

2.5 The Purchaser agrees not to divert articles and services received under this LOA for purposes or uses other than those for which it was furnished, including, but not limited to, any use that could contribute to the acquisition, design, development or production of a "missile," as defined in section 74 of the Arms Export Control Act (AECA) (22 U.S.C. 2797c). The items will be used only for the purposes stated and such use will not be modified nor the items modified or replicated without the prior consent of the USG; neither the items nor replicas nor derivatives thereof will be retransferred without the consent of the USG. The USG has the right to take action under section 73(a) of the AECA (22 U.S.C. 2797b(a)) in the case of any export or transfer of any Missile Technology Control Regime (MTCR) equipment or technology that contributes to the acquisition, design, development or production of missiles in a country that is not an MTCR adherent.

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

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

2.8 The USG is not a party to any offset agreements/arrangements that may be required by the Purchaser in relation to the sales made in this LOA. The USG assumes no obligation to administer or satisfy any offset requirements or bear any of the associated costs. To the extent that the Purchaser requires offsets in conjunction with this sale, offset costs may be included in the price of contracts negotiated under this LOA. Such costs shall be determined or deemed reasonable in accordance with SUBPART 225.73 of the Defense Federal Acquisition Regulation Supplement (DFARS). If the Purchaser desires visibility into these costs, the Purchaser should raise this with the contractor during negotiation of offset arrangements.

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

Section 2.1 Purchaser Right to Cancel

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

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

Section 2.2 End-Use Purposes

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

Section 2.3 Reports Verification

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

Section 2.4 Third Country Transfers

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

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

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

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

Section 2.5 Missile Technology Control Regime

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

Section 2.6 Security Requirements

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

Section 2.7 End-Use Monitoring

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

Section 2.8 Offset Arrangements

Section 2.8 incorporates a previous mandatory note on offset arrangements. Section 2.8 notifies the customer that the USG is not a party to any offset arrangements and assumes no obligation to administer any offset requirements. In addition, Section 2.8 notifies the customer any offset costs (indirect) shall be determined or deemed to be reasonable in accordance with the DFARS. A more detailed explanation of offsets is contained in chapter 9, "Foreign Military Sales Acquisition Policy and Process."

Section 3 Indemnification and Assumption of Risks

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

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

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

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

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

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

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

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

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

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