

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 considers 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 partners establish their prioritized source selection criteria to evaluate each system's relative benefits and shortcomings under review. In addition to considering systems produced by nations other than the U.S., our international partners might also consider one or more U.S. defense systems during their selection process.

The Department of Defense's (DOD's) official position regarding the international partner's selection is clear. The DOD prefers that allies and friendly nations purchase U.S. systems rather than foreign systems (SAMM C4.3.4). The purchase of U.S. defense systems by international partners provides various political, military, and economic advantages derived from the United States and its international partners using the same military equipment.

Although the U.S. Government (USG) officially prefers that international partners select U.S. systems, the USG is generally neutral regarding their choice to purchase by means of Foreign Military Sales (FMS) or Direct Commercial Sales (DCS) (SAMM C4.3.4). Thus, most U.S. military systems may be purchased through either FMS or 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 to examine the various factors that impact FMS and DCS acquisition decision-making. Another pertinent reference that is available on this topic is "A Comparison of Foreign Military Sales (FMS) versus Direct Commercial Sales (DCS)" research paper which is posted on the DSCA Publications website: <https://www.dsca.mil/resources/publications>.

FOREIGN MILITARY SALES-ONLY ITEMS

Although most defense items, services, or training 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 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, who makes the designation based on DOD input. Military Departments (MILDEPs) and DOD components forward recommendations and rationales for FMS-Only designations to the Defense Security Cooperation Agency (DSCA). DSCA provides FMS-Only recommendations to the Department of State (DOS) for review and approval/disapproval. The Defense Technology Security Administration (DTSA), in coordination with the MILDEPs, implements this process through its involvement with DOS in reviewing commercial export license requests. DOS will not issue a commercial export license for sales that have been designated FMS-Only. The SAMM C4.3.5 outlines the process for designating a particular sale or military item as FMS-Only. DOS uses four general criteria to determine if a sale is required to proceed through the FMS process. The criteria are:

- Legislative/Presidential restrictions
- MILDEP policy, directive, or regulatory requirement (e.g., the National Disclosure Policy); (3) government-to-government agreement requirements; and (4) interoperability/safety requirements for U.S. forces.

These criteria, particularly DOD/MILDEP policy, can be further understood by considering four possible elements:

- U.S. 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 the United States and the international partner within the context of existing world security circumstances.
- Sale of a new or complex system or service. DOD may recommend FMS-Only:
 1. To maximize the international partner's ability to assimilate the technologies and manage its acquisition/logistics
 2. For enhanced interoperability and cooperation between U.S. and international partner's military forces
 3. For end items or services that require complex systems integration with other combat systems
 4. For end items or services that require access to sensitive U.S. government (USG) databases, libraries, or software-source code
 5. For end items or services that require Enhanced End-Use Monitoring (EEUM) or on-site accountability
 - 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.
 - Feasibility of separating weapon system components into FMS/DCS elements. At times, international partners 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 "FMS Only List", located in SAM C4.3.5.2., lists military capabilities and systems by general category that the USG broadly considers to be available for export on an FMS only basis. This list is reflected in Table 15-1.

**Table 15-1
General FMS-Only Categories**

• Select Radars: such as but not limited to AESA, Ballistic Missile Defense, and High-Frequency Phased Array Microwave	• Air-to-Air Missiles
• Attack Helicopters	• Autonomous Weapons Systems
• Ballistic Missile Defense Items: Effectors; Firing Units; Software	• Special Purpose Aircraft Items
• Counter Improvised Explosive Device Items	• Cross Domain Solutions (involving critical U.S. systems)
• Directed Energy Weapons	• Fighter Aircraft
• Ground Based Air Defense Items	• Infrared Countermeasures
• Intelligence Libraries/Threat Data	• LADAR/LIDAR (Laser/Light Detection and Ranging)
• Man-Portable Air Defense Items	• Military Aerosol Delivery Systems
• Missiles	• Mission Equipment/Systems
• Mission Planning Systems	• Missile Technology Control Regime CAT I Items
• GPS/PPS (Allowances made for certain DCS transfers remain in effect)	• Nuclear Weapon/Nuclear Propulsion
• Select Electronic Warfare Items	• Select Sensor Fusion Man-Portable Night Vision Devices
• Sensor Fused Weapons	• Stand Off Weapons
• Sonar	• COMSEC
• Select Torpedoes	• Torpedo Countermeasures
• Anti-Ship Cruise Missile Countermeasures	• Unmanned Aerial Systems and related components

DIRECT COMMERCIAL SALES PREFERENCE

In instances where the USG is neutral regarding the purchase by FMS or DCS, SAMM C4.3.6 permits U.S. defense firms to designate a preference that a sale of their products or services is on a DCS basis. When a company receives a request for proposal from an international partner 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 international partner for a DCS preference item, the IA notifies the international partner of the DCS preference and advises them 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. International Partners funding a purchase using Foreign Military Financing (FMF) funds may be required to purchase by FMS. The Director, DSCA, may also recommend that it mandate FMS for a specific sale to the DOS.

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, SAMM C4.3.5.4.4 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 international partner.

In regard to FMS materiel or services support for DCS, 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 not authorized to make commitments on behalf of the USG. Industry should inform the international partner 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 U.S. military schools, aircraft ferry or other transportation services, or the provision of FMS-Only articles or services. The international partner 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 international partners' 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 international partners to obtain sustainment support for that system through the same original acquisition method. Per SAMM C4.4.3, 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 international partner desires, except for of any FMS-Only sustainment items.

UNITED STATES GOVERNMENT SALES SUPPORTING DIRECT COMMERCIAL SALES

The AECA, Section 30, authorizes the USG to sell defense articles and services to U.S. companies in support of a proposed direct commercial sale and pursuant to an approved export license from the USG into end items being sold an international partner. Services may include transportation, installation, testing, or certification directly associated with the sale. Per SAMM C11.T9, the sales must meet the following criteria:

- Sale is to a company incorporated in the United States that has an approved export license for final assembly, manufacture, or concurrent or follow-on support of an end item being procured for the armed forces of a friendly country or for an international organization.
- The articles would be supplied to the prime contractor as GFE/GFM if the end item were being procured for the use of the U.S. Armed Forces;
- Any services being provided must be performed in the United States and may include transportation, installation, testing, or certification that are directly associated with the sale.
- And the articles and services are available only from USG sources or are not available to the prime contractor directly from the U.S. sources at such times as may be required to meet the prime contractor's delivery schedule.

The USG uses a unique sales agreement for the sale of defense articles and/or services to U.S. 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 before executing 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 international partner has the choice to purchase by either FMS or DCS. However, it is the policy of the USG not to compete with U.S. industry for foreign defense sales. Per SAMM C4.3.7, 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.

If the international partner obtains FMS data and, later determines they should request a commercial price quote, the international partner should cancel the LOR prior to requesting commercial data. If an LOA has been offered and the international partner then solicits formal bids from private industry for the same item, the IA should query the international partner as to its intentions and indicate that the LOA may be withdrawn. If the international partner requests FMS data after soliciting bids from contractors, the international partner must supply information to the IA showing that commercial acquisition efforts have ceased before any FMS data is provided. If an international partner's national policy or specific circumstances require that both FMS and commercial data be obtained for the item to be procured, the international partner should submit a request for exception with justification to DSCA (Strategy, Plans, and Policy Directorate (SPP)).

FOREIGN MILITARY FINANCING (FMF) PROGRAM

Foreign Military Financing (FMF) program funds (if available) are generally required to be used through the FMS process. The purpose is that FMF program funds are grant funds provided by the USG to further U.S. interests around the world by ensuring that international partners are equipped and trained to work toward common security goals and share burdens in joint missions. However, per SAMM C9.7.3, FMF program funding can, in certain circumstances, be used to fund DCS contracts. Under law, only ten countries can use FMF 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 FMF program funds in DCS contracts, all FMF purchases must be approved by DSCA on a contract-by-contract basis using *Foreign Military Financing of Direct Commercial Contracts* (FMF DCC), which is posted at the DSCA Resources Publications website <https://www.dsca.mil/resources/publications>. Commercial contracts financed with FMF program funds 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 the DOD). Offset costs are prohibited from being included on an FMF- financed DCS. Additionally, the prime contractor must be incorporated or licensed to do business in the United States unless DSCA has approved an offshore procurement per the procedures in SAMM C9.7.2.7.3.

COMPARISON CONSIDERATIONS

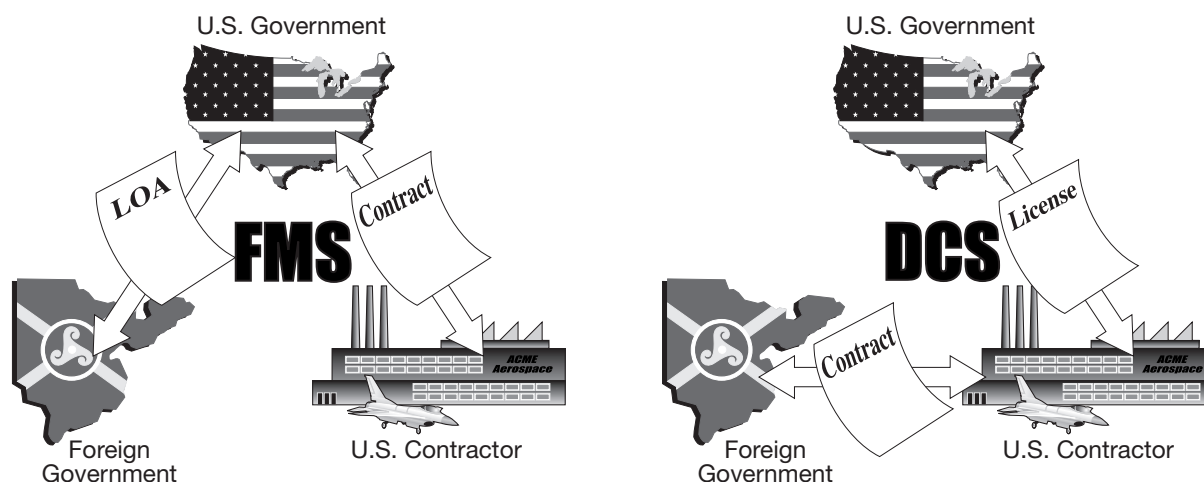
Relationship Considerations

Under FMS, the international partner is entering a direct government-to-government relationship with the USG. In fact, the international partner is purchasing directly from the USG. This arrangement can be viewed as either an advantage or a disadvantage depending on the political climate. Some international partners desire the association implied by the FMS interaction. Other international partners, where the popular view of the United States 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.

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 U.S. Congress if the proposed sale meets or exceeds the statutory dollar thresholds. The statutory Congressional Notification requirements for FMS can be found in Chapter 2 of this textbook. The key difference in Congressional Notifications between FMS and DCS relates to the timing during the acquisition cycle. For FMS, Congressional Notification occurs prior to the U.S. Government contracting with a U.S. contractor for the goods and prior to LOA offering. For Direct Commercial Sales, Congressional Notification takes place following contract signing with the foreign party. This has created a misconception that DCS is faster, because, under DCS, there is a shorter timeline to contract signing. However, this does not necessitate a difference in the delivery timeline.

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



All sales of defense articles or services, FMS or DCS, must not negatively impact U.S. strategic national security and foreign policy interests. This determination is made for DCS in the licensing process and for FMS in the internal coordination process of preparing a case. Although it rarely occurs, the USG always reserves the right to terminate a DCS export license or an FMS case 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 United States.

Other relationship considerations are decisions of technology transfer and disclosure of classified information, as discussed in Chapter 7 of this book. Decisions on technology transfer and disclosure of classified information are also referred to as releasability decisions or releasability policy decisions. Under FMS, the DOD IA engages with the DOD technology transfer and disclosure infrastructure to support releasability for the proposed sale. Generally, releasability must be completed prior to the U.S. Government engaging in technical conversations or prior to issuing a DCS license to U.S. industry to comply with the avoiding false impressions policy. Under a DCS arrangement, industry must precoordinate the requested scope of the license with the MILDEPS and/or releasability community if the request does not fall within existing export policy allowances. Releasability reviews can be resource-intensive, both in terms of available experienced personnel with knowledge of the capability and system and funding of the manpower to support the review process. The availability of FMS administrative funding for FMS cases to support these reviews, including activities as requirements definition with the international partner, Critical Program Information (CPI) assessments, and differential capability analysis, among other activities, can be an enabler to support first-time exports of complex systems.

Management Considerations

The FMS process is executed by U.S. DOD civilian employees, DoD support contractors providing specialized assistance as needed (i.g. information technology), and active-duty U.S. military personnel. The direct involvement of DOD personnel in managing the procurement and delivery of an international partner's programs leads to robust communications throughout the FMS case life as many day-to-day program issues are identified, evaluated, and resolved. This level of communication and personal interaction is often viewed as a catalyst for 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 who possess extensive experience with the DOD and often include individuals with prior active-duty-experience in the U.S. military. Despite this prior DOD experience, many international partners value the direct interaction with DOD civilian and active-duty U.S. military personnel offered through the FMS process.

Lead Times

Care should be taken when comparing timelines under FMS and DCS; neither FMS nor DCS are faster than the other in general, and many factors impact delivery timelines. The FMS acquisition process involves the development, review, and acceptance of the case, plus the assembling of requirements for economic quantity or consolidated purchasing cycles as well as contract negotiations and production lead times. An individual international partner's priorities must be integrated into the overall DOD-acquisition priority in the FMS process.

By contrast, the DCS system only involves contract negotiations and production lead times after the company obtains the export license. In general, industry prepares its proposal more quickly than the USG prepares the case. Under DCS, the international partner negotiates its priority with industry. Industry may be capable of accelerating their processes for commensurate financial compensation. It is also possible that international partners with a well-developed purchasing capability can negotiate sales contracts more quickly than the 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 international partner, if the materiel is available in DOD inventories, it may be possible for the FMS international partner to achieve faster delivery through shipment from DOD stocks or through the diversion of items that are under production for the 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 an international partner 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 and international partners.

Under the FMS system, purchases for an international partners are made by a well-established DOD contracting network. The 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 the DOD's procurement process offers these benefits, the international partner will be charged an appropriate fee in the case, for the contracting and administrative services provided by the DOD.

In DCS, the international partner assumes contract negotiation and management responsibility. These activities represent overhead management costs to the international partner and the actual contract cost. Although it is not necessary for an international partner to fully duplicate the DOD contracting network to make an efficient commercial purchase, the size and skill of the international partner'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 procure the total system. The capability and capacity of the international partner's indigenous procurement system must be evaluated.

Contract Negotiation

Direct Commercial Sales can allow for more flexible contracting because U.S. industry is not required to adhere to the same regulatory requirements as the U.S. Government. International partners 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 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 international partner trusts the USG to negotiate a contract that will meet the international partner's needs.

The USG generally purchases directly from as many original manufacturers as possible, 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 an international partner's purchasing staff is sufficiently large and skilled, a comparable procurement approach of purchasing directly from subcontractors cannot be duplicated in DCS.

Contract Administration Services

Under FMS, Contract Administration Services are included as standard components of the overall FMS price; they include contract quality assurance, inspection, and audit services.

For commercial contracts, the purchasing international partner must consider the additional cost of resources needed 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 international partners personnel throughout the United States to perform contract administration functions, it may be more cost-effective to acquire this support from the USG. It is possible for the international partners to purchase contract administrative services for a DCS under a separate FMS case with the Defense Contract Management Agency (DCMA).

Financial Considerations

International partners frequently desire to compare the FMS total cost to the DCS total cost. It is the policy of the USG for FMS not to compete with U.S.-industry DCS; the USG does not support cost comparisons. It is difficult to predict whether employing the FMS system or direct commercial channels would be more or less expensive 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 case provides 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 applied under the provisions of U.S. laws and regulations.

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

On the other hand, DCS prices, typically provide a fixed price with a fixed payment schedule. U.S. industry may profit under DCS. Depending on the negotiated contract structure, U.S. industry may assume losses on a sale. U.S. industry could structure a contract such that the international partner assumes any additional charges over the final price, protecting U.S. industry from losses. Flexibility under DCS allows for U.S. industry to weigh potential profit gains against potential losses.

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. 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 achieve cost savings by offering other than DOD military standard configurations. It is important for the international partner to understand that any deviations from typical DOD configurations could limit interoperability and cooperative logistics follow-on support from the 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 two or more manufacturers are competing for the international partner's 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 that are below the normal profit margins allowable under DOD contracting regulations. Price advantages under DCS may also 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. Additionally, the DOD may already have priced contracts in place for the DOD that can potentially support new FMS requirements. Typically, the DOD has procured the same or similar items under other contracts. With this knowledge and experience, the DOD may be more informed in the negotiation process. The FAR permits the DOD, under certain contracting conditions, to require the contractor to substantiate their bid with supporting cost or pricing information. This is an important factor in ensuring that a fair and reasonable price is being paid for the articles or services under a 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 with 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 international partner's procurement decision.

One special feature of the FMS system involves the potential use of cross-leveling agreements. Cross-leveling agreements allow international partner 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 the international partner's funds. Two methods can accomplish Cross-leveling. In the first method, international partner financial personnel conduct their analysis to provide cash transfer direction to the USG. In the second method, the international partner authorizes the USG, by a 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 international partner to meet changing requirements.

Non-recurring Cost (NC) Recoupment Charges

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. This AECA requirement is not imposed on DCS; it is up to industry to decide how much of the industry Internal Research And Development (IRAD) costs to shift to the international partner. For systems or capabilities in the U.S. inventory, the USG Research and Development (R&D) investment can only be recouped under FMS via NC. The same system or capability sold under DCS would not result in a recuperation of U.S. taxpayer R&D investment dollars. However, for international partners desiring to purchase via FMS, a provision exists to potentially waive the application of NC under FMS. More information on the waiver process for NC Recoupment Charges is contained in Chapter 12 of this text, "Financial Management," and 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 FMS on a non-profit basis. Except for specific statutory exemptions, all USG expenses for FMS must be recovered from the international partner. The FMS administrative surcharge and FMS contract administration services costs that are added to the basic price of an FMS agreement recover the cost of the following

- Pre-LOR and Case development
- Case implementation
- Case management
- Contract negotiation
- Contract management and auditing
- Financial management
- Processing reports of discrepancy
- Case reconciliation/closure

SAMM Table C9.T2 outlines FMS-related activities and their proper source of funding. Activities listed in the “Admin” column represent indirect charges funded by the FMS Administrative Surcharge.

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 international partner will not normally have access to information that 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 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 an international partner must also consider.

Production Priority

There are many defense articles produced by U.S. industry using production equipment provided by the 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 such equipment or facilities 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 shares the U.S. industrial priority. DCS involves independent contracts that do not automatically receive the same production priorities as DOD procurements.

Another consideration involves government-furnished equipment (GFE) or government-furnished material (GFM). The contractor generally incorporates such items into larger systems, which are then delivered to either the DOD or an international partner. Contractor access to GFE or GFM in support of DCS could significantly impact the capability of a contractor to make a direct sale. By contrast, under the FMS system, the DOD coordinates the delivery of GFE or GFM directly to the prime contractor for both U.S. and FMS requirements. As identified earlier in this chapter, under certain conditions, U.S. 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 international partner 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 international partner 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 required from U.S. sources. If the items being purchased are also being used by the U.S. military and are known to require substantial logistical, technical, and training support, the FMS purchase may offer support advantages. FMS permits the international partner to capitalize on U.S. experience and existing USG logistics inventories and training facilities. If items are not available from the DOD spare parts inventory, the DOD logistics structure serves as procurement staff for the international partner by procuring required individual items from the current U.S. sources. Additionally, the FMS cooperative logistics supply support arrangement, as described in Chapter 10 of this book, offers an effective means to replenish in-country spare and repair parts.

Some U.S. contractors who also are capable of providing full logistics support for the items that they sell. Corporate reputations depend on good performance, and where contractors can furnish 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, the 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 international partner's ability to use DOD information and data transmission systems such as the following:

- International Logistics Communication System (ILCS)
- Supply Tracking and Reparable Return/Personal Computer (STARR/PC) (No longer supported by the USG, but international partner can still use it as long as it continues to work.)
- Security Cooperation Information Portal (SCIP)

The DOD also has dedicated security cooperation staffs and in-country SCOs to facilitate the administration of FMS. Per SAMM C2.1.8, the SCO can also provide limited support to industry. For DCS activities, the SCO supports and coordinates with the commercial attaché whose role is predominately facilitating U.S. industry's marketing phase rather than aiding in program execution. More information on FMS logistics support is contained in Chapter 10 of this book.

Nonstandard Items and Non-Programs of Record

Nonstandard items are those systems or capabilities that differ from the U.S. configuration. Non-Program of Record systems or capabilities are items that are not DOD Programs of Record and may include nonstandard items. Standard items can become nonstandard items as the DOD phases out certain items, models, or configurations and replaces them with other items, models, or configurations. Supporting the releasability review of Non-Program of Record systems and capabilities can add complexity. The DOD introduced the Non-Program of Record Community of Interest (NPOR COI), with DSCA as the Executive Secretariat, to help address this challenge. Together, the industry associations and DOD created the USG Community of Interest (COI), comprised of representatives from select DOD offices (e.g., USD(A&S) and DSCA), various implementing agencies (IAs), and other interagency entities. “The formation of the COI represents a significant step forward in facilitating a centralized, formal process for NPOR proposals,” noted an August 3, 2020, DSCA letter. The COI’s work culminated with the release of the July 2020 “Non-Program of Record U.S. Industry Handbook” (<https://www.ndia.org/-/media/sites/ndia/policy/blog/documents/npor-us-industry-handbook.ashx>) that outlines the acquisition, FMS, and DCS procedures for NPORs. Moreover, it provides points of contact for contractors and finally sets up a classification framework for NPORs. Sustaining non-program of record goods can be challenging under FMS because of the lack of existing logistics infrastructure in place to support items that do not have a DOD Program Office. The DOD has implemented the commercial buying service (CBS) support (e.g., Parts and Repair Ordering System (PROS) and Simplified Non-Standard Acquisition Process (SNAP) as discussed in SAMM C6.4.4 and Chapter 10 of this book) 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 may have more flexibility in providing support for nonstandard items. The international partner should consider how much responsibility and visibility they desire when procuring a NPOR, versus utilizing the FMS infrastructure to obtain USG oversight and efforts in transparency.

Training

Training is a key element of successfully operating and maintaining today’s high technology military equipment. The DOD has established training resources to support its own training needs. Under FMS, international partners 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 the DOD’s unique training ranges. On the other hand, the international partner may require some form of tailored training not available from the DOD.

Classified Items

Classified items can be procured through either DCS or FMS unless otherwise specified by the FMS-Only list or otherwise restricted from export. Transportation of classified goods procured under DCS needs to be coordinated through the USG. The same national security and foreign policy reviews will take place regardless of whether classified items are procured through FMS or DCS.

RANGE OF CHOICES

In comparing the FMS system to the DCS system, it is important to realize that the decision rests with the international partner, and the USG is generally neutral, aside from the FMS-Only list. Additionally, both FMS and DCS acquisitions offer various international partner participation options. In essence, the decision concerning procurement via FMS or DCS fundamentally involves a decision about the degree of procurement involvement the international partner desires to assume and what degree of procurement responsibility the international partner is willing to give to the DOD. Table 15-2 presents the range of options, each of which will be discussed further in the sections on the next page.

**Table 15-2
International Partner Participation Options**

Traditional FMS
FMS funded with FMF
FMS with Sole Source designated
FMS with International Partner Participation in Contracting
FMS with Industry Offsets
Hybrid FMS/DCS
DCS funded with FMF
DCS with USG contract administration
DCS with Industry Offsets
Traditional DCS

Traditional Foreign Military Sales

Under traditional FMS, the international partner initiates the process by submitting a LOR to the USG. The IA will coordinate national security and foreign policy reviews (which includes releasability reviews) during the development of the case. Following completion of these reviews, the IA will generate an LOA. Following any necessary 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 international partner 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 international partner and the USG have entered a formal sales agreement for the provision of defense articles and services. If any situation arises that puts at risk the USG's ability to meet a commitment made to an international partner, it is the Case Manager's responsibility to alert the DSCA CPD/CFM in writing so that the broader SC enterprise can be informed in advance and a unified response can be provided. If the IA does not intend on offering the requested capability in the LOR, the IA will coordinate with DSCA.

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

- 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 an international partner, by means of the case, employing the DOD to conduct defense procurement on its behalf. As such, the international partner entrusts the DOD to make decisions and take actions on its behalf. The international partner relies on the good faith commitment that the DOD makes to conduct FMS procurement business in essentially the same manner that it conducts procurement business for itself.

FMS Funded with Foreign Military Financing (FMF) Program

Per SAMM C9.7.2.9.2, Foreign Military Financing (FMF) Program funds are used to finance FMS. The traditional FMS process is used to establish the government-to-government sales agreement; however, the FMS case LOA will specify the fund source as either a non-repayable grant or a repayable direct loan.

Sole Source Foreign Military Sales

International partners often have an interest in reviewing various vendors' business proposals to fulfill a particular defense requirement. Depending on the international partner 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 international partner an important opportunity for direct involvement in that decision. Sole source procedures allow the international partner to request the DOD initiate a particular FMS procurement exclusively with a specific vendor of the international partner's choice, which is often expressed as a request for a specific system as opposed to a particular capability. This process is referred to as sole source procurement. Details on the sole source process are presented in Chapter 9 of this textbook.

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 international partner can be involved in source selection by downselecting to the specified vendor or system requested in their sole source LOR while benefiting from the FMS system's extensive expertise in contract negotiation, contract administration, quality control, inspection, acceptance, and audit functions.

FMS with International Partner Participation in Contracting

SAMM C6.3.5 outlines the areas for potential international partner participation in the DOD contracting process. Traditionally, the norm has been no or very limited international partner involvement in the DOD contracting process; however, policy in both the SAMM and the DFARS, permit international partners to participate in certain elements of the contracting process. This policy supports the overarching intent for the FMS process to provide transparency to international partners. Chapter 9 of this text discusses potential areas and limitations for international partner participation.

Foreign Military Sales with Offsets

Offsets offer a mechanism for the international partner to leverage a major defense acquisition to obtain other domestic benefits for the international partner's nation. The concept of offsets is presented in detail in Chapter 9 of this textbook. Many international partners have the misconception that offsets are only compatible with DCS procurements, but this is not true. Offset agreements can occur in conjunction with international partner-funded FMS cases, but FMS cases financed with FMF 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, also commonly referred to as hybrid FMS/DCS. 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 international partners 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 (FMF) Grant

Typically, countries that receive FMF grants must use those funds via the FMS process. However, under law, ten countries (as documented in SAMM C9.7.3 - Foreign Military Financing of Direct Commercial Contracts (DCCs) are authorized, on a contract-by-contract basis, to use their FMF funds in DCS contracts. This alternative was discussed earlier in this chapter under the section titled “Foreign Military Financing (FMF) Grant Funding.”

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

Direct Commercial Sales with United States Government Contract Administration

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

While the international partners’ government representatives 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 geographically-dispersed locations. As such, it may be difficult and expensive for the international partners’ representatives to conduct these functions throughout the United States.

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

Direct Commercial Sales with Offsets

International partners 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 FMF, or other non-repayable funds, cannot include an offset agreement.

Traditional Direct Commercial Sales

Traditional DCS offers the international partner the greatest degree of direct involvement in their U.S.-sourced defense procurement. In DCS, the international partner directly interfaces with the contractor on all elements of the contract without the DOD being an intermediary. Traditional DCS provides a range of opportunities. However, the international partner 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 U.S. company that is preparing to enter a sales contract with the international partner 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 generally does not participate in the DCS. License provisos or limitations may be imposed on an export license requiring USG involvement to support continued national security and foreign policy reviews (e.g., Technology Control Plans [TCPs]) to control the transfer mechanism of classified information and goods, and under other limited situations. This exclusion includes contract negotiation, contract administration, quality control, inspection, acceptance, and audit functions. In DCS, the international partner gets what they negotiate. In general, U.S. 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.

Despite 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 international partner 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 international partner and the defense contractor. Although the DOD may concurrently be procuring the same or similar items with the same contractor, the 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 the international partner may employ for the purchase of U.S. defense articles and services. In a commercial acquisition, a U.S. contractor and an international partner enter into a direct contract in accordance with U.S. law and regulations and provisions of international commercial law, except for export control approval and compliance enforcement. The USG is not a party to these commercial contractual transactions. The international partner has the responsibility to select the source and manage the contract directly with the U.S. contractor.

Under the FMS system, the USG and the international partner 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 international partner. The DOD employs essentially the same procurement criteria as if the item/service was being purchased for U.S. needs. The USG, not the international partner, selects the source and manages the contract consistent with the provisions of the FAR, DFARS, and the case.

Unless the USG has determined that a specific item or service will only be offered via FMS, there are few absolutes that dictate 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 international partner 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 other 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 international partner about how much procurement responsibility they are willing to assume and how much they are willing to entrust to the DOD.

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

REFERENCES

Contractor's Certification and Agreement with DSCA August 2009. http://www.dscamilitary.com/sites/default/files/contractor_certificationv4_0.pdf

DSCA Manual 5105.38-M. *Security Assistance Management Manual* (SAMM). Chaps. 2, 4, 6, 9, and 11. <https://www.samm.dscamilitary.com/>.

Guidelines for Foreign Military Financing of Direct Commercial Contracts and Contractor's Certification and Agreement. https://www.dscamilitary.com/sites/default/files/dsca_guidelines_for_foreign_military_financing_of_direct_commercial_contracts.pdf.

**Attachment 15-1
Foreign Military Sales–Potential Advantages and Considerations**

Potential Advantages	Considerations
Total package approach based on U.S. military experience.	international partner 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 international partners.	Sophisticated international partner's 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 the DOD.	Contractor may be able to offer a similar range of contractor logistics support.
Federal acquisition regulations, economic order quantity buys, and 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.	international partner must decide on the degree of standardization required for a purchase.
International partner pays only the actual cost to the 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 the international partner's 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 the DOD's own priorities and inventory positions.
Government-to-government obligation, ensuring involvement of DOD personnel in total package planning and sustainment concepts.	Due to the political climate, the international partner may prefer procuring from the U.S. contractor rather than the USG.
Total package includes training at U.S. military schools.	International partner can procure hardware under commercial contract and generally obtain associated training at U.S. military schools via FMS.
International partner customers can require offsets in FMS-related contracts.	Is dependent on the funding source. If non-repayable FMF, 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 international partner's negotiators.
Business-to-business relationship allows international partner to negotiate cost and contract terms.	If closer military-to-military relationships are a international partner'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 international partner negotiators.
Generally better support for nonstandard items.	Purchaser must decide upon desired degree of standardization with U.S. forces.
More capability to tailor package to unique international partner 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 military-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 international partner's contract negotiators.
Generally fixed payment schedule, which eases budgeting problems.	Payment schedules may be more front-loaded than under FMS.
International partner can include offset provisions in one contract.	International partner can negotiate offsets (directly with contractor) and still procure under FMS.
FMS administrative surcharge and DOD management costs can be avoided.	International partner 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 an international partner 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 are 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.
An international partner cannot have an offset arrangement when they have an FMS case.	A international partner 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 international partner control or participation is permitted in FMS.	Selection of configuration, range, and depth of spares, support equipment, etc. remains in control of the international partner. Program management review conferences are held as necessary to ensure the international partner needs are met. Under certain circumstances, the international partner may participate in selected contract discussions.
FMS system is characterized by a lack of continuity due to military personnel rotations.	While this may be true for some cases, there are many DOD civilians who do not rotate. Also, a military tour is normally three to four years, about equal to commercial executive transfer patterns.
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.

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

Misperceptions	Facts
USG reserves the right to terminate only FMS in the U.S. national interest but not DCS.	This applies equally to both FMS and commercial sale systems.
DCS lacks adequate quality control.	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.