

Foreign Military Sales vs. Direct Commercial Sales

A Customer's Point of View

**Werner Kaelin
Former Defense Procurement Counselor
at the Embassy of Switzerland
Washington D.C. 2008**

Overview

- **Security Assistance/Cooperation**
- **FMS vs. DCS**
- **Offset**

Security Assistance

Security Cooperation

- Security Assistance concerns the transfer of military defense articles and/or services from the United States to friendly foreign governments and specific international organizations.
- Security Cooperation is a reengineered designation of the same laws, processes and procedures.
- DSCA, the Defense Security Cooperation Agency is responsible for Security Assistance, Foreign Military Sales and related issues for the Office of the Secretary of Defense.
- DSCA's guidance is published in the Security Assistance Management Manual (SAMM) that provides definitive guidance for Security Assistance matters.

Direct Commercial Sales

- Direct Commercial Sales (DCS) are sales made by U.S. companies directly to an international customer.
- DCS agreements are not administered by DoD and do not involve a government-to-government agreement.
- U.S. industry is responsible for obtaining a license from the Office of Defense Trade Controls in the Department of State for each of these sales.
- Under DCS the foreign customer engages directly in contract negotiations and program management decisions with a U.S. supplier or manufacturer.
- In broad terms, the contract follows commercial rules and procedures.

Foreign Military Sales

- Foreign Military Sales (FMS) is a U.S. Government program that allows a foreign government to purchase defense articles, services, construction services, and training from the U.S. Government .
- FMS is conducted under the authority of the AECA of 1976 and the Foreign Assistance Act of 1961, both as amended.
- By law, FMS is operated on a “no-profit” and “no-loss” basis to the USG.
- FMS follows an unusual set of rules, regulations and procedures.
- On the basis of a Letter of Request (LOR) from an international customer, the U.S. Government issues a government-to-government agreement, known as a Letter of Offer and Acceptance (LOA).
- Once the LOA is accepted (signed) by the foreign government and the initial financial requirements are fulfilled, the FMS case is implemented.

Positive Aspects of FMS

- ▶ *Foreign customer gains access to a vast knowledge base.*
- ▶ *Release process is facilitated with assistance from DOD and military services.*
- ▶ *Acquisition of experience and project management.*
- ▶ *“Most favored” pricing is guaranteed.*
- ▶ *Government audits are the norm.*
- ▶ *USG allows access to primes and subs.*

Negative Aspects of FMS

- ▶ *Release processes are not transparent.*
- ▶ *FMS cases are gov't-to-gov't agreements - not contracts. Commitment is for “dependable undertaking.”*
- ▶ *“Dependable undertaking” concept difficult to sell at home.*
- ▶ *LOA preparation schedule is unpredictable.*
- ▶ *FMS customer subjected to bureaucratic attitudes.*
- ▶ *Co-production or license production MOUs take nine(!) months.*
- ▶ *Before FMS reform, case closure used to be an everlasting accountants quandary: “no gain-no loss.”*

Positive Aspects of DCS

- ▶ *Follows commercial rules and procedures.*
- ▶ *The customer has control over his money.*
- ▶ *Payment schedule tied to contractual performance.*
- ▶ *Customer can negotiate penalties for late delivery and poor performance.*
- ▶ *Books can be closed when contract is fulfilled and final payment is made.*
- ▶ *Offsets and Industry Participation are part of the deal.*

Negative Aspects of DCS

- ▶ *Foreign customer often encounters difficulties in gaining access for pre-award and price audits.*
- ▶ *Purchaser has to provide additional manpower for project oversight and quality control.*
- ▶ *Repairs or replacements of faulty parts or workmanship are often disputed.*
- ▶ *U.S. contractor may try to implement contract as an open-ended U.S. Government contract irrespective of the actual contractual terms.*

Recommendations for FMS

- ▶ *U.S. Government should manage LOAs as an ombudsman for the foreign government.*
- ▶ *Make LOA, MOU, NDP, etc. approval processes transparent to customers.*
- ▶ *FMS offices need to adopt a "can do" attitude.*
- ▶ *Offsets are a fact of business. Why fight them?*
- ▶ *Make closing FMS cases a priority.*
- ▶ *Recognize that foreign orders reduce cost for U.S. acquisitions.*
- ▶ *Cash paying countries deserve better treatment.*

DSCA is committed to continued improvements through FMS Reform and Business Process Re-engineering

Recommendations for DCS

- ▶ *Commercial contracting is not the solution to all (FMS) problems.*
- ▶ *Commercial contracts should reduce bureaucratic waste, not quality and performance.*
- ▶ *Keep lawyers out of the customer's hair.*
- ▶ *Prepare for foreign governments' requests for audits. Foreign governments have legal requirements, too.*

Offsets in FMS & DCS Programs

- *Offsets are political necessities*
- *Offset is a fact of defense business and is here to stay.*
- *Every country employs a form of Offset. Even the U.S., but with another spin.*
- *There are no free lunches.*
- *Instead of fighting it, governments should help to make it work.*

Offsets in FMS Programs

- *Contract/Agreement with contractor separate from FMS case.*
- *USG agencies not involved in Offset negotiations and performance.*
- *Any Offset cost allowable, if contracting officer deems reasonable.*
- *Note on Offset costs in LOA*
- *Statutory notification to Congress*

Offset's Win-Win Formula

- ❖ *The buying country acquires defense equipment which satisfies its requirements.*
- ❖ *The supplier sells sophisticated defense equipment, thus supporting his country's industrial base.*
- ❖ *The buyer's industry broadens its technology and market base and increases sales of competitive products.*
- ❖ *The supplier expands his business base and saves money through buying competitive products from abroad.*

Offset Conclusions

Offset is Real!

Offset is Important!

Offset is REAL IMPORTANT!

Steve Piro of Lockheed Martin

international trade as follows:

**Thank You
For Your Attention**