have been the result of insufficient paint cure time prior to XAF acceptance and test flying the aircraft, a review of the paint, test flight, and delivery dates proved this not to be the case. The NARF engineer who examined the aircraft unambiguously concluded:[9]

(a) The worst of the peeling and flaking appears to be the result of improper surface preparation/primer application

(b) The minor peeling problems in other areas appear to be the result of the final finish process in the aircraft paint complex.

The weight of this expert opinion led to the conclusion that defects in the manufacturing process occurring prior to passage of title caused the paint on the aircraft to peel and flake.

Color Mismatch

A similar analysis applies to the paint color mismatch. These painting defects also occurred prior to passage of title to the aircraft. With respect to the color mismatch, the NARF engineer concluded that:

The color deviation from specifications was due to the material contractor providing paint which did not meet the specified color match. While each color provided carried the proper color number, the actual color deviated significantly.[10]

The XAF first noted the color deviation from specifications when the first three aircraft arrived in X after ferry and were compared to other XAF aircraft. When contacted concerning the color mismatch, the paint manufacturer remixed the remaining batch of incorrect paint. Records showed that the XAF had accepted five of the six mismatched aircraft prior to discovering the color mismatch and notifying NARF of it. Although the XAF accepted the sixth aircraft subject to the ROD procedure, the manufacturing defects in quality assurance of conformity of paint batch colors to samples of specified colors provided by the XAF, and in application of paint according to the specified pattern, occurred prior to transfer of title for all six aircraft. These defects resulted in non-conforming products under the FMS contract.

Application of the Uniform Commercial Code

The LOA is the contract used for selling defense goods and services to foreign purchasers. As such, it is subject for its interpretation and application by the U.S. courts not only to the AECA but also, with respect to the sale of goods (and associated services) to the provisions of article 2 of the UCC. One of the uniform laws developed by the National Conference of Commissioners on Uniform State Laws and the American Law Institute, the UCC has been adopted in all fifty states, the District of Columbia, and the U.S. Virgin Islands. By judicial decision, the UCC also constitutes the federal law of sales transactions.[11] For foreign military sales, the UCC serves as an interpretive tool to augment and explain contractual terms and to allocate risks among the parties in the absence of specific contractual language.[12] This article discusses the UCC's application to FMS contracts from the point of view of a U.S. court applying U.S. law.[13]

The following UCC provisions pertain to the relations between the parties in this case. First, the UCC permits buyers a reasonable time to inspect goods tendered, and such inspection may be done after arrival of the goods.[14] Payment for the goods before inspection does not constitute an acceptance of goods or impair either the buyer's right to inspect or any of his remedies.[15] If the goods or the tender of delivery fail in any respect to conform to the contract, the buyer may reject the whole, accept the whole, or accept any commercial unit or units and reject the rest.[16] Acceptance of goods occurs when the buyer has a reasonable opportunity to inspect the goods and retains them in spite of their non-conformity.[17] Acceptance of non-conforming goods precludes rejection and cannot be revoked unless based on the reasonable assumption that the non-conformity would be seasonably cured, but acceptance does not impair any other remedy for non-conformity. The buyer must notify the seller of the breach within a reasonable time.[18] The buyer may recover as damages for any non-conformity of tender the loss resulting in the ordinary course of events from the seller's breach as determined "in any manner which is reasonable," plus applicable incidental and consequential damages.[19]

DSAA policy guidance concerning delivery performance and adherence to stated conditions addresses conformity with contract specifications:[20]

Importance of Prompt and Effective Service. The quality of delivery performance directly reflects the degree to which the U.S. meets its FMS commitments and is therefore a key element in the supplier-customer relationship. The importance of prompt and effective service to the purchaser must be continually emphasized to assure overall success in the attainment of FMS program objectives.

....

DOD components shall require that FMS material conform to the material offered, is serviceable and is complete. . . .

This policy is consistent with both FMS program objectives and the established norms of contract law enumerated above.

USG Liability for Repair or Reimbursement

Paragraph A.3.a. of Annex A to the LOA, quoted above, requires repair or replacement of defective items at no extra cost to the foreign purchaser. Notification of defects via the ROD procedure satisfies the notice requirement of UCC section 2-607 above. The *Security Assistance Management Manual* (SAMM) sets forth guidelines for payment of RODs when the USG is liable. The following table describes the sources of funds to pay RODs for defective material from stock:[21]

<u>FMS Administrative Funds</u>	<u>U.S. Government Appropriations/Funds</u>
Transportation of materiel for rework or disposal, or, if more cost effective, travel and per diem costs of rework team.	Applicable U.S. Government appropriation or fund is responsible for (1) replacement without additional charge, (2) refund to the customer account, or (3) repair or rework of defective items issued to FMS customers (except as indicated under "FMS Administrative Funds" heading).
The cost of testing defective items when it is necessary in order to service the FMS customer.	

Under this DSAA-promulgated guidance, "refund to the customer account" is clearly a contemplated and permissible alternative to repair or replacement of defective items sold from DOD stocks.

The foregoing regulation permits correction of subject paint defect by "repair or rework" or by "refund." DSAA takes the position that the choice of means of correcting defects is that of the USG, not the purchaser. To the extent that the USG may supply personnel or materials to correct either of the paint defects, the appropriate fund sources are those specified above. Travel and per diem for a NARF paint rework team would come from FMS Administrative Funds; cost of materials, salaries, and other rework expenses would come from applicable USG appropriations. If, instead, the XAF were permitted to repaint its own aircraft, it may recover by way of "refund to customer account" its actual expenses in correcting the painting defects. The USG might also choose to refund the difference in the value of the aircraft with paint as contracted for as opposed to their value with mismatched, peeling, and flaking paint, or any other measure calculated "in any manner which is reasonable." A refund, of course, must come from appropriate USG funds.

To the extent that any express or implied warranty of color existed in the contract for paint, the USG may pursue the paint manufacturer for indemnification under General Condition A.2. of the LOA. To the extent that the USG has not yet corrected the non-conforming condition, it may do so either by way of rework or by way of refund of any amount claimed that is not unreason -

able. Since the delay in resolving these RODs was attributable to the USG, it should not prejudice the XAF's right to cure of or refund for the defects, based on the conditions reported in the RODs and by the NARF engineer.

Arguments Opposing USG Liability

Several arguments put forth opposing compensation for these RODs merit mention because they show how important it is to analyze carefully the facts of each ROD case. The argument that XAF quality assurance representatives at the NARF did not object to the paint job has some validity with regard to the color mismatch problem; however, it cannot by itself absolve the USG of responsibility to provide the contracted-for performance--a defective-free paint job. Because the peeling and flaking problem manifested itself only after the trans-oceanic ferry flight, the resident XAF quality assurance representative could not have detected it. The color mismatch, while possibly susceptible of detection prior to acceptance, was likewise not discovered until the ferried aircraft were parked beside other XAF aircraft in Country X. Although both appear to have been "latent defects," some ambiguity exists regarding the pre-delivery detectability of the mismatched colors. Neither the XAF quality assurance representative or NARF quality assurance personnel detected the color mismatch on the first few aircraft produced, perhaps for lack of a standard of comparison as obvious as a properly painted aircraft parked nearby. Assuming that the mispainting was, nevertheless, a latent defect, neither the XAF's acceptance of the mismatched aircraft, nor its declination to delay the ferry flight on one or two aircraft so they could be repainted with corrected colors, bars the submission of a ROD for compensation for, or correction of, this discrepancy.[22]

The further assertion that paint peeling in no way *prohibits* the aircraft from fulfilling its "intended purpose," is correct as far as it goes. But peeling paint will nevertheless *limit* the product from fulfilling its intended purposes--the other branch of the two-pronged definition of product quality deficiency.[23] Peeling paint increases an aircraft's vulnerability to corrosion, which can attack exposed surfaces and infiltrate to electrical and mechanical systems below. To prevent and control corrosion is a primary reason for painting aircraft. Thus, peeling and flaking paint will limit an aircraft from fulfilling its intended purpose by limiting its ability to withstand corrosion. "Intended purpose" must be understood not in isolation, as focusing upon a single flight in which all systems operate properly; rather, the intended purpose of a military aircraft is to be a reliable, serviceable, defense vehicle with a useful life of a predictable number of years. To the extent that exposure to corrosion due to peeling and flaking paint reduces the useful life of a given aircraft, that defect limits the aircraft from fulfilling its intended purpose.

Such limitation is even more apparent in the case of the paint mismatch (argued not to be a "Rodable item" since mispainted aircraft are still capable of flight). The argument that despite their incorrect colors these aircraft retained a "preponderance of inherent camouflage capability" and that the degree of effect on their camouflage "is a matter of interpretation and opinion" fails to overcome the fact of a contractual breach. Certainly, this argument would be correct in the case of a mispainted civilian airliner, the external coloring of which is irrelevant to its functional (though not necessarily to its commercial) purpose of flying passengers from one point to another. But military aircraft have a fighting purpose that encompasses much more than moving the flight crew from point A to point B. Camouflage is an inherent part of a fighter aircraft's battery of deceptive techniques and equipment that enable it effectively to fulfill its intended purpose. Improper paint that causes a fighter to stand out from, rather than blend into, the landscape *limits* and may even *prohibit* the fighter's ability to fulfill its intended military purpose. Rather, the "inherent camouflage" argument appears useful only in the limited circumstances of determining monetary damages by assessing the difference between the values of the product as contracted for and as delivered, should the XAF elect not to correct the mismatched paint.

Having witnessed the basic application of the UCC to an FMS ROD and recognized the USG's liability to repair, replace, or refund for defective defense articles sold from DOD stocks, let us probe a further dimension of the problem: the rights of the parties when the FMS purchaser returns a defective product and cancels the order for it.

COUNTRY Y: GUNS THAT WOULDN'T SHOOT

In connection with the purchase of a half-dozen attack aircraft from DOD stocks, Country Y ordered, among other equipment listed in a note to the LOA, nine 20 mm. gun pods. Although no mention is made of it in the LOA, the USG apparently represented, as part of this sale, that it could take off-the-shelf U.S. gun pods and modify them to accommodate the series M-50 NATO ammunition used by the YAF. A NARF modified the guns, ground-tested them, and shipped them to the YAF. Subsequent YAF flights with the gun pods were unsuccessful. Unable to identify the technical problem, YAF officials returned the gun pods for further evaluation and testing. When, after nearly two years and some \$154,000 worth of rework and testing, the Navy still had not corrected the persistent "ammo link jam" on the single pod it chose for analysis, the YAF cancelled its order for the gun pods. The other eight pods remained at the NARF, unprotected from corrosion.

Applying the standard of General Condition A.3.a., the GPU-7A gun pods, as modified, were defective.[24] It is immaterial whether one characterizes the defect as one of manufacture or design, for 1) the defect was present in the modified gun pods prior to passage of title to the YAF, and 2) a gun that doesn't shoot when fired "cannot be used at all for the purpose for which [it was] designed."

In this case, the gun pods came from U.S. Navy stock and were subsequently modified by Navy employees. No procurement contract was involved. Accordingly, for the purposes of interpreting the AECA as it applies to the provisions of the LOA, sale of the gun pods, *as modified*, was a sale from "DOD stocks." [25]

Delivery

The SAMM states that the "point of delivery" for items supplied from DOD stocks will be the DOD depot loading facility, unless otherwise specified in the LOA.[26] There is no doubt that a physical delivery of defense articles took place at some point in this case. The question is whether that delivery was legally effective under the LOA.

As with the aircraft sale to Country X, the UCC gives the YAF a reasonable time to inspect the goods tendered, and this may be done after arrival of the goods.[27] Prior payment neither constitutes acceptance nor impairs the YAF's right to inspect, or any of its remedies.[28] If the goods fail in any respect to conform to the contract, the YAF may accept any commercial units and reject the rest.[29] Where a tender or delivery of goods so fails to conform to the contract as to give a right of rejection, the risk of loss of the goods remains on the seller until cure or acceptance.[30] A rejection or other refusal by the buyer to receive or retain the goods, whether or not justified, revests title to the goods in the seller by operation of law.[31] If the seller had a reasonable belief that the tendered goods would be acceptable, the seller may have further reasonable time to "cure" the defect.[32] However, a buyer is not required to allow a vendor to tinker with a defective article indefinitely in hope that it may ultimately be made to comply.[33]

The delivery of a non-conforming article is, therefore, not an effective delivery under the foregoing contract principles. The DSAA Comptroller reached the same conclusion regarding the relationship between defects, delivery, and cancellation in this case: "We have determined that, in the case of items shipped from stock and returned by the purchaser for correction of a deficiency, delivery should not be deemed effected and the purchaser is entitled to cancel the order without

payment of cancellation costs until reshipment of corrected stock items." [34] This specific DSAA policy statement is also consistent with the SAMM's general guidance concerning delivery performance and adherence to stated conditions, as quoted above. [35]

Cancellation

General Condition B.7. of the LOA permits the FMS customer to cancel the LOA with respect to "any or all of the items listed . . . at any time prior to . . . delivery." It also places upon the customer the burden of "all costs resulting from cancellation *under this paragraph*" [emphasis added]. Since no effective delivery of modified gun pods occurred, the terms of the LOA permitted the YAF to cancel the portion of the LOA for purchase of the yet-undelivered gun pods, for reason of non-performance by the USG. The YAF's cost of cancellation must, therefore, be computed in light of the earlier-submitted ROD. The YAF returned the defective pods and filed its ROD concerning them within a reasonable period after discovering the defect. [36] When, after nearly two years of waiting for correction of the defect, only one of nine units had been modified, and the modified unit still did not perform satisfactorily, the YAF exercised reasonable business judgment and cancelled the gun pod portion of the contract. In computing cancellation costs to the Government of Y, charges incurred after the date of the ROD are excluded because the USG was bound from that date, if the ROD was valid, to repair, replace, or refund, "at no extra cost" to the YAF. The USG attempted without success to rework the product. Unable to repair or replace, the USG had only one alternative, to refund the purchase price of the gun pods less required cancellation charges, if any.

The SAMM provides for cancellation charges only in the event an "entire FMS case (LOA or amendment)" is cancelled. [37] The absence of parallel specific guidance concerning partial cancellation strongly implies that no charges apply to partial cancellations. This analysis finds support in the DSAA Comptroller's letter on this case, which states: "The purchaser is entitled to cancel the order *without payment of cancellation costs* until reshipment of corrected stock items." [38] Accordingly, to make the YAF whole with respect to its gun pod order, the USG is liable to refund the *full purchase price* of the gun pods (or whatever lesser portion was collected from the YAF). [39] While the actual refund amount on its face appears to be limited by the amount of the ROD, inquiry into the financial records of the case may reveal that additional credit is due for payments made subsequent to the filing of the ROD, or otherwise. It appears from the ROD that YAF officials believed they were claiming the full cost to them of the gun pods. [40] If no additional credit is due, the amount claimed should be refunded in full to the YAF.

USG Responsibility for Returned Property

The YAF's rejection of the gun pods owing to their defective condition returned title in the pods to the USG by operation of law. [41] Thus, it became the responsibility of the cognizant agency of the USG to provide instruction to the YAF for adequate preservation and shipping of USG property at USG expense and, subsequently, to safeguard and maintain the material condition of the gun pods during its attempts to "cure" the deficiency and redeliver an acceptable product. Accordingly, the subsequent deterioration in the condition of the gun pods was attributable to neglect by employees of the USG, not the YAF. Further charges to the YAF FMS case for repair of the corrosion would therefore be inappropriate.

THE MISLEADING MYSTIQUE OF "NO PROFIT, NO LOSS"

Most of us take the FMS no profit, no loss principle to mean that the USG does not intentionally price-gouge the FMS customer, but that unanticipated expenses of the sale become the purchaser's financial problem, since the USG is not permitted to lose money on the sale. A typical formulation of this view was put forth in the XAF case: since "by law, the U.S. Government cannot . . . lose money" in FMS transactions, "the cost to repaint [the aircraft] would by law have

to be charged to the applicable FMS case." To act otherwise would constitute an unauthorized provision of security assistance, or so conventional wisdom goes. This view, however, is inaccurate, on both the profit and loss sides of the equation.

On the profit side, this principle really means that activities supplying articles for FMS sales cannot ship used parts of lesser value when new ones are paid for, nor purge inventories by sending broken, obsolete items when serviceable, used items are paid for. Following the guidance of the SAMM that the USG conduct the FMS program on a break-even basis, it would be a violation of this principle to charge more for an item than it is really worth, particularly if it differs from the item ordered and paid for.[42] Yet, this too frequently happens. In the typical material discrepancy ROD case, such as that of the XAF's aircraft, the value of the fourteen mispainted aircraft to the XAF was less than the price they paid for them under the FMS contract. The difference, the price of making the fourteen aircraft conform to the contract, represents an overcharge, or "profit," by the USG--profit in the sense that the full purchase price was not properly earned by the supplying DOD activity. Accordingly, the expense of repainting the fourteen aircraft or refunding their diminished value is really a disgorgement of unearned charges rather than an actual loss. Here, the application of the UCC to the ROD procedure actually reinforces the "no profit" side of the formula.

On the loss side, the SAMM specifically recognizes that some losses in FMS cases will occur. To build a contingency reserve for payment of losses, in fact, is one of the functions of the FMS Administrative Surcharge.[44] In the case of disgorging unearned charges, the costs of these corrections and refunds are apportioned by the SAMM between FMS Administrative Funds and applicable USG appropriations or funds.[45] In those less frequent instances when expenses beyond unearned profits may be involved, the SAMM indicates that the break-even principle will apply "in determining whether USG or FMS administrative funds will absorb the cost of a particular ROD transaction determined to require USG corrective action." [46] Thus, DSAA has the ability with its Administrative Funds to cushion real losses to DOD activities in particular cases. This does not, however, relieve DOD instrumentalities of their self-insurance responsibilities for the portion of AECA section 21 sales transactions for which they undertake contractual responsibility under FMS LOAs. To the extent permitted by regulation, industrially-funded activities may guard against such losses by establishing surcharges to build reserves to cover anticipated expenses to correct defective products sold under FMS. Such a procedure would reduce the impact a case like that of the YAF's cancelled gun pods has on the activity whose funds must refund the purchase price or the value of the ROD. This would dissipate the perception of a loss whenever such activities may be called upon to fulfill their contractual obligations to repair or replace defective products or refund their diminished value. The UCC merely focuses more sharply on our understanding of when such contractual obligations arise.

CONCLUSION

In the face of defective performance in FMS cases such as those discussed above, responsible USG officials are likely to state truthfully and with conviction, "We performed the work in good faith, and we certainly didn't intentionally send out defective products." But good faith performance and the absence of knowing misconduct are not enough; they do not excuse defective performance under a contract for the sale of goods. Even the "boilerplate" of the LOA acknowledges this. Nor can these officials simply rely on conventional application of the no profit, no loss principle to decide the outcome of these cases. Rather, they must understand that "no profit" means "no payment charge not properly earned." And "no loss" applies only to real losses beyond disgorgement of unearned reimbursements and Administrative Fund payments for correcting RODs.

As these cases demonstrate, the AECA must be read in conjunction with other applicable laws. For interpretation of LOA provisions, this includes article 2 of the UCC, which states the

law applicable to contracts for sales of goods, including FMS sales. In particular, the UCC's provisions are consistent with and reinforce the LOA's General Conditions and the guidance of the SAMM that specifically require the USG to replace, refund, or repair defective articles "without additional charge" to the FMS customer. The UCC helps us to focus more sharply on the rights and responsibilities of the parties under FMS contracts and thereby to recognize that the no profit, no loss policy of the AECA as heretofore understood has its limits.

NOTES:

1. 22 U.S.C.A. § 2751-96c (West Supp. 1986).
2. AECA § 21; 22 U.S.C.A. § 2761 (West Supp. 1986).
3. AECA § 22; 22 U.S.C.A. § 2762 (West Supp. 1986).
4. DD Form 1513 and its associated annexes.
5. Annex A.
6. For a phrase-by-phrase analysis of General Condition C, see "Purchaser's Liability in Foreign Military Sales Transactions," 6 *DISAM J.*, No. 2, at 79 (Winter 1983-84).
7. On Standard Form 364.
8. The other three aircraft were unavailable for inspection at time of the NARF engineer's visit to Country X. They had peeling and flaking paint only.
9. This report and other case-specific documents are on file with the author. Excerpts are limited and will not be cited to preserve the privacy of the parties and agencies involved.
10. See note 9 *supra*.
11. *McDonnell Douglas Corp v. Islamic Republic of Iran*, 591 F. Supp. 293, 298 (E.D. Mo. 1984), *aff'd* 758 F.2d 341 (8th Cir. 1985), *cert. denied* U.S., 106 S.Ct. 347 (1985); *Gardiner Manufacturing Corp v. U.S.*, 479 F.2d 30, 41 (9th Cir. 1973); *U.S. v. Wegematic Corp.*, 360 F.2d 674, 676 (2d Cir. 1966).
12. Unless otherwise agreed between the parties, the UCC applies to transactions bearing an appropriate relation to the jurisdiction in question. UCC § 1-105(1), 1 U.L.A. 33-34 (1976). Article 2 applies to "transactions in goods" but does not impair statutes regulating sales to specified classes of buyers (*id.* § 2-102 at 113), such as FMS customers. This means that whenever possible, the AECA and article 2 of the UCC will be applied consistently with each other. When a conflict of specific requirements of the two laws cannot be reconciled, the AECA will prevail.
13. More specifically, the discussion is based on the assumption that, since the LOA makes no choice of law or forum, a suit on the FMS contract would be brought in a U.S. District Court and U.S. federal law would apply. Soon, the legal basis for applying UCC principles will become more certain. On 9 October 1986 the Senate unanimously voted its advice and consent and on 11 December 1986 the President ratified the 1980 United Nations Convention on Contracts for the International Sale of Goods. When the Convention enters into force on 1 January 1988, it will become the supreme law of the land, governing many aspects of the international sales of goods, unless the parties elect not to apply its provisions. Because in general the Convention follows Article 2 of the UCC, contractual analysis under the Convention will resemble that presented in this article. A major exception applicable to FMS cases is that the Convention will not apply to international sales of ships and aircraft. Further discussion of the Convention's application to FMS cases will be the subject of a separate article. After 1 January 1988, the UCC will become a secondary source in international sales cases to supplement the new Convention where it is silent.
14. U.C.C. § 2-513(1), 1A U.L.A. 220 (1976).
15. *Id.* § 2-512(2) at 218.
16. *Id.* § 2-601 at 229.
17. *Id.* § 2-606(1)(a) at 249.
18. *Id.* § 2-607 at 261.
19. *Id.* § 2-714 at 428. Incidental and consequential damages are judicial remedies; they would not apply in the case of administrative reimbursement, discussed in the next section.
20. *Security Assistance Management Manual* [hereinafter SAMM], DOD 5105.38-M (Change 5), ch. 8. sec III, pars. C.4.a. & D at 8-15 & 16.
21. *Id.* table 8-III-3, par. A.1.b. at 8-39.
22. See U.C.C. § 2-607 and text between notes 17 and 18 *supra*.
23. NAVMATINST 4355.72 (DLA Regulation 4140.60 of 1 Feb 80), par. III.K.
24. Which requires the USG to repair or replace at no extra cost articles "defective in respect to material workmanship, when . . . these deficiencies existed prior to passage of title, or . . . defective in design to such a degree that the items cannot be used at all for the purpose for which they were designed."

25. Both functions took place under AECA § 21, Sales from stocks. Although the objection may be raised that the modification effort was merely a provision of defense services not governed by the UCC, both General Condition A.3.a. to the LOA and the UCC contemplate defects in the manufacturing process, including "workmanship" and "design" defects. Unless separately charged and separately listed as line items on the LOA, remanufacturing "services," such as those performed here, must be considered integral to the end product they produce for the FMS purchaser. Thus, manufacturing-related services performed under AECA § 21 as part of an end-product sale, and not separately, will fall under the UCC.
26. SAMM, ch 8, sec. III, par. F.2.a. at 8-18.
27. U.C.C. § 2-513(1), 1A U.L.A. 220 (1976).
28. *Id.* § 2-512(2) at 218.
29. *Id.* § 2-601 at 229.
30. *Id.* § 2-510(1) at 208.
31. *Id.* § 2-401(4) at 132.
32. *Id.* § 2-508(2) at 194.
33. 77 C.J.S. Sales § 340 (1952). *E.g.*, *Transcontinental Refrigeration Co. v. Figgins*, 179 Mont. 12, 585 P.2d 1301 (1978); *Schroeder v. Fageol Motors, Inc.*, 12 Wash. App 161 528 P.2d 992 (1974); *Steele v. J.I. Case Co.*, 197 Kan. 554, 419 P.2d 902 (1966); *Allen v. Brown*, 181 Kan. 301, 310 P.2d 923 (1957).
34. DSAA Comptroller memo I-001005/86 of 6 May 86. The SAMM requires all RODs in excess of \$10,000.00 to be submitted to DSAA for approval. SAMM, ch. 8, sec. IV, par. F.3.c. at 8-50.
35. See text at note 20 *supra*.
36. The time limit for filing a ROD is one year from the later of passage of title or billing for the goods. NAVMATINST 4355.72, *supra* note 23.
37. SAMM, ch. 8, sec. IV, par. E at 8-49; see also *id.* ch 7, sec. III, par. D.4.b.(2) at 7-77.
38. DSAA Comptroller memo *supra* note 34 (emphasis added).
39. And if sued for reimbursement of the ROD, the USG could also be liable for incidental and consequential damages, if any, as specified in U.C.C. § 2-715, 1A U.L.A. 445 (1976).
40. The claimed amount (\$423,000), however, is less than half the responsible agency's recently-computed costs charged for the modification of gun pods (\$904,000).
41. U.C.C. § 2-401(4), 1A U.L.A. 132 (1976).
42. SAMM, ch 8, sec. IV, par. F.2 at 8-49.
43. *Id.*
44. "An administrative charge shall be added to all FMS cases to recover DOD expenses related to . . . administering Reports of Discrepancy [and] the cost of correcting deficiencies or damage to items sold under Section 21 of the AECA . . ." *FMS Financial Management Manual*, DOD 7290.3-M (Sep. 18, 1986), par. 70501 at 705-1.
45. SAMM, table 8-III-3 at 8-39.
46. *Id.* ch. 8, sec. IV, par. F.2 at 8-49.

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