
PERSPECTIVES

Foreign Military Sales Policy Changes, Clarifications, and Initiatives

By

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I recommend changing the “S” in FMS to “C” for Customer. There is a simple explanation for the difference between marketing and selling. Selling is getting rid of what you have in your inventory. Marketing is understanding your customer before you build your inventory. Pushing a product, or hard selling, is not marketing. Marketing requires customer focus and provides a product or service that is tailored to the customer’s continually changing needs. The “win win” of marketing is a satisfied customer who trusts the supplier to continue to provide a quality product or service.

Foreign military sales is governed by the Foreign Assistance Act 1961, as amended, and the Arms Export Control Act 1976, as amended, and is implemented by the Security Assistance Management Manual which authorizes sales of defense articles and defense to foreign customers to equip their forces services to further United States security objectives. With approval, the law states that U.S. government can sell what it has in inventory. Selling inventory is how FMS has operated in the past. Today, the majority of foreign customers demand a defense article or service that is customized to fit their unique requirements. The key word is “customer.” How do we meet the needs of FMS customers and stay within the guidelines of public law and policy? According to the concerns expressed by FMS customers, simply delivering a defense article or service does not meet all of the expectations of the foreign customer.

Foreign military customers are asking for increased involvement in the requirements definition and contract definition phases of the acquisition process. FMS customers are becoming increasingly sophisticated, and are less likely to accept the U.S. government’s historical reluctance to involve FMS customers in the acquisition process. This reluctance often translates as patronizing, and sends a mixed and negative message: “you’re not smart enough to get it; I don’t trust you enough to share information with you; you’re an outsider; I don’t like your politics.”

OSD Deputy Secretary of Defense Policy Memoranda

Dr. John J. Hamre, Deputy Secretary of Defense, has been listening to the complaints of foreign military customers who feel disenfranchised with the FMS acquisition process. Foreign customers want greater participation and increased insight and understanding of the U.S. government procurement process. On 26 January 1999, Dr. Hamre issued a white paper entitled

“Process Transparency.” The introduction emphasizes the requirements of the foreign military customer:

Process transparency in security cooperation is intended to provide foreign customers and U.S. industry greater visibility of what traditionally have been internal U.S. government activities. Our foreign customers and industry believe an increased level of access will promote teamwork, increase customer satisfaction, and assist in the streamlining of the security cooperation system.

On 23 March 1999, Dr. Hamre issued a policy memorandum entitled, “Department of Defense Customer Participation in Foreign Military Sales (FMS) Contract Preparation and Negotiations.” As a result of this memorandum, the OSD Director of Defense Procurement proposed an amendment to the Defense Federal Acquisitions Regulations Supplement (DFARS) 225.7304 intended to increase FMS customer visibility into the contract formation phase of the FMS acquisition. If requested by the FMS customer, the contracting officer should permit the FMS customer to observe price negotiations and should provide the FMS customer with information regarding price reasonableness. The safeguards built into the proposed DFARS rule require the contractor’s written consent and foreign customer agreement not to disclose any proprietary contractor data. Further, the foreign customer must agree not to undermine the authority of the contracting officer by discussing any issue related to the negotiation of price, either during negotiations or separate from negotiations, with the potential offeror. As of this writing, DoD is still considering the public comments and has not published a final rule on FMS customer participation.

The intent of Dr. Hamre’s FMS policy memoranda is to facilitate greater insight and understanding by the foreign customer through “process transparency.” Just “observing” price negotiations may not go far enough to create an environment of teaming and openness, as negotiation is the final stage in pre-contract award activities. The foreign customer can “participate” in evaluating the contractor’s proposed approach and the amount of effort required to perform the work. This participation is intended to answer questions which will lead to increased understanding. It is not intended to constitute the government’s technical evaluation or its objective but rather can supplement the government’s understanding of the nature and extent of the FMS requirement. The actual “cost” of the work may not be an appropriate area for customer evaluation or involvement. The contractor’s stance on protecting or disclosing contractor proprietary data will affect the level of pricing detail that is shared with the FMS customer. The basis of estimate presents a good level for customer review because rates and factors are not applied at this level. A thorough explanation of the role of the Defense Contract Audit Agency and the general rules that contractors comply with when submitting acceptable proposals should be provided to the foreign military customer.

Explaining and enforcing the ground rules for foreign customer participation could turn into an arduous, time consuming task depending on the attitude of the team leaders. Customer participation should be a team challenge met with enthusiasm and the desire to improve the quality of the evaluation team with increased representation by all of the stakeholders. The same challenge existed when “one pass,” “shoulder to shoulder,” or “alpha” contracting were new processes. Team training was conducted and several proposals were evaluated before everyone became comfortable with their new team roles; now everyone shares in the benefit of increased communications. FMS customer involvement is a comfortable fit with the current policy of open communications and teaming with defense contractors.

OSD Director of Defense Procurement Policy Memorda

The OSD Director of Defense Procurement issued memoranda dated 13 July 1999 that clarified the requirements for pricing FMS contracts. To accommodate these clarifications, a final rule, amending DFARS, was issued on 13 September 1999.

a. Offset Cost Allowability

The policy clarified that contracting officers should treat offset costs as allowable costs under the contract. Sales of military equipment, through FMS or direct commercial sales, are accompanied by offset agreements which are negotiated between the foreign government and the defense contractors. The U.S. government is not party to, nor has any liability for, the enforcement of the offset agreement. Offset agreements allow foreign governments to “. . . leverage their imports of major weapon systems so as to yield benefits for their domestic economies . . . Such programs are often an essential part of a weapons procurement and allow the purchasing government to build public support for large expenditures of public funds.”¹ One aspect of offsets that creates confusion is the difference between the actual cost of the offset and the cost of the offset expressed as an offset commitment or obligation. Offsets are typically expressed as a percentage of the weapon system procurement cost. For example, a country might require an offset equal to 100% or even 300% of the cost of the weapon system procurement. Stating that an offset is worth 100% of an \$800M program has created the impression that the offset cost itself is \$800M. Historical averages indicate that offset costs range from 3-8% of the cost of the weapon system. The out-of-pocket costs to the contractor to implement a \$800M or 100% offset arrangement might be \$24M to \$64M and is an allowable element of cost included in the price of the defense equipment being procured.

The offset agreement describes the types of activities that are eligible for offset credit. “Countries can encourage companies to undertake highly desirable offset activities by granting additional offset credit through multipliers.”² For example, technology transfers can create large offset credits because the perceived value to the customer is very high, yet the cost to implement is relatively low. All of the offset costs can be recovered under the FMS contract and should be treated as normal contract costs, subject to negotiation of a fair and reasonable price. The offset agreement is not a material requirement or a deliverable under the contract and therefore should not be segregated as a separate contract line identification number.

There is an opinion that the foreign customer may be insulted or surprised that the contractor would enter into an offset agreement and then recoup the actual cost of the offset under the Letter of Offer and Acceptance (LOA) and the contract. The customer, it is believed, expects to receive the economic benefits associated with the offset without incurring any additional cost. On the other hand, it is also evident that FMS customers believe the cost of the offset in the LOA is a good deal in comparison to the benefits received. The customer acquires a defense article or service and the economy of the country is strengthened by the “multiplier” effect of all the other business development activities of the offset arrangement. The LOA should include appropriate language to the effect that all reasonable costs associated with the offset commitment may be included in the LOA.

b. Foreign Competitions: Can they meet the standard of adequate price competition?

The policy also recognized that a foreign competition could be determined to meet the standards of adequate price competition, thereby precluding the requirement for additional cost or pricing data. An increased number of FMS customers are conducting their own best value competitions in advance of entering into the LOA with the U.S. Although the source selection process is managed, controlled, and conducted by the foreign purchaser, their competition could be determined to meet the standard of adequate price competition at FAR 15.403-1(c)(i). The standard does not require the contracting officer to evaluate the foreign customer's source selection plan, procedures, or evaluation criteria. The FAR states that a price is based on adequate price competition if two or more responsible offerors, competing independently, submit priced offers that satisfy the government's expressed requirement. The FAR then states that award is made to the offeror whose proposal represents best value where price is a substantial factor. The last condition requires that there is no finding that the price of the otherwise successful offeror is unreasonable.

In most cases, the foreign customer approaches the U.S. government before conducting a competition and makes it known they plan to go FMS after their source selection decision. This is the right opportunity for the government to act as a business advisor and describe the pros and cons of conducting the type of source selection which could be determined to meet the standard of adequate price competition.

As business advisors, the role of the contracting officer is actually expanded in terms of supporting and advising the foreign military customer during pre-LOA discussions and directing and controlling the team, including the foreign military customer, during the pre-contract award phase. United States government business or technical support and advisement must be provided on an existing LOA or on a new LOA written specifically to provide this type of assistance to the foreign customer. What a tremendous challenge and opportunity to create customer confidence by focusing on the "C" instead of the "S," and by tailoring the "process" to the "customer" rather than the "customer" to the "process".

Notes

1. GAO Report, "U.S. Contractors Employ Diverse Activities to Meet Offset Obligations", GAO/NSIAD-99-35 dated December 1998, page 2.
2. Ibid., page 4.

About the Author

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