

# 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 to include system cost, performance, delivery schedule, lifecycle logistics support, interoperability, and industrial utilization as well as the political implications of the selected source. Customers must rank the priorities in their selection process and evaluate the relative benefits and shortcomings of the systems under review.

If the customer is an ally or friend of the United States (U.S.), hopefully, the prospective customer will consider one or more U.S. systems. 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 U.S. systems rather than foreign systems. The reason for the U.S. preference relates to the various political, military and economic advantages derived from the U.S. and its friends using the same military equipment.

Although DoD officially prefers that allies and friends select U.S. systems, the DoD is generally neutral regarding the choice to purchase via foreign military sales (FMS) or direct commercial sales (DCS). Under law, U.S. military systems can be purchased through 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, what method is best for a particular customer depends on a number of considerations. The purpose of this chapter is to look at the various areas that should be considered in making the FMS/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 items 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) C4.5.9 outlines the process for designating an item as "FMS only". The "FMS only" designation may be based on legislation, presidential policy, disclosure policy, interoperability concerns or safety concerns. Some factors that may be considered in requiring a system to be sold "FMS only" include the political and military relationship with the purchaser; the degree of difficulty to integrate the new system with existing purchaser capabilities and infrastructure; the sensitivity of the technology; and the feasibility of separating system components into a DCS portion and a FMS portion. The Defense Technology Security Administration (DTSA), through its involvement with the Department of State (DoS) in reviewing commercial export license requests, monitors this 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**

On the other hand, U.S. firms may prefer that a sale be made commercially rather than using FMS procedures. When a company receives a request for proposal from a country and prefers a direct commercial sale, the company may request Defense Security Cooperation Agency (DSCA) issue a DCS preference for that particular sale. Approved DCS preferences are valid for one year and are held within security assistance offices (SAOs) and at the item manager level to allow screening of future letters of request. If the applicable implementing agency receives a request from the purchaser for a DCS preference item, the implementing agency (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 efforts 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 do not normally qualify for DCS preference.

## **COMPARISON CONSIDERATIONS**

### **Nature of Relationship**

Under FMS, the customer is entering a direct government-to-government relationship with the U.S. government (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 U.S. is not as positive, may desire to distance themselves from the USG and enter into a DCS arrangement with a U.S. contractor. In this situation, public opinion may view a relationship with U.S. industry more favorably than the direct government-to-government relationship inherent in FMS.

### **United States Government Involvement**

The USG is involved in approving both FMS and DCS sales. 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 Arms Export Control Act (AECA), both FMS and DCS sales must be notified to the U.S. 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.

It should also be noted that the USG always reserves the right to terminate a DCS munitions export license or a FMS letter of offer and acceptance (LOA) and to halt the actual export deliveries of FMS items or DCS licensed items when it is determined to be in the national interest of the U.S.

### **United States Military Involvement**

The FMS process is executed by U.S. DoD civilian employees and active duty U.S. military personnel. The direct involvement of DoD personnel in managing the procurement and delivery of a foreign purchaser's programs leads 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. Many contractor employees possess prior active duty experience in the U.S. military. In spite of this, many customers value the direct interaction with DoD civilian and active duty U.S. 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.

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 letters of offer and acceptance. It is also possible that governments with a well-developed purchasing capability can negotiate sales contracts more quickly than DoD.

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 system 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 feasible 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 duplicate fully the DoD contracting network in order to make a wise 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. Many contractors and subcontractors may be involved in supplying a weapon system, since no single contractor can

normally provide a total major system. Multiple DCS contracts may be necessary to make the total system procurement.

### ***Contract Negotiation***

Governments with extensive business ties to the West, and which are knowledgeable of U.S. law and financing, may perceive additional flexibility in direct commercial sales. The greater degree of flexibility in contracting is possible because U.S. industry has no structured, regulatory guidance, such as the *Federal Acquisition Regulation (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 insuring 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 aircraft 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 meets the customers' 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 the associated prime contractor mark-ups in price. 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 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, may be required to perform such functions.

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

### **Financial Considerations**

The issue of the total FMS cost in comparison to DCS cost is frequently a factor considered by the purchasing government. It is difficult to predict for any particular acquisition whether it would be less expensive to employ the FMS system or direct commercial channels. 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 charges that are required to be charged under the provisions of U.S. 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. The reason for this situation is that the U.S. personnel who prepare LOA price estimates may tend to apply a safety factor in their estimates for unanticipated increases in labor or raw materiel costs, higher than projected inflation rates or other unknown risks. 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 fixed payment schedule. Under DCS, the customer can 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 total package approach. 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 savings by offering other than DoD military standard configurations. It is important for the customer to understand any deviations from typical DoD configurations because this may limit interoperability as well as cooperative logistics follow-on support from DoD. The cost savings achieved in the initial acquisition 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 direct commercial sales also may be possible during times of rapid inflation in the U.S., 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. DoD also may already have priced contracts in place for DoD that can also be used to support new FMS requirements.

### ***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 LOA acceptance 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. Such 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 use of cross-leveling agreements. Such 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. This practice 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.

### **Concurrent Price Comparisons**

The USG does not compete with U.S. industry for foreign sales. Moreover, as a matter of policy, the USG normally does not knowingly provide foreign governments with comparison pricing information, especially in those instances where it is known that a direct commercial contract is already being negotiated. An exception to the policy of not providing comparison pricing information can be made if the country has a national policy requiring both FMS and commercial data be obtained.

If the purchaser submits an LOR then decides to obtain a DCS price quote, they should cancel their LOR prior to making the DCS request. If the purchaser has received an LOA offer then requests DCS proposals, the USG may withdraw the LOA offer. If the purchaser initiates DCS activities then decides to submit an LOR through the FMS process, the purchaser should inform the IA that DCS acquisition efforts have ceased.

### **Nonrecurring Cost Application**

The AECA requires a charge for a proportionate amount of any nonrecurring costs (NRC) of research, development, and production of major defense equipment sold through FMS. However, DCS is exempt from these NRC 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 NRC under FMS. The purchaser can request a NRC waiver when:

- Standardization benefits result to the U.S. from the sale
- Cost saving benefits accrue to the U.S. 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 NRC waiver process is in the SAMM, C9.6.3.

### **Other Costs**

The issue of other costs in both commercial contracts and FMS agreements also requires clarification. Except for specific statutory exemptions, all USG expenses for FMS program implementation 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, contract negotiation, contract management, financial management, certain reports of discrepancy, etc. Contractor profits are also included within the final FMS price, but are limited by the provisions of the FAR.

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. U.S. firms typically add administrative costs as part of their equipment unit prices, whereas FMS administrative costs are identified as a separate line item on the FMS agreement.

### **Production Priority Considerations**

There are many defense articles produced by U.S. 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 direct commercial sales 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 U.S. 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 U.S. equipment, and thereby shares the U.S. industrial priority. Direct commercial sales, however, involve independent contracts that do not automatically receive the same production priorities as DoD procurements.

Another consideration involves government-furnished equipment (GFE) or government-furnished materiel (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 U.S. and FMS requirements.

If GFE and GFM components are not available directly to a contractor, the foreign purchaser could acquire them under FMS procedures, and then 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 U.S. defense articles involves the nature of the follow-on support which will be required from U.S. sources. If the items being purchased are being used by the U.S. 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 U.S. experience and existing USG logistics inventories and training facilities. Under a cooperative logistics supply support arrangement (CLSSA), the DoD spare parts inventory can be drawn upon in support of the purchaser's requirements, and this can be accomplished simply by the submission of requisitions for individual parts. In effect, the DoD logistics structure serves as a procurement staff for the purchaser by procuring required individual items from the current U.S. sources.

There are some U.S. 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 where equipment may not match the support available through the normal U.S. logistics systems. For example, if the manufacturer only employs commercial stock 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 the international logistics communications system (ILCS), supply tracking and repairable return/personal computer (STARR/PC), Air Force Security Assistance Center (AFSAC) on-Line, Navy e-business suite, and the security assistance information portal (SCIP). DoD also has security assistance dedicated staffs and in-country SAOs to facilitate the administration of the FMS program.

### **Nonstandard Items**

Historically, DoD has not performed well at providing nonstandard item support because it lacks the normal logistics infrastructure that is in place for standard items. Previously, DCS provided better access and performance to nonstandard items. The DoD has improved in this area by implementing commercial buying service support (CBS) for nonstandard items. Essentially, DoD has contracted out nonstandard support by means of CBS. FMS customers can access the CBS nonstandard support by using FMS cases.

### **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 itself acquire contractor training in certain circumstances, some training is simply not available through commercial sources. For example, contractors cannot provide some of the training range resources that are unique to DoD.

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 assures that all security provisions are in place for sales of classified items, and it also provides for required purchaser agreements to protect U.S. concerns and to assure 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 DoD review of the license request.

### **Foreign Military Financing Program Funding**

Foreign military financing program (FMFP) funding generally requires that it be used through the FMS process. However, FMFP funding can in certain circumstances be used to fund DCS contracts.

Under law, only ten countries are authorized to use FMFP funding to pay for DCS contracts: Israel, Egypt, Jordan, Morocco, Tunisia, Turkey, Portugal, Pakistan, Yemen, and Greece.

These purchases are approved by DSCA on a case-by-case basis using “Guidelines for Foreign Military Financing of Direct Commercial Contracts” and 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 non-standard items (items that do not have a national stock number and are not procured by DoD). Exceptions may be requested from DSCA with written justification. The prime contractor must be incorporated or licensed to do business in the U.S.

## **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 about conducting a procurement via FMS or DCS fundamentally involves a decision about the degree of procurement involvement the foreign purchaser desires to assume and what degree procurement responsibility the foreign purchaser is willing to delegate to the DoD.

### **Traditional Foreign Military Sales**

Under traditional FMS, the foreign purchaser initiates the process by submitting a letter of request to the USG. The applicable implementing agency will develop the necessary pricing and availability estimates to generate a LOA. Following any necessary technology transfer reviews, releasability reviews, and Congressional notifications, the implementing agency will forward the LOA as an offer by the USG to sell the respective defense articles or services. If, upon review of the LOA, the foreign purchaser decides to accept the LOA, a government representative will sign the LOA and the government will forward the initial deposit to the Defense Finance and Accounting Service (DFAS). At this point, per the *Security Assistance Management Manual* (SAMM) C4.1, 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 nature of this sales relationship. Section 1.2 specifically defines the procurement responsibilities. In summary, Section 1.2 states that the foreign purchaser has essentially delegated the entire procurement process to the DoD. In this relationship 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 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, 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 a 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.

## **Sole Source Foreign Military Sales**

FMS procedures include the provision for the foreign purchaser to request the DoD initiate a particular FMS procurement exclusively with a specific vendor that is identified by the foreign purchaser. This process is referred to as sole source procurement. Details on the sole source process are presented in Chapter 9, “Foreign Military Sales Acquisition Policy and Process,” of this text. Sole source procedures offer the foreign purchaser an important opportunity for direct involvement in one of the most key steps in the procurement process, namely source selection.

As a foreign purchaser contemplates a future procurement, the area that most purchasers express an interest for increased involvement concerns the area of source selection. Foreign purchasers often have an interest in reviewing various vendors’ business proposals to fulfill a particular defense requirement. Under FMS sole source procedures, the foreign purchaser has the ability to interface directly with the vendors in the marketplace and independently conduct a source selection. Subsequently, the foreign purchaser can submit a LOR to the USG that includes a sole source justification that identifies a specific vendor as the desired contractor. The SAMM outlines five primary justifications for requesting sole source. These five reasons include: urgent need, nonstandard requirement, procurement history, standardization and foreign purchaser’s own source selection process. Sole source requests are not limited to just these five justifications but most situations will fit into one of these categories.

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. The normal FMS process applies to executing the LOA. Under sole source, the foreign purchaser gains involvement in one of the most important contract phases, source selection, but still obtains the benefit of DoD’s extensive expertise in contract negotiation, contract administration, quality control, inspection, acceptance and audit functions.

In considering choice of FMS or DCS, the FMS sole source process offers a key opportunity for direct foreign purchaser participation while still retaining the benefits of the overall DoD contracting process.

## **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, “Foreign Military Sales Acquisition Policy and Procedures,” of this text. The important point for a foreign purchaser to understand is that offset agreements can occur in conjunction with an FMS case. It has been a misconception that offsets are only compatible with DCS procurements.

## **Combination of Foreign Military Sales and Direct Commercial Sales**

Another procurement option is to divide an overall procurement into both a 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.

## **Direct Commercial Sales with Foreign Military Financing Program**

Typically, countries that receive FMFP funds must utilize those funds via the FMS process. However, under law, ten countries are authorized on a case-by-case basis to use their FMFP funds in

DCS contracts. These ten countries are: Israel, Egypt, Jordan, Morocco, Tunisia, Turkey, Portugal, Pakistan, Yemen, and Greece. 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 would relate to the export license approval decision. However, foreign purchasers should recognize that they can purchase contract administration services (CAS) from the DCMA to obtain CAS for their DCS.

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

Acquiring CAS from the DCMA for the foreign purchaser 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 services in support of the particular DCS. Under the LOA, DCMA utilizes its existing infrastructure to perform CAS on behalf of the foreign purchaser.

### **Traditional Direct Commercial Sales**

Traditional DCS offers the foreign purchaser the greatest degree of direct involvement in the 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 accepts a significant level 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 sale of defense articles or services, the U.S. 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, “Technology Transfer, Export Controls and International Programs Security,” of this text book.

Following export license approval, the USG and specifically the DoD do 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. Most all U.S. defense contractors will diligently work to deliver quality items and services in accordance with all the contract provisions. These defense contractors are in business for the long term and are very interested in maintaining a positive relationship with each individual purchaser 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 of varying degrees of difficulty that must be resolved. In the DCS scenario, the foreign purchaser must be prepared to address and resolve these matters in a timely and technically proficient manner directly with the 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 system and the DCS system are simply different procurement methods which a foreign government may employ for the purchase of U.S. defense articles and services. In the commercial case, a U.S. contractor and a foreign government enter into a direct contract in accordance with U.S. 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 in such purchases to select the source and manage the contract directly with the U.S. 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 U.S. manufacturer on behalf of the foreign government. The DoD employs essentially the same procurement criteria as if the item/service was being purchased for U.S. needs. The USG, not the foreign government, selects the source and manages the contract, consistent with the provisions of the FAR and the LOA.

In reviewing the pertinent factors associated with the two procurement systems, one should bear in mind that 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. In essence, the decision about conducting a procurement via FMS or DCS fundamentally involves a decision about the degree of procurement involvement the foreign purchaser desires to assume and what degree procurement responsibility the foreign purchaser is 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**

DoD 5105.38-M, *Security Assistance Management Manual* (SAMM), Chapter 4, 6, and 9.

Guidelines for Foreign Military Financing of Direct Commercial Contracts and Contractor's Certification and Agreement with DSCA. Available at: [www.dscamilitary.com/DSCA\\_memoranda/fmf-dcc.htm](http://www.dscamilitary.com/DSCA_memoranda/fmf-dcc.htm).

## **ATTACHMENT 15-1**

### **FOREIGN MILITARY SALES - POTENTIAL ADVANTAGES AND CONSIDERATIONS**

#### **Potential Advantages**

1. Total package approach based on U.S. military experience.
2. USG uses its own procurement procedures and acts as procurement agent for foreign countries.
3. Proven and established logistics support for items common to DoD.
4. Federal acquisition regulations, economic order quantity buys, use of GFE or GFM tends to reduce price.
5. Facilitates establishment of design configuration and enhances potential for interoperability.
6. Purchaser pays only the actual cost to DoD (including management expenses), with profits controlled by the FAR.
7. Cross-leveling in the FMS trust fund can maximize use of country funds.
8. Quality control to assure item meets MILSPECs is done by USG personnel.
9. Items may be available from DoD stocks in times of emergency.
10. Government-to-government obligation, assuring involvement of DoD personnel in military planning, deployment concepts, operational planning, etc.
11. Total package includes training at U.S. military schools.
12. FMS customers can use ILCS system.

#### **Considerations**

1. Purchaser must decide whether the total package may exceed its needs or financial capabilities.
2. Sophisticated foreign purchasing staff may (or may not) be able to achieve better overall deal by negotiating directly with the contractor.
3. Contractor may be able to offer a similar range of contractor logistics support.
4. Compliance with DoD procedures may increase lead times.
5. Purchaser must decide on the degree of standardization required for a purchase.
6. While initial LOA estimates tend, in the aggregate, to be higher than final LOA costs, final costs fluctuate both up and down .
7. Firm fixed priced contracts and fixed payment schedules can be obtained under direct commercial contracts.
8. This service can be purchased under FMS for certain commercial contracts.
9. Availability is significantly dependent on DoD's own priorities and inventory positions.
10. Due to the political climate, the purchaser may prefer procuring from the U.S. contractor rather than the USG.
11. Purchaser can procure hardware under commercial contract, and generally obtain associated training at U.S. military schools via FMS.
12. Commercial customers must rely on the commercial telecommunications system.

## ATTACHMENT 15-2

### DIRECT COMMERCIAL SALES - POTENTIAL ADVANTAGES AND CONSIDERATIONS

#### Potential Advantages

1. Potential for fixed delivery or fixed price, with penalty if contractor fails.
2. Business-to-business relationship allows country to negotiate cost and contract terms.
3. Direct negotiations with contractor can result in a quicker response.
4. Generally better support for nonstandard items.
5. More capability to tailor package to unique country needs.
6. Continuity of personal contacts with contractor technical personnel.
7. New equipment directly from production line.
8. Lower prices possible under certain circumstances.
9. Generally fixed payment schedule which eases budgeting problems.
10. Purchaser can include offset provisions in one contract.
11. FMS administrative surcharge and DoD management costs can be avoided.
12. Commercial purchases of some types of items could help to create and develop a procurement capability.

#### Considerations

1. Requires considerable experience and sophistication by country negotiators.
2. If closer military-to-military relationships are a purchaser's objective, FMS provides an avenue to achieve this objective.
3. Requires considerable experience and sophistication by country negotiators.
4. Purchaser must decide upon desired degree of standardization with U.S. forces.
5. Tailored package may detract from standardization desires.
6. Value of continuity must be compared to the value of direct military-to-military contacts.
7. Option exists to request only new and unused items via FMS.
8. Final price may be dependent on experience and sophistication of country contract negotiators.
9. Payment schedules may be more front-loaded than under FMS.
10. Purchaser can negotiate offsets (directly with contractor) and still procure under FMS.
11. Purchaser must consider entire cost of transaction, including its contracting staff costs and possibly increased contractor administrative costs.
12. Scarcity of resources and time may not allow for retaining procurement staff.

## ATTACHMENT 15-3 COMMON MISPERCEPTIONS OF FMS OR COMMERCIAL SALES

<u>Misperceptions</u>	<u>Facts</u>
1. FMS prices are cheaper.	1. Depends on item being purchased, negotiating skills, and many other variables.
2. Commercial prices are cheaper.	2. Depends on item being purchased, negotiating skills, and many other variables.
3. FMS offers better assurance for approval of transfer of technology.	3. Technology release considerations are identical for FMS and commercial sales.
4. Commercial sales offer a better assurance for approval of transfer of technology.	4. Technology release considerations are identical for FMS and commercial sales.
5. FMS is unreliable during hostilities involving either the user or the USG.	5. Foreign policy or DoD military priority decisions affect the flow of supplies to a country and can be expected to relate to the resource involved. FMS orders may still be filled and may receive priority support depending on the nature of the hostilities.
6. Commercial sales are unreliable during hostilities involving either the user or the USG.	6. Foreign policy or DoD military priority decisions affect the flow of supplies to a country and can be expected to relate to the resource involved. There may be a tendency to fill FMS orders first, depending on the nature of the hostilities.
7. FMS provides slow delivery with frequent slippages.	7. The numerous built-in FMS system safeguards do sometimes slow the procurement process although there seldom are slippages once delivery schedules are established. However, in a contingency a potential exist to divert items from service stocks and expedite delivery.
8. Nonrecurring cost recoupment charges for major defense equipment is always assessed on FMS sales.	8. Nonrecurring cost recoupment waivers may be authorized for FMS on a case-by-case basis. Recent history indicates a high probability of waiver approval.
9. A country cannot have an offset arrangement when they have an FMS case.	9. A country may negotiate a separate arrangement with the contractor in addition to a FMS agreement, but the USG will not be the enforcer of offset arrangements between the country and the commercial contractor.
10. No purchaser control or participation is permitted in FMS.	10. 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 contracting discussions.

**ATTACHMENT 15-3 (CONTINUED)**  
**COMMON MISPERCEPTIONS OF FMS OR COMMERCIAL SALES**

**Misperceptions**

**Facts**

- |   |   |
|---|---|
| 11. FMS system is characterized by a lack of continuity of personnel contact due to military personnel rotations. | 11. 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. |
| 12. Only FMS requires USG approval and congressional notifications [Section 36(b), AECA], if necessary.           | 12. All items meeting AECA notification thresholds require notification under both sales systems. AECA, Section 36(c), applies to commercial sale notifications to Congress.                          |
| 13. USG reserves the right to terminate only FMS in the U.S. national interest but not DCS.                       | 13. Applies equally to both FMS and commercial sale systems.  |
| 14. Quality control is not assured for items bought commercially.   | 14. Contractor sales depend on product reputation. Also, USG quality control procedures may be purchased for standard items.  |
| 15. Contractor involvement stops once an end item is sold.  | 15. Contractor participation in follow-on support and maintenance programs is common under either commercial or FMS.  |
| 16. USG controls third country sales only for items sold under FMS.   | 16. Criteria and policy are the same for items purchased through either commercial or FMS.  |