Chapter

8 Foreign Military Sales Contractual Agreements

Introduction

Basic contract law concepts are evident in the government-to-government agreements for security assistance (SA). This chapter examines the foreign military sales (FMS) case standard terms and conditions that are an integral component of every FMS Letter of Offer and Acceptance (LOA). Additionally, this chapter discusses the purpose and application of other SA agreements such as LOA amendments, LOA modifications, leases, loans, and international agreements.

Contracts

A contract is an agreement between two or more parties which is enforceable by law. *The Security Assistance Management Manual* (SAMM) states that the FMS LOA is the government-to-government contract between the purchaser government and the US. LOAs are also commonly referred to as cases. In practice, the terms LOA and case are synonymous. Chapter 5 of this text, "Foreign Military Sales Process," discusses the procedures for requesting and developing an LOA.

Under traditional FMS, an LOA is a bilateral agreement between the US government (USG) and an authorized foreign purchaser. In the LOA, the USG commits itself to provide certain defense items or services and the purchaser commits itself to abide by specific terms and conditions associated with the sale and to make specified financial payments.

It is important to note that the LOA document is also used to implement security cooperation (SC) programs. Under SC programs, the LOA and overall FMS processes and infrastructure are utilized to track and implement funds appropriated by Congress for designated SC activities. The terminology applied to an LOA used in this manner is to refer to these documents as either a pseudo LOA or a Building Partner Capacity (BPC) LOA. Pseudo LOAs are not signed by a foreign purchaser, and therefore the LOA standard terms and conditions are not applicable to these pseudo cases.

Elements of a Contract

Six basic elements must be present for an agreement to be enforceable by law as a contract. These six contractual elements are present in each LOA. This section highlights how these six contract elements relate to the LOA process.

Offer

The offer is a proposal by one party to enter into a contractual relationship with another party. In order for a statement or communication to be a valid offer, the respective statement or communication must be intended to be an offer. This element plays an important role in the SA process. A foreign customer may submit a request for price and availability (P&A) data. When P&A data is provided to a foreign purchaser, the SAMM requires that a statement be included with the P&A response to emphasize that providing P&A data does not constitute an offer to sell. A P&A response only provides information. If a foreign purchaser desires an LOA to purchase the material or services identified in the P&A data, the purchaser must submit a subsequent request for an LOA.

Under the FMS process, a formal USG offer to sell military articles or services is communicated by presenting an LOA, complete with the authorized USG signatures, to the prospective customer. LOAs are generally only offered in response to a specific customer's letter of request (LOR). The customer's LOR is referenced in each LOA offered. The LOA offer remains valid through the offer expiration date cited in the LOA. After the offer expiration date, the LOA is no longer an offer and cannot be accepted unless reinstated or reissued by the USG.

Acceptance

Acceptance is an expression of agreement to the contract offer. In order for the acceptance to be effective, it must be clear, timely and in the same terms as the offer. This contract principle is key to the LOA process. Even though a customer submitted an LOR for an LOA, the customer is under no obligation to accept the LOA offered by the USG. Acceptance of the LOA is accomplished by an authorized country representative signing the LOA prior to the offer expiration date, forwarding the specified initial deposit and returning the proper number of signed LOA copies. Payment of the initial deposit is a condition of acceptance. Implementation of the FMS case cannot take place without receipt of the initial deposit. Additionally, in the acceptance process, the customer informs the USG of the applicable mark for code, freight forwarder code, procuring agency code and the name/address of their paying office. This information is entered by the customer on the bottom of the first page of the LOA.

Consideration

Consideration exists when something of legal value or benefit is offered by one party to another. Consideration is the value of a promised action and is often stated in monetary terms. With respect to an LOA, consideration consists of the purchaser's financial payment(s) in return for defense articles and services provided by the USG.

Competent Parties

Competent parties means that both parties to the contract possess the legal capacity to enter into the contract. Competent parties relative to the LOA are the authorized US and purchaser representatives that sign the LOA. Each LOA will contain a written signature by a representative of the implementing agency (IA) that generated the LOA. Additionally, each LOA will contain an electronic countersignature signifying that DSCA has reviewed and approved the LOA.

Each customer establishes their own process for LOA review and acceptance. From a US perspective, receipt of a signed LOA from the customer coupled with receipt of the initial deposit, which is typically substantial, indicates that the individual that signed to accept the LOA is an authorized representative of that respective government.

Lawful Purpose

As a general rule, a contract which violates a statute is unlawful and will not be enforced. Under the FMS process, it is incumbent upon the representatives of both governments to ensure that the LOA is in compliance with their respective laws and policies prior to offering or accepting a given LOA. The USG must comply with the Arms Export Control Act (AECA), the Foreign Assistance Act (FAA), and other associated statutes. Each FMS LOA includes the statement "Pursuant to the Arms Export Control Act" in the second paragraph. From the US perspective, the Congressional notification process for certain high-value LOAs is an example of ensuring that LOAs offered to customers comply with US statutory requirements. A DSCA Office of General Counsel attorney reviews each LOA to ensure the legal sufficiency of each proposed LOA offer. DSCA countersignature signifies that each LOA offer complies with all applicable statutory and policy requirements. Foreign purchasers have the responsibility to ensure that their actions regarding the LOA are in compliance with their respective national laws.

Terms and Conditions

A contract must clearly delineate what each party has committed to perform. A contract that poorly defines what, when, where, how, at what cost, and under what conditions, may lead to confusion and may be unenforceable. In this regard, every FMS LOA contains a set of standard terms and conditions. This same set of standard terms and conditions applies to all FMS LOAs and is exactly the same for all foreign purchasers.

It is important to note that the LOA standard terms and conditions do not apply to pseudo LOAs used to implement BPC programs. The reason for this difference is that under pseudo LOAs, the USG is actually selling defense articles and services to another component of the USG rather than directly to a foreign purchaser.

Letter of Offer and Acceptance Standard Terms and Conditions

The standard terms and conditions to be used with all FMS LOAs are discussed below. The standard terms and conditions are categorized into seven sections. These LOA terms and conditions establish certain rights and responsibilities for each of the parties in the contract. The terms and conditions also delineate certain limitations or constraints associated with the sale.

Section 1	Conditions—United States Government Obligations
Section 2	Conditions—General Purchaser Agreements
Section 3	Indemnification and Assumption of Risks
Section 4	Financial Terms and Conditions
Section 5	Transportation and Discrepancy Provisions
Section 6	Warranties
Section 7	Dispute Resolution

Section 1. Conditions—United States Government Obligations

1.1 Unless otherwise specified, items will be those which are standard to the US Department of Defense (DOD), without regard to make or model.

1.2 The USG will furnish the items from its stocks and resources, or will procure them under terms and conditions consistent with DOD regulations and procedures. When procuring for the Purchaser, DOD will, in general, employ the same contract clauses, the same contract administration, and the same quality and audit inspection procedures as would be used in procuring for itself; except as otherwise requested by the Purchaser and as agreed to by DOD and set forth in this LOA. Unless the Purchaser has requested, in writing, that a sole source contractor be designated, and this LOA reflects acceptance of such designation by DOD, the Purchaser understands that selection of the contractor source to fill requirements is the responsibility of the USG, which will select the contractor on the same basis used to select contractors for USG requirements. Further, the Purchaser agrees that the US DOD is solely responsible for negotiating the terms and conditions of contracts necessary to fulfill the requirements in this LOA.

1.3 The USG may incorporate anti-tamper (AT) protection into weapon systems and components that contain critical program information (CPI). The AT protection will not impact operations, maintenance, or logistics provided that all terms delineated in the system technical documentation are followed.

1.4 The USG will use its best efforts to provide the items for the dollar amount and within the availability cited.

1.5 Under unusual and compelling circumstances, when the national interest of the US requires, the USG reserves the right to cancel or suspend all or part of this LOA at any time prior to the delivery of defense articles or performance of defense services. The USG shall be responsible for termination costs of its suppliers resulting from cancellation or suspension under this section.

Termination by the USG of its contracts with its suppliers, other actions pertaining to such contracts, or cessation of deliveries or performance of defense services is not to be construed as cancellation or suspension of this LOA itself under this section.

1.6 US personnel performing defense services under this LOA will not perform duties of a combatant nature, including duties relating to training and advising that may engage US personnel in combat activities outside the US, in connection with the performance of these defense services.

1.7 The assignment or employment of US personnel for the performance of this LOA by the USG will not take into account race, religion, national origin, or gender.

1.8 Unless otherwise specified, this LOA may be made available for public inspection consistent with the national security of the United States.

Section 1.1 Standard Items

This section notifies the purchaser that the items to be furnished under the LOA will typically be standard items. The term "standard" in this context means that the items provided will be the same as those currently in use by DOD. The ultimate purpose of SA is to enhance US national security. When friends and allies use standard US systems and components, opportunities for interoperability and logistics cross-servicing are greatly increased which, in turn, enhances US national security. This general commitment to supply standard items will be applied subject to US releasability determinations and technology transfer decisions which are discussed in chapter 7, "Technology Transfer, Export Controls and International Programs Security."

This condition further highlights that items will be provided without regard to make or model. This provision is necessary because the DOD generally procures using a competitive process. In the competition, the potential exists for any given manufacturer's make or model product to be selected if the respective product meets the procurement specification requirements such as performance, form, fit, or function. Although the foreign customer may have received a certain make and model product in a prior procurement, the customer should not expect to automatically receive the exact same make and model product in future procurements. If the purchaser has certain unique requirements for specific makes or models, this condition places the responsibility on the purchaser to make those unique requirements known to the IA, otherwise the standard US configuration will be supplied.

Section 1.2 Buyer-Seller Relationship

This section establishes the buyer-seller relationship between the international purchaser and the USG. By accepting the LOA, the purchaser authorizes the USG representatives to act on its behalf. When the DOD procures items to fulfill the purchaser's requirements, it will generally apply the same acquisition and contract procedures that it uses in procuring for itself. This affords the international purchaser the same benefits and protection that apply to DOD procurements, and is one of the principal reasons why nations choose to procure through FMS channels.

Sole source for the purposes of an LOA is a process whereby a FMS purchaser may request LOA items or services to be procured from one specific vendor. Sole source procedures are outlined in the SAMM, section C6.3.4, and *Defense Federal Acquisition Regulation Supplement* (DFARS) 225.7304. More information on sole source procurement is contained in chapter 9, "Foreign Military Sales Acquisition Policy and Process."

Section 1.3 Anti-tamper Protection

Incorporation of anti-tamper protection alerts the FMS customer that the USG may use anti-tamper protection in equipment sold under FMS to safeguard critical technology. In addition, usage of anti-tamper protection will not alter the form, fit and function of the equipment or component.

Section 1.4 Best Efforts

The term "best efforts" is a legal term that implies a party's good faith or intent to achieve a stated future outcome; however, this term also recognizes the potential for other factors to subsequently arise that could preclude the offer from actually attaining the intended goal. Good faith is defined by Black's Law Dictionary 701 [7th edition 1999] as:

> A state of mind consisting in (1) honesty in belief or purpose, (2) faithfulness to one's duty or obligation, (3) observance of reasonable commercial standards of fair dealing in a given trade or business, or (4) absence of intent to defraud or to seek unconscionable advantage.

Therefore, a party performing under a "best effort" condition will not be considered in default of the contract if the intended performance outcomes are not achieved.

In regard to the LOA, this section means that the USG will undertake the execution of each LOA with the intent to deliver within the estimated cost and delivery dates cited in the LOA but the USG cannot promise or guarantee these estimates will be achieved. As such, the purchaser understands and accepts the risk that the USG may fail to meet the LOA cost and delivery estimates.

Section 1.5 US Government Right to Cancel or Suspend

The USG reserves the right to cancel an LOA, in whole or in part, when determined to be in the USG's best interest. The USG carefully reviews customer requests before extending an LOA offer. As indicated by section 1.5, an unusual, significant event must occur to cause the USG to change its position and decide to cancel or suspend the LOA sale. If the USG chooses to cancel an LOA, the USG is responsible for paying the costs associated with terminating the respective procurement contracts with its suppliers. This does not necessarily mean that the entire LOA amount will be refunded to the purchaser. Given the fact that there will be unusual and compelling circumstances surrounding the exercise of this LOA term, history shows that a politically negotiated agreement will be necessary to settle the financial obligations and disposition of material associated with cancelled or suspended LOAs. SAMM section C6.6 states that DSCA will provide the IA direction regarding the disposition of property and the liquidation of liabilities in regard to any cancelled or suspended LOA.

Section 1.6 & 1.7 US Personnel Requirements

Sections 1.6 and 1.7 implement FAA and AECA statutory requirements which apply to US personnel performing SA functions. Section 1.6 emphasizes that the presence of US SA personnel in the purchaser's country does not necessarily constitute a commitment by the US to conduct any combat activity with the purchaser. Additionally, section 1.7 specifies that the US will use its own personnel management processes to select individuals to conduct SA functions on behalf of the purchaser.

Section 1.8 Freedom of Information Guidelines

Section 1.8 implements the provisions of the Freedom of Information Act (FOIA). However, under FOIA, information provided to the USG in confidence by a foreign government may be exempt from disclosure to the public. Conditions which may exempt the LOA from public release include determinations that the LOA contains information not normally released by the respective foreign government. Any decision to release or withhold information must be coordinated with DSCA and the appropriate legal counsel of the involved DOD component. The official policy for release is found

in SAMM, section C3.5. More information on FOIA is contained in chapter 7, "Technology Transfer, Export Controls, and International Programs Security."

Section 2. Conditions—General Purchaser Agreements

2.1 The Purchaser may cancel this LOA or delete items at any time prior to delivery of defense articles or performance of defense services. The Purchaser is responsible for all costs resulting from cancellation under this section.

2.2 The Purchaser agrees, except as may otherwise be mutually agreed in writing by the Purchaser and the USG, to use the defense articles sold hereunder only:

2.2.1 for internal security;

2.2.2 for legitimate self-defense;

2.2.3 for preventing or hindering the proliferation of weapons of mass destruction and of the means of delivering such weapons;

2.2.4 to permit the Purchaser to participate in regional or collective arrangements or measures consistent with the Charter of the United Nations, or otherwise to permit the Purchaser to participate in collective measures requested by the United Nations for the purpose of maintaining or restoring international peace and security; or

2.2.5 for the purpose of enabling foreign military forces in less developed countries to construct public works and to engage in other activities helpful to social and economic development.

2.2.6 for purposes specified in any Mutual Defense Assistance Agreement between the USG and the Purchaser; or,

2.2.7 for purposes specified in any other bilateral or regional defense agreement to which the USG and the Purchaser are both parties.

2.3 The Purchaser agrees that the USG retains the right to verify reports that defense articles and services have been used for purposes not authorized or for uses not consented to by the USG.

2.4 The Purchaser will not transfer title to, or possession of, the defense articles, components and associated support materiel, related training or other defense services (including plans, specifications, or information), or technology furnished under this LOA to anyone who is not an officer, employee, or agent of the Purchaser (excluding transportation agencies) or of the USG, and shall not use or permit their use for purposes other than those authorized, unless the written consent of the USG has first been obtained. The Purchaser will ensure, by all means available to it, respect for proprietary rights in any items and any plans, specifications, or information furnished, whether patented or not. The Purchaser also agrees that the defense articles offered will not be transferred to Cyprus or otherwise used to further the severance or division of Cyprus, and recognizes that the US Congress is required to be notified of any substantial evidence that the defense articles sold in this LOA have been used in a manner that is inconsistent with this provision.

2.5 The Purchaser agrees not to divert articles and services received under this LOA for purposes or uses other than those for which it was furnished, including, but not limited to, any use that could contribute to the acquisition, design, development or production of a "missile," as defined in section 74 of the Arms Export Control Act (AECA) (22 U.S.C. 2797c). The items will

be used only for the purposes stated and such use will not be modified nor the items modified or replicated without the prior consent of the USG; neither the items nor replicas nor derivatives thereof will be retransferred without the consent of the USG. The USG has the right to take action under section 73(a) of the AECA (22 U.S.C. 2797b(a)) in the case of any export or transfer of any Missile Technology Control Regime (MTCR) equipment or technology that contributes to the acquisition, design, development or production of missiles in a country that is not an MTCR adherent.

2.6 The Purchaser will maintain the security of such article or service and will provide substantially the same degree of security protection afforded to such article or service by the United States Government. To the extent that items, including plans, designs, specifications, technical data, or information, furnished in connection with this LOA may be classified by the USG for security purposes, the Purchaser certifies that it will maintain a similar classification and employ measures necessary to preserve such security, equivalent to those employed by the USG and commensurate with security agreements between the USG and the Purchaser. If such security agreements do not exist, the Purchaser certifies that classified items will be provided only to those individuals having an adequate security clearance and a specific need to know in order to carry out the LOA program and that it will promptly and fully inform the USG of any compromise, or possible compromise, of US classified material or information furnished pursuant to this LOA. The Purchaser further certifies that if a US classified item is to be furnished to its contractor pursuant to this LOA: (a) the item will be exchanged through official Government channels, (b) the specified contractor will have been granted a facility security clearance by the Purchaser at a level at least equal to the classification level of the US information involved, (c) all contractor personnel requiring access to such items will have been cleared to the appropriate level by the Purchaser, and (d) the Purchaser is also responsible for administering security measures while the item is in the contractor's possession. If a commercial transportation agent is to be used for shipment, the Purchaser certifies that such agent has been cleared at the appropriate level for handling classified items. These measures will be maintained throughout the period during which the USG may maintain such classification. The USG will use its best efforts to notify the Purchaser if the classification is changed.

2.7 Pursuant to section 505 of the Foreign Assistance Act of 1961, as amended (FAA) (22 U.S.C. 2314), and section 40A of the AECA (22 U.S.C. 2785), the USG will be permitted, upon request, to conduct end-use monitoring (EUM) verification with respect to the use, transfer, and security of all defense articles and defense services transferred under this LOA. The Purchaser agrees to permit scheduled inspections or physical inventories upon USG request, except when other means of EUM verification shall have been mutually agreed. Upon request, inventory and accountability records maintained by the Purchaser will be made available to US personnel conducting EUM verification.

2.8 The USG is not a party to any offset agreements/arrangements that may be required by the Purchaser in relation to the sales made in this LOA. The USG assumes no obligation to administer or satisfy any offset requirements or bear any of the associated costs. To the extent that the Purchaser requires offsets in conjunction with this sale, offset costs may be included in the price of contracts negotiated under this LOA. If the Purchaser desires visibility into these costs, the Purchaser should raise this with the contractor during negotiation of offset arrangements.

Section 2 outlines certain rights and obligations of purchaser associated with the LOA sales contract.

Section 2.1 Purchaser Right to Cancel

In section 1.5, the USG retained the right to cancel or suspend part or all of the case. Similarly, this section provides the FMS customer the right to change their mind. Simply because the customer accepted the case at one point does not mean the customer is locked into that decision. The customer is a voluntary participant and can cancel the entire LOA or delete specific items prior to delivery.

If the customer chooses to exercise this right, the customer is financially liable for all the associated termination costs. Termination costs are incurred to cancel work that is already underway to execute the LOA. Most termination costs relate to payments to contractors arising from contract cancellations. Generally, contractors are entitled to certain payments when contracts are unilaterally cancelled prior to normal contract completion. Depending on how much work is already in-process, the termination cost to cancel or delete items may be substantial. Because this condition provides the right to cancel, termination liability is a factor calculated into the LOA payment schedule. The calculation of termination liability ensures that at any point in the LOA execution, the US should have collected sufficient funds in advance from the customer to cover all outstanding liabilities in the event the customer elects to cancel part or all of the LOA. More information on termination liability is contained in chapter 12 of this textbook, "Financial Management."

Section 2.2 End-Use Purposes

This condition stipulates that the purchaser will only use the material or services purchased under the LOA for certain purposes, referred to as end-use. At first, it may appear unfair that the USG attaches end-use limitations to the sale but you must remember that the USG is selling defense articles and services rather than consumer products. Additionally, as discussed in section 1.1, this is often the same material used by US military forces. As such, the USG has valid concerns over how these articles or services are used by the customer. More information on end-use is contained in chapter 18, "End-Use Monitoring and Third-Party Transfers."

Section 2.3 Reports Verification

Section 2.3 establishes the right of the USG to verify any reports that defense articles or services are being used for purposes other than as specified in section 2.2. The incorporation of this language into the terms and conditions of the LOA allows the USG the right to investigate any report of violation to the use provisions of the LOA.

Section 2.4 Third Country Transfers

Section 2.4 restates the obligations imposed on the FMS purchaser under the AECA. Although the FMS customer actually becomes owner of the material, the USG requires, as a condition of the sale, that the purchaser agree to not resell or transfer possession of the purchased items without first obtaining written USG consent.

This condition does not mean that the customer can never sell the material or turn over possession for maintenance to a third country. It simply means that the USG is very concerned about who has access and possession of this defense material. Before offering the LOA, the USG determined that it was in its best interest to permit the customer to possess this material. The USG wants to ensure that possession of this defense material by a prospective third party is also in the USG's best interest. More information on third-party transfers is contained in chapter 18, "End-Use Monitoring and Third-Party Transfer."

This condition also requires FMS purchaser to respect the proprietary rights of US contractors. US industry often has made significant investments in defense technologies that enable the firm to compete both commercially and in the defense sector. This condition protects the intellectual property of US contractors from being misused.

This section also specifically identifies conditions related to Cyprus. It does appear unusual that provisions regarding Cyprus would be included in the standard terms and conditions used with all FMS LOAs. This is an example of the political influences that impact SA. The Congress was concerned about unauthorized transfers of defense articles to Cyprus. As a result, Congress specifically addressed this concern within the language of the AECA. Given these conditions relative to Cyprus are contained

within the law, these same conditions flow over into the standard terms and conditions used with all FMS LOAs.

Section 2.5 Missile Technology Control Regime

Section 2.5 alerts the customer not to divert articles and services provided under the LOA for purposes other than for which it was furnished. This specifically excludes any use that would support the design, development or production of missile technology as specified in the AECA.

Section 2.6 Security Requirements

The USG is very concerned about preserving the security of classified material transferred under FMS. This condition requires the FMS customer to maintain equivalent security measures. This does not mean the customer must use the same USG security procedures. It means that the end result of the customer's security process will achieve a level of security that is equivalent to the security level provided by the US. Additionally, the customer is responsible for security not only when the item is in government possession but also when it is provided to the FMS purchaser's domestic contractors or when it is in the transportation pipeline. More information on security controls is contained in chapter 7, "Technology Transfer, Export Controls, and International Programs Security."

Section 2.7 End Use Monitoring

Section 2.7 states the USG retains the right to conduct end-use monitoring (EUM) verification of articles transferred under the LOA. The purchaser agrees to permit scheduled inspections or physical inventories upon request and make accountability records available to USG EUM personnel. A more detailed explanation of EUM is contained in chapter 18, "End Use Monitoring and Third Party Transfers."

Section 2.8 Offset Arrangements

Section 2.8 incorporates a previous mandatory note on offset arrangements. Section 2.8 notifies the customer that the USG is not a party to any offset arrangement and assumes no obligation to administer any offset requirements. A more detailed explanation of offsets is contained in chapter 9, "Foreign Military Sales Acquisition Policy and Process."

Section 3. Indemnification and Assumption of Risk

3.1 The Purchaser recognizes that the USG will procure and furnish the items described in this LOA on a non-profit basis for the benefit of the Purchaser. The Purchaser therefore undertakes to indemnify and hold the USG, its agents, officers, and employees harmless from any and all loss or liability (whether in tort or in contract) which might arise in connection with this LOA because of:

3.1.1 Injury to or death of personnel of Purchaser or third parties,

3.1.2 Damage to or destruction of (a) property of DOD furnished to Purchaser or suppliers specifically to implement this LOA, (b) property of Purchaser (including the items ordered by Purchaser pursuant to this LOA, before or after passage of title to Purchaser), or (3) property of third parties, or

3.1.3 Infringement or other violations of intellectual property or technical data rights.

3.2 Subject to express, special contractual warranties obtained for the Purchaser, the Purchaser agrees to relieve the contractors and subcontractors of the USG from liability for, and will assume the risk of, loss or damage to:

3.2.1 Purchaser's property (including items procured pursuant to this LOA, before or after passage of title to Purchaser), and

3.2.2 Property of DOD furnished to suppliers to implement this LOA, to the same extent that the USG would assume for its property if it were procuring for itself the items being procured.

Section 3 begins by reminding the customer that the USG's purpose in the FMS sales contract is not for financial gain. Obviously, the USG believes the sale is in its best interest but financial profit is not the motivating factor. In recognition of this fact, this condition states that the purchaser indemnifies the USG. This means that the purchaser agrees to accept the risks of financial liabilities that may arise in the execution of the LOA.

At first, the requirement for indemnification may seem unfair and appear that the USG is placing undue risk upon the FMS purchaser. However, you must remember that the USG is conducting business on behalf of the FMS customer in the same manner that the USG conducts business for itself. As a normal business practice, the USG exposes itself to certain degrees of risk. Given the broad range of risks the USG faces, it is less expensive to absorb the occasional loss than it is to purchase insurance to insulate against all these risks. In procurements, the USG may include limitation of liability clauses to relieve contractors from certain liabilities (like acts of God). The reason for limitation of liability contract clauses is to reduce overall procurement costs. If contractors were required to cover all potential risks, they would demand a higher contract price in compensation for being exposed to greater risk.

When it comes to executing FMS programs, the USG faces certain risks just like it does while conducting business for itself. Under the LOA, the USG is simply requiring the customer to absorb the risks that the USG would absorb if the actions were conducted in support of a USG requirement. So, in reality, the USG is not asking the customer to be exposed to an extraordinary degree of risk. The USG is only requiring the customer to stand in the USG's place to face the same level of risk that the USG normally faces in conducting business for itself.

Liability Illustration

Suppose, under an FMS case, a foreign purchaser wanted to purchase an excess aircraft and have that aircraft's avionics upgraded prior to delivery. Following LOA acceptance, the US awarded a contract for the upgrade, removed the aircraft from storage and transported it to a contractor for upgrade work. After the contractor completed the work, the contractor's test pilot flew the aircraft on a functional check flight. During the check flight, a catastrophic problem developed which caused the aircraft to crash and be destroyed, causing significant property damage on the ground at the crash site.

In this hypothetical scenario, who is financially liable for the costs? The answer is that it depends. The USG would investigate the crash to determine the cause. In the investigation, the contractor's contractual responsibility would be examined to determine if contractor non-performance or negligence contributed to the accident. If the contractor would have held some financial responsibility if the work was being done for the benefit of the USG, then the contractor would also be held to the same degree of financial responsibility in the case of the work being performed for an FMS customer.

If, at the conclusion of the investigation, it was found that the contractor had fulfilled all his contractual requirements and the accident cause was in an area that the USG normally accepts the liability risk, this LOA condition states that the FMS purchaser will assume this financial liability rather than the USG or the contractor. Again, this provision simply informs the FMS customer that they should be prepared to be exposed to the same degree of financial risk that the USG exposes itself to in the normal course of business.

Section 4. Financial Terms and Conditions

4.1 The prices of items to be procured will be billed at their total cost to the USG. Unless otherwise specified, the cost of items to be procured, availability determination, payment schedule, and delivery projections quoted are estimates based on the best available data. The USG will use its best efforts to advise the Purchaser or its authorized representatives of:

4.1.1 Identifiable cost increases that might result in an overall increase in the estimated costs in excess of ten percent of the total value of this LOA,

4.1.2 Changes in the payment schedule, and

4.1.3 Delays which might significantly affect estimated delivery dates. USG failure to advise of the above will not change the Purchaser's obligation under all subsections of section 4.4.

4.2 The USG will refund any payments received for this LOA which prove to be in excess of the final total cost of delivery and performance and which are not required to cover arrearages on other LOAs of the Purchaser.

4.3 The Purchaser's failure to make timely payments in the amounts due may result in delays in contract performance by DOD contractors, claims by contractors for increased costs, claims by contractors for termination liability for breach of contract, claims by USG or DOD contractors for storage costs, or termination of contracts by the USG under this or other open Letters of Offer and Acceptance of the Purchaser at the Purchaser's expense.

4.4 The Purchaser agrees to the following:

4.4.1 To pay to the USG the total cost to the USG of the items even if costs exceed the amounts estimated in this LOA.

4.4.2 To make payment(s) by check or wire transfer payable in US dollars to the Treasurer of the United States.

4.4.3 If Terms of Sale specify "Cash with acceptance," to forward with this LOA a check or wire transfer in the full amount shown as the estimated Total cost, and agrees to make additional payment(s) upon notification of cost increase(s) and request(s) for funds to cover such increase(s).

4.4.4 If Terms of Sale specify payment to be "Cash prior to delivery," to pay to the USG such amounts at such times as may be specified by the USG (including initial deposit) in order to meet payment requirements for items to be furnished from the resources of DOD. USG requests for funds may be based on estimated costs to cover forecasted deliveries of items. Payments are required 90 days in advance of the time DOD plans such deliveries or incurs such expenses on behalf of the Purchaser.

4.4.5 If Terms of Sale specify payment by "Dependable Undertaking," to pay to the USG such amounts at such times as may be specified by the USG (including initial deposit) in order to meet payments required by contracts under which items are being procured, and any damages and costs that may accrue from termination of contracts by the USG because of Purchaser's cancellation of this LOA. USG requests for funds may be based upon estimated requirements for advance and progress payments to suppliers, estimated termination liability, delivery forecasts, or evidence of constructive delivery, as the case may be. Payments are required 90 days in advance of the time USG makes payments on behalf of the Purchaser.

4.4.6 If the Terms of Sale specify Foreign Military Financing (FMF), the Purchaser will pay to the USG such costs as may be in excess of the approved FMF funding amount.

4.4.7 If Terms of Sale specify "Payment on delivery," that bills may be dated as of the date(s) of delivery of the items, or upon forecasts of the date(s) thereof.

4.4.8 That requests for funds or billing are due and payable in full on presentation or, if a payment date is specified in the request for funds or bill, on the payment date so specified, even if such payment date is not in accord with the estimated payment schedule, if any, contained in this LOA. Without affecting Purchaser's obligation to make such payment(s) when due, documentation concerning advance and progress payments, estimated termination liability, or evidence of constructive delivery or shipment in support of requests for funds or bills will be made available to the Purchaser by DOD upon request. When appropriate, the Purchaser may request adjustment of any questioned billed items by subsequent submission of a discrepancy report.

4.4.9 To pay interest on any net amount by which it is in arrears on payments, determined by considering collectively all of the Purchaser's open LOAs with DOD. Interest will be calculated on a daily basis. The principal amount of the arrearage will be computed as the excess of cumulative financial requirements of the Purchaser over total cumulative payments after quarterly billing payment due dates. The rate of interest paid will be a rate not less than a rate determined by the Secretary of the Treasury taking into consideration the current average market yield on outstanding short-term obligations of the USG as of the last day of the month preceding the net arrearage and shall be computed from the date of net arrearage.

4.4.10 To designate the Procuring Agency and responsible Paying Office and address thereof to which the USG will submit requests for funds and bills under this LOA.

4.4.11 Any articles, equipment, materials, supplies, goods, or other commodities purchased with USG assistance funds appropriated and allocated pursuant to foreign operations, export financing, and related programs appropriations acts in support of this LOA, whether provided directly by the USG or through procurement contracts or otherwise in support of this LOA, shall be exempt from all value added taxes and customs duties imposed by the recipient country or the full amount of the tax or customs duty must be reimbursed by the Purchaser. This exemption is in addition to any other tax exemption provided by the Purchaser through separate agreements or other means.

Section 4 states the purchaser's financial obligation and liability when purchasing items or services through FMS. Chapter 12 of this textbook, "Financial Management," provides greater detail regarding FMS financial processes.

Section 4.1 Recovery of Cost

This section reiterates that the LOA data reflects a best estimate of costs and delivery dates. The LOA estimates may be subject to change. In accordance with the AECA, this section obligates the purchaser to pay the USG the total cost for the items or services. FMS is often characterized as a "no profit, no loss" financial agreement. This section reiterates the "no loss" aspect.

Section 4.2 Refunds

The USG will refund payments that are in excess of the total LOA cost unless there are other unpaid financial requirements on other LOAs with the same purchaser. In this situation, the excess payments from one LOA may be applied toward the delinquent amount due on another LOA. While section 4.1 serves as the "no loss" condition, this section reaffirms the "no profit" condition stated in section 3.1.

Section 4.3 Payment Delays

Any delay in making the LOA payments by the purchaser may result in the USG directing the contractor to stop work which, in turn, may lead to additional or increased costs, storage costs and delayed delivery. Failure to make payments may also result in contract terminations that may require the purchaser to pay for contract termination liability costs.

Section 4.4 Terms of Sale

The purchaser agrees to pay the total cost incurred under the LOA even if the final amount exceeds the estimated costs provided earlier. The purchaser agrees to make payments in accordance with the applicable terms of sale specified on the LOA. Chapter 12 of this textbook, "Financial Management," gives a more detailed explanation of the specific terms of sale.

Section 5. Transportation and Discrepancy Provisions

5.1 The USG agrees to deliver and pass title to the Purchaser at the initial point of shipment unless otherwise specified in this LOA. With respect to items procured for sale to the Purchaser, this will normally be at the manufacturer's loading facility; with respect to items furnished from USG stocks, this will normally be at the US depot. Articles will be packed, crated, or otherwise prepared for shipment prior to the time title passes. If "Point of Delivery" is specified other than the initial point of shipment, the supplying US Department or Agency will arrange movement of the articles to the authorized delivery point as a reimbursable service but will pass title at the initial point of shipment. The USG disclaims any liability for damage or loss to the items incurred after passage of title irrespective of whether transportation is by common carrier or by the US Defense Transportation System.

5.2 The Purchaser agrees to furnish shipping instructions which include Mark For and Freight Forwarder Codes based on the Offer Release Code.

5.3 The Purchaser is responsible for obtaining insurance coverage and customs clearances. Except for articles exported by the USG, the Purchaser is responsible for ensuring that export licenses are obtained prior to export of US defense articles. The USG incurs no liability if export licenses are not granted or they are withdrawn before items are exported.

5.4 The Purchaser agrees to accept DD Forms 645 or other delivery documents as evidence that title has passed and items have been delivered. Title to defense articles transported by parcel post passes to the Purchaser at the time of parcel post shipment. Standard Form 364 (Supply Discrepancy Report (SDR)) will be used in submitting claims to the USG for overage, shortage, damage, duplicate billing, item deficiency, improper identification, improper documentation, or non-shipment of defense articles and non-performance of defense services. The Standard Form 364 will be submitted promptly by the Purchaser. The USG will disallow any claim, including a claim for shortage or nonperformance, received more than 1 year after delivery or more than 1 year after passage of title to the defense articles, whichever comes first, or received more than 1 year after the end of the scheduled period of performance for defense services, unless the USG determines that unusual and compelling circumstances involving latent defects justify consideration of the claim. Claims for non-shipment or non-receipt of an entire lot will be disallowed by the USG if such claims are received more than 1 year after the scheduled delivery date or initial billing, whichever is later. The Purchaser agrees to return discrepant articles to the USG's custody promptly in accordance with any direction provided by the USG. The Purchaser may submit SDRs for documentation purposes regardless of the dollar value, but only SDRs valued at $200 or more will be reviewed for possible compensation regardless of the type of discrepancy. This minimum value includes the value of the item plus any transportation and handling costs.

Section 5 delineates the transportation obligations and requirements of the purchaser, defines the role of the USG in arranging for transportation, and describes the process for submitting claims to the USG.

Section 5.1 Title Transfer and Delivery Point

Section 5.1 identifies where title transfers and where delivery occurs. Title represents ownership. This condition states that the purchaser becomes the owner of material at the initial shipping point. Delivery, in this context, does not mean the material has arrived at the final customer destination. Delivery refers to the point where transportation responsibility transfers from the USG to the purchaser. The delivery term code applied to each LOA line will indicate where the purchaser becomes responsible for transportation. Under certain delivery term codes, the USG may arrange for transportation in various increments up to and including to an in-land location within the purchasers country. Regardless of when the purchaser assumes transportation responsibility, the title still will transfer at the initial shipping point. This means that the USG will not be financially liable for items damaged in transit even if USG arranges or provides the transportation.

This condition should not be interpreted to mean that the purchaser's financial liability does not begin until title transfer. Per section 3, the purchaser's liability begins with case acceptance. As the USG initiates actions towards fulfilling the LOA requirements, financial liabilities begin to accrue. In section 3, the purchaser has agreed to indemnify the USG and its contractors. Additionally, in section 2, the purchaser has agreed to be liable for termination costs if they elect to delete items or to cancel the LOA.

Section 5.2 Shipping Instructions

Section 5.2 describes the customer's obligation to provide the required transportation information so that the items are shipped through the appropriate channels to arrive at the correct customer destination. The customer provides this information at the bottom of the first LOA page as part of the LOA acceptance process. The freight forwarder code identifies the commercial freight company employed by the purchaser to accomplish overseas transportation. The mark-for code identifies the ultimate in-country destination address.

Section 5.3 Insurance and Export Licenses

Given the fact that the purchaser bears the risk of any damage that may occur in shipment, the purchaser is responsible to obtain any desired insurance coverage. Additionally, the purchaser is responsible for completing the necessary documents to clear customs. Most FMS customers delegate the task of coordinating all customs paperwork to their freight forwarder. More information on export licensing is contained in chapter 7 of this textbook, "Technology Transfer, Export Controls, and International Programs Security."

Section 5.4 Delivery Documents and Claims

Section 5.4 delineates the purchaser's obligation to accept certain USG documentation as evidence that title transfer and delivery has occurred. Additionally, this section outlines the process and conditions under which the purchaser can submit claims for discrepancies. Although the USG would like the FMS process to operate error free, in reality, things sometimes do go wrong. The customer has an avenue of recourse to submit claims for shipping or billing discrepancies. This process is called the supply discrepancy reporting process. More information on the supply discrepancy process is contained in chapter 10 of this textbook, "Logistics Support of International Military Sales."

Section 6. Warranties

6.1 The USG does not warrant or guarantee any of the items sold pursuant to this LOA except as provided in section 6.1.1. DOD contracts include warranty clauses only on an exception basis. If requested by the Purchaser, the USG will, with respect to items being procured, and upon timely notice, attempt to obtain contract provisions to provide the requested warranties. The USG further agrees to exercise, upon the Purchaser's request, rights (including those arising under any warranties) the USG may have under contracts connected with the procurement of these items. Additional costs resulting from obtaining special contract provisions or warranties, or the exercise of rights under such provisions or warranties, will be charged to the Purchaser.

6.1.1 The USG warrants the title of items sold to the Purchaser hereunder but makes no warranties other than those set forth herein. In particular, the USG disclaims liability resulting from infringement or other violation of intellectual property or technical data rights occasioned by the use or manufacture outside the US by or for the Purchaser of items supplied hereunder.

6.1.2 The USG agrees to exercise warranties on behalf of the Purchaser to assure, to the extent provided by the warranty, replacement or correction of such items found to be defective, when such materiel is procured for the Purchaser.

6.2 Unless the condition of defense articles is identified to be other than serviceable (for example, "As-is"), DOD will repair or replace at no extra cost defense articles supplied from DOD stocks which are damaged or found to be defective in respect to materiel or workmanship when it is established that these deficiencies existed prior to passage of title, or found to be defective in design to such a degree that the items cannot be used for the purpose for which they were designed. Qualified representatives of the USG and of the Purchaser will agree on the liability hereunder and the corrective steps to be taken.

Section 6 describes the warranty provisions of the LOA. Under FMS, the customer is purchasing from the USG rather than from a commercial company. This section defines what warranties the USG provides on FMS material. Section 6.1 discusses warranty provisions for items obtained from procurement and section 6.2 concerns items delivered from DOD inventory.

Section 6.1 Procurement Warranties

For items supplied from procurement, the USG does not provide any type of performance warranty. The USG only warrants clear title of the material to the purchaser. This simply means that there will be no financial claim or lien against the material delivered.

This does not mean that the FMS purchaser has no method of recourse if an item from procurement does not function properly. Customers with defective items from procurement should submit a Supply Discrepancy Report (SDR) to the USG. The USG may be able to resolve the problem by seeking resolution through the contractor under the provisions of the USG procurement contract.

This condition also provides the FMS purchaser the option of identifying specific warranty requirements when they request an item via the FMS process. Based on the foreign purchaser's specific warranty request, the USG will attempt to procure the desired warranty from the vendor in conjunction with the procurement of the material or service. The FMS customer will pay any additional costs necessary to acquire the desired warranty. The USG agrees to exercise the warranty rights on behalf of the FMS purchaser. The SAMM requires that special customer requested warranties be treated as a defense service on the LOA and be described in an LOA note. The LOA note outlines the process the customer is to use in exercising the special warranty rights.

Section 6.2 Warranties from Stock

This condition states that the US will repair or replace damaged or defective items delivered from DOD inventories when it can be determined that the defect or damage existed prior to shipment. This can be a difficult determination. The IAs have SDR offices that evaluate SDR claims and make determinations regarding the appropriate corrective action. More information on the supply discrepancy process is contained in chapter 10, "Logistics Support of International Military Sales," of this textbook.

Section 7. Dispute Resolution

> 7.1. This LOA is subject to US law and regulation, including US procurement law.
>
> 7.2. The USG and the Purchaser agree to resolve any disagreement regarding this LOA by consultations between the USG and the Purchaser and not to refer any such disagreement to any international tribunal or third party for settlement.

This section explains the method by which disputes will be resolved.

Section 7.1 means that all activities the USG undertakes to execute the LOA, such as procurement contracts, are subject to US federal procurement law.

Section 7.2 provides for the resolution of LOA disagreements by a bilateral consultative process. The purchaser agrees that he will not seek redress from any international tribunal such as the world court or a third party.

Additional Letter of Offer and Acceptance Notes

In addition to the standard terms and conditions, an LOA may require supplemental information to clarify requirements and responsibilities. LOA notes provide more detailed information concerning items or services being offered. When LOAs are prepared before details are known, notes include general coverage of this information and an estimate of when specific information on these topics can be provided to the purchaser. These notes may be shared in advance with the purchaser to ensure any purchaser unique requirements are accommodated.

The SAMM, appendix 6, lists the various LOA notes and identifies the situations for which the respective notes should be applied. If a full line item description cannot fit in the space available under the military articles and services description, SAMM appendix 1, Line Item Description states that a separate line item description note should be used to provide a detailed description of the items being sold or services performed.

Changes to the Letter of Offer and Acceptance

An international purchaser's requirements and the conditions and circumstances of the accepted LOA may change during the course of implementation and execution. Examples of changes include:

- Increased or decreased costs of the item
- Revised delivery dates
- Additional items
- Changes in system configuration

To authorize these changes and establish an audit trail, proper documentation must be prepared for accurate and complete case management. The specific document that implements the change, whether it is a new LOA, an amendment, or modification, will be dictated by the special conditions surrounding each change. FMS interests are best served through use of the document which best safeguards US and customer interests while most efficiently accomplishing the needed program change. Selection of the appropriate document to implement the change revolves around the scope of change compared to the original LOA. Scope refers to the basic intention, goal, or purpose of the original LOA agreement.

Specific details for identifying the correct document to use and for complying with the necessary administrative requirements of review and/or countersignature by DSCA are found in SAMM, section C6.7. When a case manager has doubt as to which document is appropriate after reviewing the SAMM guidance, DSCA should be consulted.

Major Changes in Scope—New Letter of Offer and Acceptance

Revisions that significantly change original requirements are normally considered to be major changes in scope. Examples are the addition or deletion of significant military equipment (SME), or a substantial expansion of a program. Major changes normally require the preparation of a new LOA. New LOAs for major changes to an ongoing program will cross reference the previous LOA. While new LOAs are preferred for major scope changes, under certain exceptional conditions, an amendment may be more advantageous. Use of an amendment for a major scope change requires approval by DSCA.

Minor Changes in Scope—Amendment

Changes to an on-going program that are not categorized as major change of scope make up this category. An amendment represents a bilateral change to the LOA. By virtue of being bilateral, an amendment will not become effective unless the purchaser accepts the change. The purchaser has a choice to either accept or reject an amendment offered by the USG.

Acceptance of the change is signified by the purchaser signing the amendment. Some amendments may require initial deposits, and these will not be implemented until sufficient payments have been received to cover the current financial requirements, including termination liability. Rejection of the change is signified by declining to sign the amendment. Examples of minor scope changes are:

- Redistributing funds among case lines
- Increases or decreases to blanket order cases
- Changes in quantity on defined order cases
- Adding or deleting case lines or requirements
- Revising line descriptions or notes to change scope
- Changes in MASL that impacts configuration
- Extending a lead time, period of performance, or availability of services
- Changes in transportation delivery code(s)

A sample amendment may be viewed in *Bandarian Security Cooperation Sample Case Documents*.

Changes Not Affecting Scope—Modification

Changes to existing LOAs that do not impact the scope of the LOA are accomplished via modifications. When the purchaser accepts the original LOA, they agree to accept the provisions of the standard terms and conditions. The standard terms and conditions permit the US to make unilateral

changes to the LOA under certain circumstances. A modification is the document the US uses to inform the purchaser of these unilateral changes. Because the purchaser already agreed to such unilateral modifications by the USG in the standard terms and conditions of the LOA, the purchaser is not required to accept a modification. A modification becomes effective upon issuance by the USG. A modification does have a line for the purchaser to sign but, in this instance, the signature simply acknowledges receipt rather than conveying acceptance. Examples of changes implemented by a modification include:

- Price changes
- Delivery schedule changes
- Revising source, offer release, line management, or type assistance codes
- Changes in the payment schedule or terms of sale
- Changes to correct administrative errors

A sample modification may be viewed in *Bandarian Security Cooperation Sample Case Documents*.

The modification also plays a critical role in financial management by the US SA community. Per the LOA standard terms and conditions, the US is committed to apply its best efforts to provide the purchaser a modification when estimated total costs change, payment schedule changes or significant delivery delays occur. A modification should also be provided for cost reductions, even if relatively minor, when all items are on order and prices are reasonably firm. More information on financial management is contained in chapter 12 of this textbook, "Financial Management."

Pen and Ink Changes

A pen and ink change refers to minor change that is authorized after an LOA or amendment is offered to the customer but is made prior to customer acceptance. Pen and ink changes are generally used to correct minor administrative or arithmetic errors. Examples are a small arithmetic change which does not increase total value and administrative changes such as an address correction, initial deposit or payment schedule adjustment, or extension of the offer expiration date. Pen and ink changes made by the customer without prior authorization by the IA are considered a counteroffer and are not valid.

Pen and ink changes to modifications are not authorized. The reason for this is that a modification is a unilateral document and becomes effective upon issuance by the USG without requiring customer acceptance. Any required changes to a modification must be accomplished by issuing another modification.

Lease of Defense Articles

Normally, the USG makes defense articles available to foreign governments by FMS under the AECA. However, there are instances where a lease, rather than sale, to eligible foreign countries or international organizations is appropriate. Leases are authorized under the AECA when it is determined that there are compelling foreign policy and national security reasons for leasing rather than selling, and the articles are not needed for US use during the proposed lease period. For example, a foreign government may desire to obtain a defense article for a short period under a lease for testing purposes to assist it in determining whether to procure the article in quantity. As another example, the USG may only be able to respond to an urgent foreign requirement for defense property by making it available from inventory, but for national defense reasons cannot sell the property and must require its return to the inventory after a specified term. Attachment 8-1 provides a sample lease. Section C11.6 of the SAMM provides lease policy.

Approval

DOD components must obtain DSCA concurrence before indicating to a foreign country or international organization that a lease is being favorably considered or is an available option. The DOD component will provide a determination and forward a memorandum written in the format specified in the SAMM, starting at section C11.F5, along with the draft lease. A detailed rationale must be provided for any proposed lease outlining the reasons why the defense articles are being leased rather than sold.

Security Cooperation Organization Responsibility

The Security Cooperation Organization (SCO) or Defense Attaché Office (DAO) where no SCO is assigned in the partner country should receive a copy of each lease entered into with that government. The SCO should assist DOD components in monitoring the use of USG-owned equipment in the country.

Lease Terms and Conditions

Attachment 8-1 illustrates the basic lease format. Additional provisions may be added with the concurrence of the appropriate legal office of the DOD component concerned and with DSCA approval. The lease will be signed by the appropriate IA and provided to DSCA for countersignature.

A separate LOA will be used for packing, crating, handling, transportation, and the sale of associated articles and services, including any refurbishment of the defense article(s) required prior to, during, or after the lease period. The LOA will also be used to recover applicable costs if the article is lost or destroyed during the lease period.

Lease Identification

Using the Defense Security Assistance Management System (DSAMS), the IA assigns a unique designator to each lease. The lease designator is composed of the country code, the IA code, and a three-position code assigned by the IA. The lease designator is included on each lease page, including schedules, appendices, and accompanying documents. FMS cases associated with leases must reference the lease designator.

Duration

Leases may be written for a maximum of five years with an additional specified period of time required to complete major refurbishment work prior to delivery. Leases may include multiple items with different lease duration periods. The shortest lease period is one month and the longest lease period is sixty months. Leases of one year or more require Congressional notification. Leases shall provide that, at any time during the lease period, the USG may terminate the lease and require the immediate return of the defense article. Leases of less than five years may be extended via an amendment but the total period under a specific lease may not exceed five years plus the time needed for refurbishment.

Amendments

Lease amendments may be used to extend or change existing leases. Such changes include variations to payment schedules, Schedule A items, or periods of performance. Each amendment includes the original lease designator and undergoes the same staffing process as the original lease. If a lease for less than one year is amended so that the total period of the original lease and the amendment equals or exceeds one year, the amendment must be reported to the Congress before entering into the lease amendment.

Loss, Destruction or Damage

The lessee must agree to pay the costs of restoration or replacement if the articles are lost, damaged, or destroyed while leased. In this case, the customer is charged the replacement cost (less any depreciation) if the US intends to replace the articles or the actual article value (less any depreciation) if the US does not intend to replace the articles. These charges are recouped under an FMS transaction via an LOA.

Lease Payment

The lessee must agree to pay in US dollars all costs incurred by the USG in leasing articles, including reimbursement for depreciation (rent) of articles while leased. The rental payment is calculated in accordance with DOD 7000.14-R, volume 15, chapter 7. Rental payments do not include an administrative charge.

Schedule A of each lease identifies the replacement costs of the items being leased and the schedule for rental payment due to the USG. Billings to the foreign lessee are based on this schedule of payments and are included on a separate DD Form 645A with the country's quarterly FMS billing statement. Defense Finance and Accounting Service (DFAS) deposits receipts from lease rental payments in the Miscellaneous Receipts Account 3041 (FMS Recoveries, DOD Lease Costs) in accordance with the *Treasury Financial Manual, Supplement to Volume 1*.

The use of Foreign Military Financing Program (FMFP) funds may not be authorized for payments of lease rental charges except for leases of aircraft for counternarcotics purposes pursuant to FAA section 484 (22 U.S.C. 2291c). FMFP funds may be authorized by DSCA for FMS cases prepared in support of a lease.

Report on Equipment Usage

The overall responsibility for all aspects of lease administration, including monitoring equipment while leased, belongs to the DOD component having logistics responsibility for the leased equipment. IAs are required to update the status of each active lease not later than thirty days after the end of each quarter. This update is made in the DSAMS.

United States Navy Ships

For leases of US Navy ships, the guidance in SAMM, section C11.6.3.1, applies. Ship leases are authorized under separate, specific legislation as required by Title 10 *United States Code* 7307.

Loans

Under the AECA section 65 and the FAA, the DOD may lend materiel, supplies, and equipment to the North Atlantic Treaty Organization (NATO) and major non-NATO allies for research and development purposes. Loans can be made to support cooperative research, development, test, and evaluation (RDT&E) programs and to strengthen the security of the US and its allies by promoting standardization, interchangeability, and interoperability of allied defense equipment. Each loan must be recorded in a written agreement between the Secretary of Defense and the country. Policy regarding loans is contained in the SAMM, section C11.7.

International Agreements

For most sales of defense articles and services, the LOA is sufficient to establish the rights and obligations of each party to the agreement. However, in exceptional instances, it may be in the USG interest to negotiate and conclude an international agreement before, concurrent with, or after conclusion of the LOA. The SAMM, section C4.4.5, provides guidance on the use of international agreements for SA programs involving commercial or government coproduction agreements.

International agreements for SA include standard provisions, some of which reflect the requirements of law or regulation. These agreements may also include unique provisions reflecting the interests of the involved parties. The final content of each agreement is determined during negotiations.

An international agreement generator has been adopted by the Secretary of Defense and the IA legal advisors to establish a standard and uniform format for DOD-wide application. International agreements are further described in chapter 13 of this textbook, "Systems Acquisition and International Armaments Cooperation." The Defense Acquisition University offers a course (PMT 304) in preparing international agreements.

Summary

The basic contractual instrument used in FMS transactions is the LOA. The LOA standard terms and conditions establish specific rights and obligations for both the USG and the foreign purchaser. These standard terms and conditions are used in all FMS LOAs regardless of the customer; however, the standard terms and conditions do not apply to pseudo LOAs. Major changes in LOA scope require a new LOA. Minor changes of scope within an LOA are accomplished through an amendment. Non-scope changes to the LOA are unilaterally notified to the purchaser through an LOA modification. Leases and loans of defense articles may also be made to international purchasers. For complex FMS programs, an international agreement may be required to define how issues beyond the scope of the LOA will be handled.

References

DSCA Manual 5105.38-M. *Security Assistance Management Manual* (SAMM). Chaps. C5, C6, and C11. http://www.samm.dsca.mil/.

DOD Directive 5530.3. *International Agreements*.

Attachment 8-1
Sample Lease Agreement

LEASE OF C-199 AIRCRAFT

BETWEEN

THE UNITED STATES GOVERNMENT

AND

THE GOVERNMENT OF BANDARIA

BN-D-ZZX

This LEASE, made as of 01 May 2011, between the United States Government (hereinafter called the "Lessor Government") represented by its Department of the Air Force and the Government of Bandaria, (hereinafter called the "Lessee Government") represented by its Republic of Bandaria, Deputy Chief.

WITNESSETH:

WHEREAS, The Lessor Government has determined that one (1) C-199 aircraft and, if applicable, all associated nonexpendable support equipment as listed in Schedule A of this lease (including but not limited to tools, ground support equipment, test equipment, and publications) (hereinafter referred to as the "Defense Articles") are not for the time needed for public use, and

WHEREAS, The Lessor Government has determined that there are compelling foreign policy and national security reasons for providing such Defense Articles on a lease basis rather than on a sales basis under the Arms Export Control Act, and

WHEREAS, The Lessor Government has considered the effects of the lease of the articles on the technology and industry base, particularly the extent, if any, to which the lease reduces the opportunity of entities in the national technology and industrial base to sell new equipment, and

WHEREAS, This lease is made under the authority of Chapter 6 of the Arms Export Control Act,

NOW THEREFORE, The parties do mutually agree as follows:

1. In consideration of a rental charge as indicated in Schedule A, and the maintenance and other obligations assumed by the Lessee Government, the Lessor Government hereby leases to the Lessee Government and the Lessee Government hereby leases from the Lessor Government the Defense Articles for the period of eleven (11) months commencing on the date first above written (unless otherwise agreed under terms of this lease) and under the terms and conditions set forth in the General Provisions hereto annexed.

2. The Lessor Government shall deliver the Defense Articles to the Lessee Government at such time and place as may be mutually agreed upon. Such delivery may be evidenced by a certificate of delivery.

IN WITNESS WHEREOF, Each of the parties has executed this lease as of the day and year first above written, unless otherwise agreed under terms of this lease.

THE GOVERNMENT OF BANDARIA

BY: _____

_____
Typed Name

_____
Title

09 May 2011
Date

THE UNITED STATES GOVERNMENT

BY: _____

KENNETH W. MARTIN
Typed Name

Chief, Int'l Spt Branch
Title

25 Apr 2011
Date

COUNTERSIGNATURE:

DSCA Reviewed/Approved
DSCA

26 Apr 2011
Date

BN-D-ZZX B
Page 2 of 6 pages

GENERAL PROVISIONS

1. Operations and Use.

a. Except as may be otherwise authorized by the Lessor Government and except for the purposes of transfer from and return to the Lessor Government, the Lessee Government shall keep the Defense Articles in its own possession, custody, and control. The Lessee Government shall not transfer title to or possession of the Defense Articles to anyone not an officer, employee, or agent of the Lessee Government and shall not permit any encumbrance or other third party interest in the defense articles.

b. The Lessee Government shall, except as may be otherwise mutually agreed in writing, use the items leased hereunder only:

(1) For the purposes specified in the Mutual Defense Assistance Agreement, if any, between the Lessor Government and the Lessee Government;

(2) For the purposes specified in any bilateral or regional defense treaty to which the Lessor Government and Lessee Government are both parties, if subparagraph (1) of this paragraph is inapplicable.

(3) For internal security, individual self-defense, and/or civic action, if subparagraphs (1) and (2) of this paragraph are inapplicable.

c. To the extent that any Defense Articles may be classified by the Lessor Government for security purposes, the Lessee Government shall maintain a similar classification and employ all measures necessary to preserve such security, equivalent to those employed by the Lessor Government, throughout the period during which the Lessor Government may maintain such classification. The Lessor Government will use its best efforts to notify the Lessee Government if the classification is changed.

2. Initial Condition. The Defense Articles are leased to the Lessee Government on an "as is, where is" basis without warranty or representation concerning the condition or state of repair of the Defense Articles or any part thereof or concerning other matters and without any agreement by the Lessor Government to alter, improve, adapt, or repair the Defense Articles or any part thereof.

3. Conditioning and Transfer Cost. The Lessee Government shall bear the cost of rendering the Defense Articles operable and transferable and of transferring the Defense Articles from the United States or other point of origin and back to the place of redelivery. In the event the Defense Articles are transported by vessel, only U.S. flag vessels may be used, unless waived by the Lessor Government.

4. Inspection and Inventory. Immediately prior to the delivery of the Defense Articles to the Lessee Government, a inspection of the physical condition of the Defense Articles and an inventory of all related items may be made by the Lessor Government and the Lessee Government. A report of the findings shall be made which shall be conclusive evidence as to the physical condition of said Defense Articles and as to such items as of the time of delivery. A similar inspection, inventory, and a report may be made by the Lessor Government upon the termination or expiration of this Lease. The findings of that report shall be conclusive evidence as to the physical condition of the Defense Articles and as to such items as of the date of termination or expiration of this Lease. At the election of the

Lessor Government, the Lessee Government at its own cost shall either promptly correct any deficiency or rebuild, replace, or repair any loss of or damage to the Defense Articles or compensate the Lessor Government for the restoration or replacement value (less any depreciation in the value as determined by the Lessor Government) of such correction, rebuilding, replacement, or repair. At the Lessor Government's choice, the Lessee Government at its own cost will remove any alterations or additions to the Defense Articles or pay the Lessor Government the cost of such removal, as determined by the Lessor Government. In the absence of removal by the Lessee Government, title to any such alterations or additions shall vest in the Lessor Government.

5. Maintenance. The Lessee Government shall maintain the Defense Articles in good order, repair, and operable condition and except as provided in paragraph four, shall upon expiration or termination of this Lease return the Defense Articles in operable condition and in as good condition as when received, normal wear and tear excepted.

6. Risk or Loss. All risk or loss of or damage to the Defense Articles during the term of this Lease and until their return to the place of redelivery shall be borne by the Lessee Government.

7. Indemnification. The Lessee Government renounces all claims against the Lessor Government, its officers, agents, and employees arising out of or incidental to transfer, possession, maintenance, use, or operation of the Defense Articles or facilities and will indemnify and hold harmless the Lessor Government, its officers, agents, and employees for any such claims of third parties and will pay for any loss or damage to Lessor Government property.

8. Alterations. The Lessee Government shall not make any alterations or additions to the Defense Articles without prior consent of the Lessor Government. All such alterations or additions shall become the property of the Lessor Government except items paid for by the Lessee Government which can be readily removed without injury to the Defense Articles and are removed by the Lessee Government prior to redelivery of the Defense Articles. As a condition of its approval of any alteration or addition, the Lessor Government may require the Lessee Government to restore the Defense Articles to their prior condition.

9. Termination. This Lease may be terminated without cost to the Lessor Government:

a. By mutual agreement of the parties;
b. By the Lessee Government on 30-days written notice; or
c. By the Lessor Government at any time.

The Lessee Government shall immediately return the leased Defense Articles at the direction of the Lessor Government. Termination will be subject to the Lessee Government's residual responsibilities hereunder (such as, duty to return leased Defense Articles promptly, to pay costs required hereunder, and to indemnify and hold harmless the Lessor Government).

10. Place of Redelivery. Upon expiration or termination of this lease, the Defense Articles shall be returned to the Lessor Government at 309th, Aerospace Maintenance and Regeneration Group (AMARG), Davis-Monthan Air Force Base, Arizonia, or as mutually agreed.

11. Title. Title to the Defense Articles shall remain in the Lessor Government. The Lessee Government may, however, place the Defense Articles under its Flag, or display its national insignia when appropriate.

12. Reimbursement for Support. The Lessee Government will pay the Lessor Government for any services, packing, crating, handling, transportation, spare parts, materials, or other support furnished for the Defense Articles by the Lessor Government pursuant to a Letter of Offer and Acceptance under the Arms Export Control Act. (FMS Case BN-D-QZX applies).

13. Covenant Against Contingent Fees. The Lessee Government warrants that no person or selling agency has been employed or retained to solicit or secure this Lease upon an agreement or understanding for a commission, percentage, brokerage, or contingent fee.

14. Officials Not to Benefit. No members of or Delegate to Congress of the United States, or Resident Commissioner of the United States shall be admitted to any share or part of this Lease or to any benefit that may arise therefrom.

15. Proprietary Rights. The Lessee Government will ensure, by all means available to it, protection of proprietary rights in any Defense Article and any plans, specifications, or information furnished, whether patented or not.

16. Reports. Any testing of articles and/or services provided under this lease must be specifically authorized by the lease. Lessee testing is subject to limitations stated in the lease. Authority to test does not excuse the Lessee from compliance with all terms and conditions of the lease. When the Lessee Government performs tests and evaluations on the leased Defense Articles and prepares a formal report of the resulting data to be released to a third party, the Lessee Government will allow the Lessor Government to observe the test and evaluation and to review the report. The Lessee Government will obtain Lessor Government approval of any release to a third party.

17. Cost of Lessor Government. The Lessee Government agrees to pay in United States dollars all costs incurred by the Lessor Government in leasing the Defense Articles covered by this Lease including, without limitation, reimbursement for depreciation of such Defense Articles while leased. The Lessee Government also agrees to pay the costs of restoration or replacement, less any depreciation in the value during the term of the lease, to the Lessor Government under the Lessor Government's foreign military sales procedures. The rental charge shown in Schedule A is based on costs identified at the time of signature of this Lease and does not relieve the Lessee Government from liability for other costs in accordance with the provisions of this Lease.

SCHEDULE A

TO

LEASE AGREEMENT

BETWEEN

THE UNITED STATES GOVERNMENT, DEPARTMENT OF THE AIR FORCE

(LESSOR)

AND

THE GOVERNMENT OF BANDARIA

(LESSEE)

I. This Lease Agreement authorizes the use of U.S. Government property identified herein:

Item Nbr	NSN/ Description	Qty	Line Duration	Replacement Cost Unit Value	Replacement Cost Total Value	Rental Charge (Including Depreciation) Per Month
1	C-199 Aircraft	1	11	$1,239,094.00	$1,239,094.00	No Cost
	Total Value			$1,239,094.00	$1,239,094.00	

II. Rental Payment No Cost

Signed Copy Distribution:

1. Upon acceptance, the Lessee Government should return one signed copy of this lease to Defense Finance and Accounting Service - Indianapolis ATTN: Security Assistance Accounting, DFAS-JAX/IN 8899 E. 56th Street Indianapolis, IN 46249-0230 . Simultaneously, wire transfer of the initial deposit or amount due with acceptance of this lease document (if required) should be made to ABA #021030004, U.S.Treasury NYC, Agency Location Code: 00003801, Beneficiary DFAS-JAX/IN Agency, showing "BN-D-ZZX, payment from Bandardia"; or a check for the initial deposit, made payable to the US Treasury, mailed to DFAS, 3801 Center Collections DFAS-JAX/IN, P.O. Box 269490, Indianapolis, IN 46226-9490, showing "BN-D-ZZX, payment from Bandaria". Wire transfer is preferred.

2. One signed copy should be returned to Department of the Air Force, Air Force Security Assistance Center, International Support Branch 1822 Van Patton Drive, Building 210, WPAFB, OH 45433-5337.

III. Related FMS Case Designator: BN-D-QZX

BN-D-ZZX B
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