Chapter

15

A Comparison of Foreign Military Sales and Direct Commercial sales

Introduction

In today's global economy, nations and international organizations have numerous choices among the various military systems produced throughout the world. The selection process must consider many factors such as: system cost, performance, delivery schedule, life cycle logistics support, interoperability, and industrial utilization as well as the political relationship with the selected source nation. International purchasers establish their own prioritized source selection criteria to evaluate the relative benefits and shortcomings of each system under review.

If the customer is an ally or friend of the United States (US), often the prospective purchaser will consider one or more US defense systems in their global source selection process. The Department of Defense's (DOD's) official position regarding the customer's selection is clear. The DOD prefers that allies and friendly nations choose to purchase US systems rather than foreign systems. The reason for the US preference relates to the various political, military and economic advantages derived from the US and its friends using the same military equipment.

Although DOD officially prefers that allies and friends select US systems, the DOD is generally neutral regarding the customer's choice to purchase by means of foreign military sales (FMS) or direct commercial sales (DCS). Under law, most US military systems may be purchased through either the FMS process or through DCS. The preceding chapters in this text provided a thorough explanation of the FMS process. This chapter will compare the FMS process to the DCS process.

The purpose of this chapter is not to promote one procurement method over the other. In reality, which acquisition method is best for a particular customer depends on a number of considerations. The purpose of this chapter is to examine the various areas that should be considered in making the FMS or DCS decision. By understanding these factors and applying them to a customer's specific situation, a better decision can be made regarding which method offers the best approach for a particular acquisition.

Foreign Military Sales Only Items

Although most defense items or services can be purchased through either FMS or DCS, in limited instances, technology or security concerns may require that sales of specific items be restricted to FMS only. The *Security Assistance Management Manual* (SAMM) C4.3.5 outlines the process for designating a particular sale or military item as FMS only. Four general criteria are used to determine if a sale is required to proceed through the FMS process. The criteria are (1) legislative/Presidential restrictions; (2) DOD/military department (MILDEP) policy, directive or regulatory requirement, e.g., the National Disclosure Policy; (3) government-to-government agreement requirements; and (4) interoperability/safety requirements for US forces. These criteria, particularly DOD/MILDEP policy, can be further understood by considering four possible elements:

1. US political/military relationship with the end-user. The geopolitical situation and security relationships are taken into account when considering the appropriateness of FMS-only. The

inherent strengths of FMS or DCS licensing methods are also considered in selecting the method that best suits the interests of US and the foreign purchaser within the context of existing world security circumstances.

2. Sale of a new or complex system or service. FMS-only may be recommended:
   - To maximize the purchaser's ability to assimilate the technologies and manage its acquisition/logistics
   - For enhanced interoperability and cooperation between US and purchaser's military forces
   - For end-items or services that require complex systems integration with other combat systems
   - For end-items or services that require access to sensitive US government (USG) databases, libraries, or software-source code
   - For end-items or services that require end-use monitoring (EUM) or on-site accountability
3. Diversion and exploitation of defense systems technologies. Security of sensitive technologies is an area of particular concern that requires greater scrutiny in the transfer process. Defense systems and munitions that are not particularly complex or sensitive, but still require enhanced control to prevent proliferation to rogue states or terrorist organizations, represent another area where FMS may be more appropriate than DCS.
4. Feasibility of separating weapon system components into FMS/DCS elements. At times, purchasers may desire all or a portion of a sale to be DCS. It is possible to separate the FMS-only aspects of a purchase from the portion that can be DCS.

The Arms Export Control Act (AECA) gives the President discretion to designate which military end items must be sold exclusively through FMS channels. This authority is delegated to the Secretary of State and executed by DOD through the Defense Security Cooperation Agency (DSCA) in close coordination with the Defense Technology Security Administration (DTSA) and the MILDEP responsible for the end item. DTSA monitors this process through its involvement with the Department of State (DOS) in reviewing commercial export license requests. The DOS will not issue a commercial export license for sales restricted to FMS only. In the absence of an export license, the only remaining method to procure US defense articles or services is the FMS process. Historical examples of FMS only items are man-portable air defense missiles, certain cryptographic equipment, precise positioning service and airborne early warning and control systems.

Direct Commercial Sales Preference

In instances where the USG is neutral regarding purchase by FMS or DCS, policy permits US defense firms to designate a preference that a sale of their products or services be on a DCS basis. When a company receives a request for proposal from a country and prefers a direct commercial sale, the company may request DSCA issue a DCS preference for that particular sale. Approved DCS preferences are valid for one year and are held within security cooperation offices (SCOs) and at the item manager level to allow screening of future letters of request. If the applicable implementing agency (IA) receives a request from the purchaser for a DCS preference item, the IA notifies the purchaser of the DCS preference and advises the purchaser to contact the applicable company directly.

Support of a DCS preference is a "best effort" commitment by the DOD. This means that any failure on the part of the IA to comply with the DCS preference will not invalidate any resultant FMS transaction. Items provided on blanket order lines and those required in conjunction with a system sale's total package approach (TPA) do not normally qualify for DCS preference. Customers that will

be funding the purchase using Foreign Military Financing Program (FMFP) funds may be required to purchase by FMS. The Director, DSCA, may also recommend to the DOS that it mandate FMS for a specific sale.

Combination of Foreign Military Sales and Direct Commercial Sales

The comparison of FMS and DCS is generally intended to evaluate the circumstances of a particular procurement to determine which method offers the greatest advantages. However, policy permits an overall sale to be separated into an FMS portion and a DCS portion. This means that an entire sale does not have to be FMS simply because there is an FMS only component to the sale. The FMS only portion can be sold through the FMS process while the remainder of the sale proceeds on a DCS basis. Close coordination is required to ensure that the FMS only portion and the DCS portion will interface seamlessly upon delivery to the customer.

In regard to FMS material or services support for DCS, the DSCA Director issued policy memorandum 09-32, "Responses to Industry Requests for FMS Support Relating to DCS." This memorandum (see attachment 15-4) states that advance planning and coordination are essential in any situation where industry anticipates requiring both DCS and FMS elements in order to fulfill the terms of a DCS contract. Industry is reminded they are not authorized to make commitments on behalf of the USG. Industry should inform the foreign purchaser of FMS articles or services required to support the DCS purchased equipment. Examples of types of FMS support for DCS include airworthiness certification, training in US military schools, aircraft ferry or other transportation services, or the provision of FMS only articles or services. The foreign purchaser should then submit a Letter of Request (LOR) early in the DCS process to obtain the required FMS support.

Sustainment Support

Initial acquisition of a major system is just the beginning of what is required to support the system throughout its life-cycle. These systems will often be active in the customers' military inventory for more than a decade. Over this period of operational utility, a significant investment will also be made in the form of sustainment support. The method utilized to initially acquire a defense system does not obligate the purchaser to obtain sustainment support for that system through the same original acquisition method. Systems acquired by DCS are eligible to obtain FMS sustainment support for common support items. Likewise, systems acquired by FMS can be supported by DCS if the purchaser desires, with the exception of any FMS-only sustainment items.

United States Government Sales Supporting Direct Commercial Sales

The AECA, section 30, permits the USG to sell defense articles and services to US companies in connection with a proposed direct commercial sale. Sales may be made to a company incorporated in the US that has an approved export license. To be eligible, the US company must intend to incorporate the item(s) or service(s) being purchased from the USG into end items being sold to a foreign country or international organization. Services may include transportation, installation, testing, or certification directly associated with the sale. Per SAMM C11.T9, the sales must meet the following criteria:

- The end item must be for the armed forces of a friendly country or international organization
- The articles would be supplied to the prime contractor as government-furnished equipment (GFE) or government-furnished materiel (GFM) if the end item were being procured for the use of the DOD
- Any services provided must be performed in the US
- The articles and services are available only from USG sources or are not available to the prime contractor by other commercial methods at such times as may be required to meet the delivery schedule

A unique sales agreement is used by the USG for the sale of defense articles and/or services to US companies. The SAMM table C11.T11 outlines the information included in the sales agreement. Payment is required upon signature of the sales agreement. If there is an increase in the cost, the company is required to make additional cash payments to fund the costs. To allow for planning and marketing, IAs are authorized to provide cost and delivery data to authorized potential companies in advance of execution of a sales agreement. Such data are identified as estimates that are not binding on the USG.

Concurrent Foreign Military Sales and Direct Commercial Sales Negotiations

For most defense articles or services, the customer has the choice to purchase by either FMS or DCS. However, it is the policy of the USG to not compete with US industry for foreign defense sales. As a result, the USG normally will not provide foreign governments with a Letter of Offer and Acceptance (LOA) to sell when it is known that a DCS contract has been requested or is already being negotiated. Any exception to this policy must be approved by DSCA.

If the purchaser obtains FMS data and later determines they should request a commercial price quote, the purchaser should cancel the LOR prior to requesting commercial data. If an LOA has been offered and the purchaser then solicits formal bids from private industry for the same item, the IA should query the country as to its intentions and indicate that the LOA may be withdrawn. If the purchaser requests FMS data after soliciting bids from contractors, the purchaser must supply information to the IA showing that commercial acquisition efforts have ceased before any FMS data is provided.

Foreign Military Financing Program Funding

Foreign Military Financing Program (FMFP) funding (if available), is generally required to be utilized through the FMS process. The reason for this requirement is that FMFP funds are grant funds provided by the USG in order for the recipient country to enhance their national military capabilities. In general, there is an expectation that the FMS process will achieve a greater level of expenditure efficiency and capability effectiveness than may be consistently obtained through customer negotiated DCS arrangements. However, FMFP funding can, in certain circumstances, be used to fund DCS contracts. Under law, only ten countries are eligible to use FMFP funding to finance DCS contracts. The ten countries are: Israel, Egypt, Jordan, Morocco, Tunisia, Turkey, Portugal, Pakistan, Yemen, and Greece.

Although ten countries are eligible to use FMFP funds in DCS contracts, all FMFP financed purchases must be approved by DSCA on a contract-by-contract basis using *Guidelines for Foreign Military Financing of Direct Commercial Contracts* and the contractor certification provided at http://www.dsca.mil. Commercial contracts financed with FMFP must be valued at $100,000 or more and are intended for the procurement of nonstandard items (items that do not have a national stock number and are not currently being used by DOD). Offset costs are prohibited from being included on a FMFP financed DCS. Additionally, the prime contractor must be incorporated or licensed to do business in the US unless DSCA has approved an offshore procurement per the procedures in SAMM C9.7.2.7.3.

Comparison Considerations

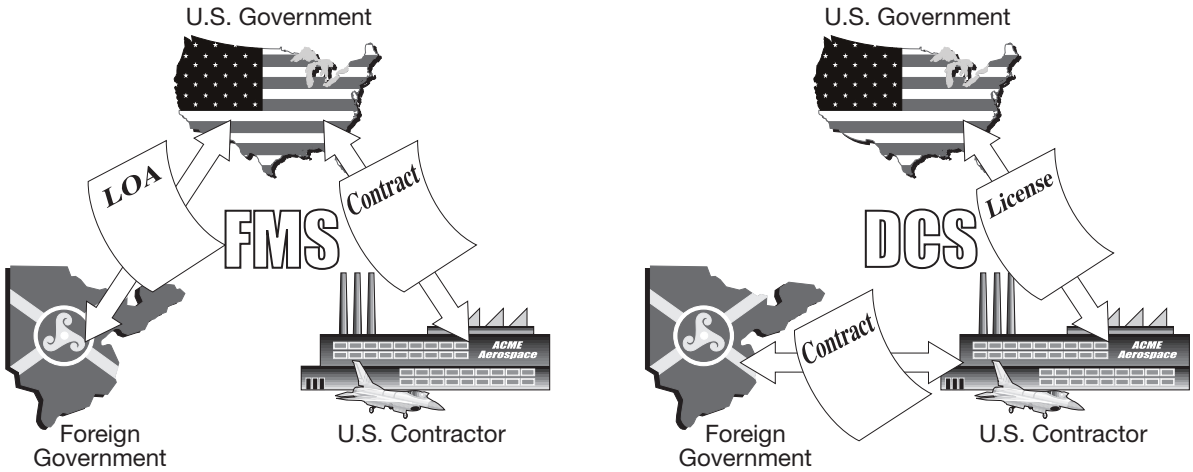
Relationship Considerations

Under FMS, the customer is entering a direct government-to-government relationship with the USG. In fact, the customer is purchasing directly from the USG. Depending on the political climate, this can be viewed as either an advantage or a disadvantage. Some nations and international organizations desire the association implied by the FMS interaction. Other governments, where the popular view of the US is not as positive, may desire to distance themselves from the USG and enter into a DCS arrangement with a US contractor. In this situation, public opinion may view a relationship with US industry more favorably than the direct government-to-government relationship inherent in FMS.

The USG is involved in approving both FMS and DCS. For FMS, DSCA consults with the DOS for approval to develop new FMS cases. For DCS, the contractor must apply to the DOS to obtain an export license. In either method, the DOS makes the final decision to authorize military defense sales.

Under the AECA, both FMS and DCS must be notified to the US Congress if the proposed sale meets or exceeds the statutory dollar thresholds. The statutory notification requirements are essentially the same for both FMS and DCS and can be found in chapter 2 of this textbook.

Figure 15-1
Foreign Military Sales and Direct Commercial Sales Relationships



All sales of defense articles or services, FMS or DCS, must promote US strategic and foreign policy interests. This determination is made for DCS in the licensing process and for FMS in the internal coordination process of preparing an LOA. Although it rarely occurs, the USG always reserves the right to terminate a DCS export license or an FMS LOA and to halt the actual export deliveries of FMS items or DCS licensed items, when doing so is determined to be in the national interest of the US.

Other relationship considerations are decisions of technology transfer and disclosure of classified information, as discussed in chapter 7 of this text. Under a DCS arrangement, industry must apply for a license and then await the normal governmental technology transfer and disclosure process to render a decision. While industry representatives may advocate for a favorable decision with the various stakeholders, industry is external to the actual decision making process. Some industry representatives have stated that the FMS process may offer a more efficient method for technology transfer and disclosure advocacy for sensitive defense transfers. Under FMS, the DOD IA engages with the DOD technology transfer and disclosure infrastructure to advocate for the proposed sale. In this way, proposed FMS transfers garner an element of internal government sponsorship, whereas proposed DCS may have only external industry sponsorship.

Management Considerations

The FMS process is executed by US DOD civilian employees and active duty US military personnel. The direct involvement of DOD personnel in managing the procurement and delivery of a foreign purchaser's programs leads to robust communications throughout the LOA life as many day-to-day program issues are identified, evaluated, and resolved. Often, this level of communication and personal interaction is viewed as a catalyst to building stronger overall military-to-military relationships.

In DCS programs, contractor personnel can be expected to be very knowledgeable about their products. Defense contractors typically employ individuals that possess extensive experience with the DOD and often include individuals with prior active duty experience in the US military. In spite of this, many customers value the direct interaction with DOD civilian and active duty US military personnel offered through the FMS process.

Lead Times

Generally speaking, defense articles that are in production can be procured more quickly via commercial channels than through the FMS system. The FMS acquisition process involves the development, review, and acceptance of the LOA, plus the assembling of requirements for economic quantity or consolidated purchasing cycles, as well as contract negotiations, and production lead times. In the FMS process, an individual customer's priorities must be integrated into the overall DOD acquisition priority.

By contrast, after the company obtains the export license, the DCS system only involves contract negotiations and production lead times. In general, industry prepares its proposal more quickly than the USG prepares the LOA. Under DCS, the customer negotiates their own priority with industry. Industry may be capable of accelerating their processes for commensurate financial compensation. It is also possible that governments with a well-developed purchasing capability can negotiate sales contracts more quickly than DOD which is bound to the structured Federal Acquisition Regulation (FAR) process.

For secondary and support items, the DOD may maintain an inventory. In cases of an emergency for the purchaser, if the materiel is available in DOD inventories, it may be possible for the FMS purchaser to achieve faster delivery through shipment from DOD stocks or through the diversion of items that are under production for DOD. Contractors normally do not produce items in anticipation of sales and generally do not maintain an extensive inventory of defense articles.

Contract Issues

Whichever procurement method a foreign government decides is best for its situation, some basic form of legal agreement is required. The contract process has several areas that should be evaluated by prospective customers.

Under the FMS system, purchases for foreign governments are made by a well-established DOD contracting network. DOD is committed to procuring FMS defense articles and services under the same contractual provisions used for its own procurements. This system is designed to acquire the required quality items at the lowest price from qualified sources and to provide for contract administration. In fact, FMS and DOD orders are often consolidated to obtain economy-of-scale buys and therefore lower unit prices. Although DOD's procurement process offers these benefits, the foreign purchaser will be charged an appropriate fee in the LOA for the contracting and administrative services provided by DOD.

In DCS, the customer assumes contract negotiation and management responsibility. These activities represent overhead management costs to the customer in addition to the actual contract cost. Although it is not necessary for a purchaser to fully duplicate the DOD contracting network in order to make an efficient commercial purchase, the size and skill of the purchaser's contracting staff may be a limiting factor in the quantity and complexity of DCS procurements. Numerous contractors and subcontractors may be involved in supplying the entire package for a major weapon system. As a result, multiple DCS contracts may be necessary to make the total system procurement. The capability and capacity of the purchaser's indigenous procurement system must be evaluated.

Contract Negotiation

Governments with extensive business ties to the West, and which are knowledgeable of US law and financing, may perceive additional flexibility in DCS. The greater degree of flexibility in contracting is possible because US industry has no structured, regulatory guidance, such as the FAR, that must be followed as is the situation in FMS. Customers may wish to participate actively in tailoring the procurement process by fixing delivery schedules, negotiating fixed prices, including special warranty

provisions and ensuring that designated penalties are stipulated for contractor failure to comply with the contractual agreement. Other flexible arrangements that may be negotiated into a DCS might include a used equipment trade-in or a sale involving a barter arrangement as partial payment.

The USG assumes responsibility for the procurement of FMS items. It determines the contract type, selects the contract source, and negotiates prices and contract terms with individual contractors. These negotiations are conducted on the same basis as procurements for DOD purchasers. Under FMS, the foreign purchaser trusts the USG to negotiate a contract that will meet the customer's needs.

The USG generally purchases directly from as many original manufacturers as possible, thereby minimizing the purchase price. This approach avoids going through a single prime contractor to procure various items from subcontractors and therefore also avoids the associated prime contractor price mark-ups on subcontracted components. Unless a country's purchasing staff is sufficiently large and skilled, a comparable procurement approach of purchasing direct from subcontractors cannot be duplicated in DCS.

Contract Administration

Under FMS, contract quality assurance, inspection, and audit services are routinely provided and are included as standard components of the overall FMS price.

For commercial contracts, the purchasing government must assess the total resources it must maintain in order to monitor production, evaluate modifications, provide for improvements, and ensure contract compliance. A large number of highly educated personnel well trained in international commerce, quality assurance, and audit processes may be required to perform such functions.

For DCS, rather than placing customer personnel throughout the US to perform contract administration functions, it may be more cost effective to acquire this support from the USG. It is possible for the customer to purchase contract administrative services for a DCS under a separate FMS case with the Defense Contract Management Agency (DCMA).

Financial Considerations

The issue of the total FMS cost in comparison to the total DCS cost is frequently a factor considered by the purchasing government. It is difficult to predict whether it would be more or less expensive to employ the FMS system or direct commercial channels for any particular acquisition. The differing contractual pricing and financing approaches, as well as variations in the total package content, make cost comparisons between FMS and DCS quite difficult.

Estimated Price Versus Final Price

The FMS system provides for estimated prices and estimated payment schedules. The final price of an FMS item or service generally will not be known until after it is delivered. The final price is determined by actual USG contract cost and other authorized FMS charges that are applied under the provisions of US laws and regulations.

The fact that the final LOA cost is generally lower than the initial LOA price estimate is a distinctive feature of the government-to-government FMS agreement. A multi-year DOD analysis of LOA prices revealed that final LOA costs generally fall below initial LOA estimates. While this is an interesting observation, the customer cannot count on their particular LOA overestimating the final cost.

DCS prices, on the other hand, typically provide a fixed price with a fixed payment schedule. Unlike FMS, DCS allows the customer to know the final price at the time of contract signature.

Support Package Differences

Under the FMS system, the USG includes all support equipment, spare parts, training and publications in the TPA. In DCS, the contractor may also develop a support package for the primary item. Depending on the factors used to develop these support packages, the actual content of the support packages may differ. As such, there may be significant cost differences in the FMS offer versus the DCS proposal even though both contain the same type and quantity of primary items.

In DCS, contractors may be able to achieve cost saving by offering other than DOD military standard configurations. It is important for the customer to understand that any deviations from typical DOD configurations could limit interoperability as well as cooperative logistics follow-on support from DOD. The cost savings achieved in the initial acquisition of a nonstandard DOD configuration may be quickly outweighed by the added cost of sustaining a nonstandard system.

Contract Price Factors

In situations where there are two or more manufacturers competing for the foreign business, DCS contract prices may be less than FMS prices. This may be possible because the manufacturers may be willing to agree to fixed prices which are below the normal profit margins allowable under DOD contracting regulations. Price advantages under DCS also may be possible during times of rapid inflation in the US, especially if the contractor has the ability to make quick deliveries from rapid new production.

The FMS process has the potential to offer lower contract prices primarily through larger quantity buys achieved by grouping DOD and multiple FMS requirements into a single procurement. Additionally, DOD may already have priced contracts in place for DOD that can also be used to support new FMS requirements. Typically, DOD has procured the same or similar items under other contracts. With this knowledge and experience, the DOD may be in a more informed position in the negotiation process. The FAR permits DOD, under certain contracting conditions, to require the contractor to substantiate their bid with supporting cost or pricing information. This is an important factor to ensure that a fair and reasonable price is being paid for the articles or services under contract.

Cash Flow Requirements

Direct commercial contracts generally require a relatively large down payment, payable at the time of contract signature. The size of such down payments varies with circumstances and the level of contractor risk. For FMS cases, the initial deposit required at the acceptance of an LOA is generally somewhat lower than commercial contract down payments. For items which have a substantial production period, the phased progress payment system used for FMS may distribute the payment burden beyond the payment requirements of commercial contracts. These possible differences in payment terms should be evaluated as part of the purchaser's procurement decision.

One special feature of the FMS system involves the potential use of cross-leveling agreements. Cross-leveling agreements allow country funds which are on deposit in the FMS trust fund to be moved to and from special holding accounts, or moved between separate FMS cases, thereby maximizing the use of country funds. Cross-leveling can be accomplished by two methods. In the first method, customer financial personnel conduct their own analysis to provide cash transfer direction to the USG. In the second method, the customer authorizes the USG, by written agreement, to conduct automatic cross-leveling to balance funds requirements among all FMS cases. Cross-leveling is in contrast to direct commercial contracts, which stand alone and typically provide for fixed prices with fixed payment schedules, but with no provision for the movement of funds between individual contracts. In short, cross-leveling under FMS provides the advantage of flexibility to the purchaser to meet changing requirements, whereas commercial sales offer the advantage of providing a final price at the time of contract signature.

Non-recurring Cost Application

The AECA requires a charge for a proportionate amount of any non-recurring costs (NC) of research, development, and production of major defense equipment sold through FMS. By contrast, DCS is exempt from these NC costs, so in this regard, it appears that DCS has an advantage. However, for customers desiring to purchase via FMS, a provision exists to potentially waive the application of NC under FMS. The purchaser can request a NC waiver when:

- Standardization benefits result to the US from the sale
- Cost saving benefits accrue to the US as a result of economic quantity purchases
- Loss of sale would occur if waiver is not granted

Waiver requests must be made by the country on a case-by-case basis and must be submitted prior to acceptance of the FMS LOA. More information on the NC waiver process is in the SAMM, C9.6.3.

Other Costs

The issue of other costs in both commercial contracts and FMS agreements requires clarification. As stated in section 3 of the LOA standard terms and conditions, the USG conducts the FMS program on a non-profit basis. Except for specific statutory exemptions, all USG expenses for FMS program performance must be recovered from the purchaser. The FMS administrative surcharge and contract administration services costs that are added to the basic price of an FMS agreement recover the cost of:

- Sales negotiations
- Case implementation
- Case management
- Contract negotiation
- Contract management
- Financial management
- Processing reports of discrepancy
- Case reconciliation/closure

SAMM table C9.T2 outlines the types of activities the DOD may perform that are funded by the FMS administrative charge. Collectively, this set of activities funded by the FMS administrative charge is referred to as the standard level of service.

For FMS, the LOA price includes the base cost that the USG paid for the item or service plus the other authorized charges necessary to recover the full cost to the USG. Although the USG does not make a profit from FMS, the price paid to DOD contractors does include a fair and reasonable profit for the contractor. However, the amount of contractor profit is limited by the provisions of the FAR. The full contract cost, including contractor profit, is paid via the LOA.

Conversely, the profit ceiling for commercial contracts is established by the marketplace. The purchasing government will not normally have access to information which reveals how much general and administrative costs or overall contractor profit is included in a direct commercial contract. US firms typically add administrative costs as part of their equipment unit prices, whereas FMS administrative costs are identified as a separate item on the FMS agreement. More information on FMS financial management is contained in chapter 12 of this text, "Financial Management."

Other Comparison Considerations

Evaluating the relative advantages or disadvantages of conducting a sale by FMS or DCS can be complex. In addition to the relationship, management, and financial issues, there are other factors that a purchaser must also examine.

Production Priority

There are many defense articles produced by US industry using production equipment provided by DOD or in USG-owned facilities. Such production equipment and facilities are made available to the contractor to fulfill DOD requirements including FMS requirements. Contractors may use such facilities and equipment for DCS only with USG approval and only when there is no adverse impact on DOD requirements. Except in times of crisis, the prioritization of the use of such equipment or facilities generally is not a problem.

The USG has established an industrial priority system to resolve conflicts in production priorities. Each US defense program is assigned a specific priority based on the program's relative importance to the USG. The USG uses its relative need for a system to settle production conflicts rather than leaving such resolution to the discretion of contractors. FMS equipment normally is purchased together with US equipment, and thereby shares the US industrial priority. DCS involves independent contracts that do not automatically receive the same production priorities as DOD procurements.

Another consideration involves GFE or GFM. Such items are generally incorporated by the contractor into larger systems which are then delivered to either DOD or a foreign government. Contractor access to GFE or GFM in support of DCS could have a significant impact on the capability of a contractor to make a direct sale. By contrast, under the FMS system, DOD coordinates delivery of GFE or GFM directly to the prime contractor for both US and FMS requirements. As identified earlier in this chapter, under certain conditions, US companies may be eligible to procure items or services from the DOD to support a DCS program.

If GFE and GFM components are not available directly to a contractor, the foreign purchaser could acquire them under FMS procedures and provide them to the contractor for incorporation in the end item. This procedure, of course, would make a commercial acquisition more complex for the purchaser and would require careful coordination of both the commercial and the FMS transaction.

Follow-on Logistics Support

An important consideration in the purchase of US defense articles involves the nature of the follow-on support that will be required from US sources. If the items being purchased are also being used by the US military, and are known to require substantial logistical, technical, and training support, an FMS purchase may offer support advantages. FMS permits the purchaser to capitalize on US experience and existing USG logistics inventories and training facilities. Under a cooperative logistics supply support arrangement, the DOD spare parts inventory can be drawn upon in support of the purchaser's requirements, and this can be accomplished by customer submission of requisitions for individual parts. In effect, the DOD logistics structure serves as procurement staff for the purchaser by procuring required individual items from the current US sources.

There are some US contractors who also are capable of providing full logistics support for the items which they sell. Corporate reputations depend on good performance and, where contractors have the capability of furnishing such support, the results can be expected to be as stated in their contracts.

The DOD may provide follow-on support for end items acquired through DCS. However, DOD's ability to support DCS items may be limited when equipment configurations differ. Also, if the manufacturer only uses commercial part numbers to identify items without cross-referencing to DOD national stock numbers, USG support will be greatly complicated and support delays may result.

Logistics support is frequently facilitated by the FMS purchaser's ability to use DOD information and data transmission systems such as:

- International Logistics Communication System (ILCS)
- Supply Tracking and Reparable Return/Personal Computer (STARR/PC)
- Air Force Security Assistance and Cooperation Center (AFSAC) Online
- Security Cooperation Information Portal (SCIP), including the Navy Community
- Federal Logistics Data (FED LOG)
- Federal Logistics Information System Web Search (WEBFLIS)

DOD also has dedicated security cooperation staffs and in-country SCOs to facilitate the administration of the FMS program. Per SAMM C2.1.8, the SCO can also provide limited support to industry. For DCS activities, the SCO's role is primarily a facilitator during industry's marketing phase rather than aiding in actual program execution (as the SCO does in support of FMS). More information on FMS logistics support is contained in chapter 10 of this text.

Nonstandard Items

Nonstandard items are those that the DOD has never used or no longer actively uses in its own operations. Standard items can become nonstandard items as DOD phases out certain items, models or configurations, replacing them with other items, models or configurations. Historically, DOD has not performed well at providing nonstandard item support. This is because DOD does not retain the logistics infrastructure in place to support items which it does not use itself. DOD has improved in this area by implementing commercial buying service (CBS) support for nonstandard items, i.e. contracting out nonstandard support. CBS support for nonstandard systems or components is usually provided via an FMS case. In general, DCS has provided better support for nonstandard items.

Training

Training is a key element to successfully operating and maintaining today's high technology military equipment. The DOD has established training resources to support its own training needs. Under FMS, customers can access many of these training resources. Although the DOD does acquire contractor training in certain circumstances, some types of military training are simply not available through commercial sources such as access to DOD's unique training ranges. On the other hand, the customer may require some form of tailored training that is not available from DOD. As an example, DOD training is normally conducted using only the English language. If the customer required training in its native language, contractor training could be an alternative training source.

Classified Items

The FMS process ensures all security provisions are in place for sales of classified items, and it also provides for required purchaser agreements to protect US concerns and to ensure the proper use of the article or service. In DCS arrangements, before an export license for classified material may be granted, security agreements establishing appropriate security measures must be executed between the purchasing government and the USG. The requirement for a security agreement is determined during the US review of the license request.

Range of Choices

In comparing the FMS system to the DCS system, it is important to realize that the decision regarding a potential procurement actually has a range of possibilities rather than just choosing between two separate options, traditional FMS or traditional DCS. In reality, there are several options available for most acquisition scenarios. The range of options focuses on the degree of foreign purchaser participation in the overall procurement activities. In essence, the decision concerning procurement via FMS or DCS fundamentally involves a decision about the degree of procurement involvement the foreign purchaser desires to assume and what degree of procurement responsibility the foreign purchaser is willing to delegate to the DOD. Table 15-1 presents the range of options, each of which will be discussed further in the sections below.

Table 15-1
Customer Participation Options

Traditional FMS
FMS funded with FMFP
FMS with Sole Source designated
FMS with Customer Participation in Contracting
FMS with Industry Offsets
Hybrid FMS/DCS
DCS funded with FMFP
DCS with USG contract administration
DCS with Industry Offsets
Traditional DCS

Traditional Foreign Military Sales

Under traditional FMS, the foreign purchaser initiates the process by submitting an LOR to the USG. The IA will develop the necessary pricing and availability estimates to generate an LOA. Following any necessary technology transfer reviews, releasability reviews, and Congressional notifications, the IA will forward the LOA as an offer by the USG to sell the respective defense articles and/or services. If, upon review of the LOA, the foreign purchaser decides to accept the LOA, a foreign government representative will sign the LOA and forward the initial deposit to the Defense Finance and Accounting Service (DFAS) Security Cooperation Accounting (SCA). At this point, per the SAMM C5.4.16, the foreign purchaser and the USG have entered a formal sales agreement for the provision of defense articles and services.

The LOA standard terms and conditions define the nature of this sales relationship. Section 1.2 specifically defines the procurement responsibilities and states that the foreign purchaser has delegated the procurement process to the DOD. The DOD will conduct the procurement on behalf of the customer using the same regulations and procedures that DOD uses to procure for itself. Under traditional FMS, the foreign purchaser is not responsible for accomplishing any procurement actions following acceptance of the LOA. Under the provisions of the LOA, the DOD takes responsibility for:

- Conducting the entire procurement process to include contractor source selection and negotiating the contract terms and conditions
- Contract administration, quality control, inspection, acceptance, and audit functions

As a very broad generalization, the traditional FMS process can be characterized as a foreign purchaser, by means of the LOA, employing the DOD to conduct defense procurement on its behalf. As such, the foreign purchaser entrusts the DOD to make decisions and take actions on its behalf. The foreign purchaser relies on the good faith commitment that DOD makes to conduct FMS procurement business in essentially the same manner that it conducts procurement business for itself. In this relationship of trust, there is no need for direct participation of the foreign purchaser in the procurement. DOD will execute the procurement based on the content of the LOA. However, as discussed in chapter 9 of this text, "Foreign Military Sales Acquisition Policy and Process," both the SAMM and the *Defense Federal Acquisition Regulation Supplement* (DFARS) permit limited customer participation in the contracting process.

Sole Source Foreign Military Sales

Foreign purchasers often have an interest in reviewing various vendors' business proposals to fulfill a particular defense requirement. Depending on the country and type of purchase, there can be significant interest in source selection, i.e., deciding which vendor(s) will fulfill their contract. FMS procedures offer the foreign purchaser an important opportunity for direct involvement in that decision. Sole source procedures allow the foreign purchaser to request the DOD initiate a particular FMS procurement exclusively with a specific vendor of the foreign purchaser's choice. This process is referred to as sole source procurement. Details on the sole source process are presented in chapter 9 of this textbook, "Foreign Military Sales Acquisition Policy and Process."

Approved sole source requests are documented within the LOA notes and serve as the basis for the USG contracting officer to negotiate on a non-competitive basis with the specific company identified in the LOA. Under sole source, the foreign purchaser can be involved in source selection just as they would under DCS, while still benefiting from the FMS system's extensive expertise in contract negotiation, contract administration, quality control, inspection, acceptance, and audit functions.

Foreign Military Sales with Offsets

Offsets offer a mechanism for the foreign purchaser to leverage a major defense acquisition to obtain other domestic benefits for the foreign purchaser's nation. The concept of offsets is presented in detail in chapter 9 of this textbook, "Foreign Military Sales Acquisition Policy and Process." Many international customers have the misconception that offsets are only compatible with DCS procurements, but this is not true. Offset agreements can occur in conjunction with customer-funded FMS cases, but FMS cases financed with FMFP funds or other non-repayable credits are not permitted to include any offset costs.

Combination of Foreign Military Sales and Direct Commercial Sales

Another procurement option is to divide an overall procurement into both an FMS portion and a DCS portion. The SAMM permits FMS cases to be prepared to support elements of a DCS procurement. This is particularly applicable to sales that may include certain FMS-only items in the total system package. Additionally, FMS policy permits foreign purchasers to obtain follow-on logistics support by means of FMS for systems that were originally procured via DCS or by DCS for systems originally procured via FMS.

Direct Commercial Sales with Foreign Military Financing Program

Typically, countries that receive FMFP funds must use those funds via the FMS process. However, under law, ten countries are authorized, on a contract-by-contract basis, to use their FMFP funds in DCS contracts. This alternative was discussed earlier in this chapter under the section titled "Foreign Military Financing Program Funding."

There are very strict procedures governing the process for funding a DCS with FMFP, but this remains an option to be considered by these ten countries.

Direct Commercial Sales with United States Government Contract Administration

Countries with extensive international procurement expertise may prefer to independently conduct their own defense procurements directly with US industry. Typically, the only USG involvement in a DCS arrangement would relate to the export license approval decision. However, foreign purchasers should recognize they can purchase contract administration services (CAS) from the Defense Contract Management Agency (DCMA) to obtain CAS for their DCS.

While the foreign purchasers' government representatives may possess all the skills and abilities to negotiate a favorable contract with US industry, the subsequent process for DCS contract administration, quality control, inspection, acceptance, and audit functions may present both a logistical and financial barrier. The US contractor may perform work at multiple geographically dispersed locations. As such, it may be difficult and expensive for the foreign purchasers' representatives to conduct these functions throughout the US.

Acquiring CAS from DCMA for self-negotiated DCS may be a cost-effective option to support DCS. Under this approach, upon receipt of an LOR, DCMA would develop an LOA for the cost of its CAS in support of the particular DCS. Under the LOA, DCMA uses its existing contract administration infrastructure to perform CAS on behalf of the foreign purchaser.

Direct Commercial Sales with Offsets

Customers electing to conduct their defense procurement via DCS may also choose to require industry to provide an offset in association with the sale. The limitation is that DCS contracts funded by USG FMFP, or other nonrepayable funds, cannot include an offset agreement.

Traditional Direct Commercial Sales

Traditional DCS offers the foreign purchaser the greatest degree of direct involvement in their US-sourced defense procurement. In DCS, the foreign purchaser directly interfaces with the contractor on all elements of the contract without DOD being an intermediary. Traditional DCS provides a range of opportunities. However, the foreign purchaser must be prepared to accept a significant level of responsibility.

Under traditional DCS, the USG essentially has no direct involvement in the procurement process except for one essential element–the export license. For a DCS of defense articles or services, the US company that is preparing to enter a sales contract with the foreign purchaser must first obtain USG approval for the sale. This approval is indicated in the form of an approved export license. More detailed information on the export license process is contained in chapter 7.

Following export license approval, the USG does not participate in the DCS. This exclusion includes contract negotiation, contract administration, quality control, inspection, acceptance, and audit functions. In DCS, the old saying: "you get what you negotiate" applies. In general, US defense contractors will work diligently to deliver quality items and services in accordance with all of the contract provisions. They are in business for the long term and are very interested in maintaining a positive relationship with each of their customers, as well as maintaining a solid reputation in the international marketplace.

In spite of all the positive intentions, the performance of major acquisition contracts will inevitably generate a variety of issues that must be resolved. In the DCS scenario, the foreign purchaser must be prepared to address the contractor directly to resolve any issues that arise. The promptness and acceptability of the resolution will depend solely upon the country and the defense contractor. Although the DOD may concurrently be procuring the same or similar items with the same contractor, DOD is not a participant in the DCS contract and therefore has no legal authority to direct the contractor in any aspect of DCS contract performance.

Summary

The FMS and DCS systems are simply different procurement methods that a foreign government may employ for the purchase of US defense articles and services. In a commercial acquisition, a US contractor and a foreign government enter into a direct contract in accordance with US law and regulations and provisions of international commercial law. The USG is not a party to these commercial contractual transactions. The foreign government has the responsibility to select the source and manage the contract directly with the US contractor.

Under the FMS system, the USG and the foreign purchaser enter into an agreement, the FMS LOA, which specifies the terms and conditions of the sale. Except for items supplied directly from DOD inventory, the USG purchases the desired items or services from the US manufacturer on behalf of the foreign government. The DOD employs essentially the same procurement criteria as if the item/service was being purchased for US needs. The USG, not the foreign government, selects the source and manages the contract, consistent with the provisions of the FAR, DFARS, and the LOA.

Unless the USG has determined that a specific item or service will only be offered via FMS, there are few absolutes which dictate that all countries should select exclusively either FMS or commercial channels for a given purchase requirement. Rather, there are many considerations, unique both to the individual purchaser and to the items being procured, that are involved in such a choice. In fact, in comparing the FMS system to the DCS system, it is important to realize that the decision regarding a potential procurement actually has a range of possibilities rather than just choosing between two separate options, traditional FMS or traditional DCS. The question of whether to procure via FMS or DCS ultimately involves a decision by the customer about how much procurement responsibility they are willing to assume and how much they are willing to delegate to the DOD.

The final decision on purchasing channels varies from country to country, and even from purchase to purchase. Given the variety of factors involved, it is important that the purchasing government's decision encompass as many factual considerations as possible.

References

DSCA Manual 5105.38-M. *Security Assistance Management Manual* (SAMM). Chaps. 2, 4, 6, 9, and 11. http://www.samm.dsca.mil/.

Guidelines for Foreign Military Financing of Direct Commercial Contracts and Contractor's Certification and Agreement. www.dsca.mil/DSCA.memoranda/fmf_dec_2009/2009_Guidelines_for_FMF_of_DCS.pdf

Contractor's Certification and Agreement with DSCA August 2009. (www.dsca.mil/DSCA_memoranda/fmf_dcc_2009/Contractor_Certificationv4.pdf

Attachment 15-1
Foreign Military Sales—Potential Advantages and Considerations

Potential Advantages	Considerations
Total package approach based on US military experience	Purchaser must decide whether the total package approach may exceed its needs or financial capabilities
USG uses its own procurement procedures and acts as procurement agent for foreign countries	Sophisticated foreign purchasing staff may (or may not) be able to achieve better overall deal by negotiating directly with the contractor.
Proven and established logistics support for items common to DOD	Contractor may be able to offer a similar range of contractor logistics support.
Federal acquisition regulations, economic order quantity buys, use of GFE or GFM tends to reduce price	Compliance with DOD procedures may increase lead time
Facilitates establishment of design configuration and enhances potential for interoperability	Purchaser must decide on the degree of standardization required for a purchase.
Purchaser pays only the actual cost to DOD (including management expenses), with profits controlled by the FAR	While initial LOA estimates tend, in the aggregate, to be higher than final LOA costs, final costs fluctuate both up and down.
Cross-leveling in the FMS trust fund can maximize use of country funds	Firm fixed price contracts and fixed payment schedules can be obtained under direct commercial contracts.
Quality control to ensure item meets MILSPECs is done by USG personnel	This service can be purchased under FMS for certain commercial contracts.
Items may be available from DOD stocks in times of emergency	Availability is significantly dependent on DOD's own priorities and inventory positions
Government-to-government obligation, assuring involvement of DOD personnel in total package planning and sustainment concepts	Due to the political climate, the purchaser may prefer procuring from the US contractor rather than the USG.
Total package includes training at US military schools	Purchaser can procure hardware under commercial contract and generally obtain associated training at US military schools via FMS.
FMS customers can require offsets in FMS-related contracts	Dependent on the funding source. If non-repayable FMFP, offset cost cannot be included

Attachment 15-2
Direct Commercial Sales—Potential Advantages and Considerations

Potential Advantages	Considerations
Potential for fixed delivery or fixed price, with penalty if contractor fails	Requires considerable experience and sophistication by country negotiators.
Business-to-business relationship allows country to negotiate cost and contract terms.	If closer military-to-military relationships are a purchaser's objective, FMS provides an avenue to achieve this objective.
Direct negotiations with contractor can result in a quicker response.	Requires considerable experience and sophistication by country negotiations.
Generally better support for nonstandard items.	Purchaser must decide upon desired degree of standardization with US forces.
More capability to tailor package to unique country needs.	Tailored package may detract from standardization desires.
Continuity of personal contacts with contractor technical personnel.	Value of continuity must be compared to the value of direct miltary-to-military contacts.
New equipment directly from production line.	Option exists to request only new and unused items via FMS.
Lower prices possible under certain circumstances.	Final price may be dependent on experience and sophistication of country contract negotiators.
Generally fixed payment schedule which eases budgeting problems.	Payment schedules may be more front-loaded than under FMS.
Purchaser can include offset provisions in one contract.	Purchaser can negotiate offsets (directly with contractor) and still procure under FMS.
FMS administrative surcharge and DOD management costs can be avoided.	Purchaser must consider entire cost of transaction, including its contracting staff costs and possibly increased contract administrative costs.
Commercial purchases of some types of items could help to create and develop a procurement capability.	Scarcity of resources and time may not allow for retaining procurement staff.

Attachment 15-3
Common Misperceptions of Foreign Military Sales or Commercial Sales

Misperceptions	Facts
FMS offers better assurance for approval of transfer of technology.	Technology release considerations are identical for FMS and commercial sales.
Commercial sales offer a better assurance for approval of transfer of technology.	Technology release considerations are identical for FMS and commercial sales.
FMS is unreliable during hostilities involving either the user or the USG.	Foreign policy or DOD military priority decisions affect the flow of supplies to a country and can be expected to relate to the resources involved. FMS orders may still be filled and may receive priority support depending on the nature of the hostilities.
Commercial sales are unreliable during hostilities involving either the user or the USG.	Foreign policy or DOD military priority decisions affect the flow of supplies to a country and can be expected to relate to the resources involved. FMS orders may still be filled and may receive priority support depending on the nature of the hostilities.
FMS provides slow delivery with frequent slippages.	The numerous built-in FMS system safeguards do sometimes slow the procurement process, but there are seldom slippages once delivery schedules are established. However, in a contingency, a potential exists to divert items from stocks and expedite delivery.
Nonrecurring cost recoupment charges for major defense equipment is always assessed on FMS.	Nonrecurring cost recoupment waivers may be authorized for FMS on a case-by-case basis. Recent history indicates a high probability of waiver approval.
A country cannot have an offset arrangement when they have an FMS case.	A country may negotiate a separate arrangement with the contractor in addition to an FMS agreement, but the USG will not be the enforcer of offset arrangements between the country and the commercial contractor.
No purchaser control or participation is permitted in FMS.	Selection of configuration, range and depth of spares, support equipment, etc., remains in control of purchaser. Program management review conferences are held as necessary to assure purchaser needs are met. Under certain circumstances, the purchaser may participate in selected contract discussions.
FMS system is characterized by a lack of continuity of personnel contact due to military personnel rotations.	While this may be true for some cases, there are many DOD civilians who do not rotate. Also, military tour is normally three to four years, about equal to commercial executive transfer patterns.

Attachment 15-3 (continued)
Common Misperceptions of Foreign Military Sales or Commercial Sales

Misperceptions	Facts
Only FMS requires USG approval and Congressional notifications [section 36(b), AECA], if necessary	All items meeting AECA notification thresholds require notification under both sales systems. AECA, section 36(c), applies to commercial sale notifications to Congress.
USG reserves the right to terminate only FMS in the US national interest but not DCS.	Applies equally to both FMS and commercial sale systems.
Quality control is not assured for items bought commercially.	Contractor sales depend on product reputation. Also, USG quality control procedures may be purchased for standard items.
Contractor involvement stops once an end item is sold.	Contractor participation in follow-on support and maintenance programs is common under either commercial or FMS.
USG controls third country sales only for items sold under FMS	Criteria and policy are the same for items purchased through either commercial or FMS.

Attachment 15-4
DSCA Policy Memo 09-32

DEFENSE SECURITY COOPERATION AGENCY
201 12TH STREET SOUTH, STE 203
ARLINGTON, VA 22202-5408

AUG 0 4 2009

MEMORANDUM FOR SEE DISTRIBUTION

SUBJECT: Responses to Industry Requests for Foreign Military Sales (FMS) Support Relating to Direct Commercial Sales (DCS), DSCA Policy 09-32 [SAMM E-Change 137]

Advance planning and coordination are essential in situations involving sales to foreign partners that combine both FMS and DCS elements, particularly when those sales originate through DCS channels. On occasion, industry has asked the United States Government (USG) to provide FMS support (e.g., airworthiness certification, training in U.S. military schools, ferrying aircraft, and the provision of equipment or components available only through FMS channels) to fulfill terms of DCS contracts.

Whether or not there is a DCS contract, industry is not authorized to make commitments on behalf of the USG and the USG cannot be held liable for industry's inability to provide support in conjunction with DCS - even if requested by the FMS purchaser. It is in industry's best interest to advise the foreign purchaser if FMS articles or services are required to support DCS purchased equipment. In this case, the purchaser must submit a Letter of Request (LOR) to obtain support and industry should inform DSCA and the relevant Implementing Agency of the possibility of a requirement for FMS support early in the process. Additionally, Security Cooperation Officers providing support to U.S. companies in-country must be alert to the need for the purchaser to submit a LOR and remind their foreign counterparts and industry representatives of this requirement.

Chapters 4 and 5 of the Security Assistance Management Manual (SAMM) have been updated to provide additional guidance on the importance of advance coordination in circumstances involving FMS support in conjunction with DCS.

If you have any questions concerning this policy or the SAMM, please contact Ms. Kathy Robinson, DSCA-STR/POL, at (703) 601-4368 or e-mail: kathy.robinson@dsca.mil.

Jeffrey A. Wieringa
Vice Admiral, USN
Director

Attachment:
As stated