OFFICE OF THE UNDER SECRETARY OF DEFENSE

3000 DEFENSE PENTAGON
WASHINGTON DC 20301-3000

ACQUISITION AND TECHNOLOGY

July 13, 1999

DP/CPF

MEMORANDUM FOR DIRECTORS OF DEFENSE AGENCIES
DEPUTY FOR ACQUISITION AND BUSINESS MANAGEMENT, ASN(RD&A)/ABM
DEPUTY ASSISTANT SECRETARY OF AIR FORCE (CONTRACTING)
DEPUTY ASSISTANT SECRETARY OF THE ARMY (PROCUREMENT)
EXECUTIVE DIRECTOR FOR PROCUREMENT MANAGEMENT (DLSC/DLA)

Subject: Pricing Issues in Foreign Military Sales Contracts

I want to clarify the requirements for pricing foreign military sales (FMS) contracts, including the treatment of offset costs.

In today's global marketplace, there is significant competition for sales of military equipment, with U.S. systems competing against foreign systems and other U.S. systems (for example, F-15 vs. F-16) to meet foreign governments' requirements. In these situations, competitions run by foreign governments should determine the price to be paid. This is true even if the sale to the foreign government is then processed as a foreign military sale and even if DoD is buying the same item sole source. The contracting officer should consult with the foreign government through security assistance personnel to determine whether adequate price competition occurred. If so, this meets the requirement of FAR 15.403-1(b)(1), which states that the submission of certified cost or pricing data shall not be required when the contract price is based on adequate price competition. No further data to support the price should be requested.

In pricing noncompetitive FMS contracts where cost or pricing data is obtained, DFARS 225.7303-2(a) instructs contracting officers to recognize the reasonable and allocable costs of doing business with a foreign government, including offset implementation costs, except when the purchase is financed with funds made available on a nonrepayable basis. In 1995, the language at DFARS 225.7303-2(a)(3) was changed to allow <u>all</u> costs of implementing an offset agreement. There appear to be differences in how this

language is being interpreted and implemented. Contracting officers should treat all offset costs as allowable FMS contract costs. To disallow such costs means that U.S. companies must absorb offset costs that are required by the foreign government as a condition of making the sale. It is only reasonable that foreign governments that require offsets should bear the costs of those offsets.

Eleanor Spector

Eleanor R. Spector
Director, Defense Procurement

OFFICE OF THE UNDER SECRETARY OF DEFENSE

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MEMORANDUM FOR DIRECTOR, DEFENSE ACQUISITION REGULATIONS COUNCIL

SUBJECT: DFARS 225.73, Acquisitions for Foreign Military Sales

Attached are recommended changes to DFARS Subpart 225.73, Acquisitions for Foreign Military Sales.

DFARS 225.7303 requires that FMS contracts be priced the same as other defense contracts. However, DFARS does not specifically address instances where the foreign government conducts a competition that results in adequate price competition. The recommended change to DFARS 225.7303 states that certified cost or pricing data shall not be obtained if the foreign government has conducted a competition resulting in adequate price competition.

In 1995, the language at DFARS 225.7303-2(a)(3) and 225.7303-5(c) was changed to allow costs of implementing an offset agreement, instead of allowing only those costs associated with administering that agreement. This change was intended to allow all offset costs. However, there appear to be differences in how this language is being interpreted and implemented. To make it clear that all offset costs are allowable, we recommend making a clarification to replace the term "offset implementation costs" with the term "offset costs." DSCA has agreed to make a conforming change to its Security Assistance Manual.

Also attached for your information is a memo I issued to the Military Departments and Defense Agencies on these matters. If you have any questions, please contact David J. Capitano at (703)695-9764.

Eleanor Spector

Eleanor R. Spector
Director, Defense Procurement

Attachments:
As stated

225.7303 Pricing acquisitions for FMS

(a) Price FMS contracts using the same principles as are used in pricing other defense contracts. Application of the pricing principles in FAR Parts 15 and 31 to an FMS contract~~, however,~~ may result in prices that differ from other defense contract prices for the same item due to the considerations of this section.

(b) If the foreign government has conducted a competition resulting in adequate price competition (FAR 15.403-1(b)(1)), the contracting officer shall not require the submission of certified cost or pricing data. The contracting officer should consult with the foreign government through security assistance personnel to determine if adequate price competition has occurred.

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225.7303-2 Cost of doing business with a foreign government or an international organization.

(a)(3) Offset ~~implementation~~ costs

(i) A U.S. defense contractor may recover all costs incurred for ~~to implement its~~ offset agreements with a foreign government or international organization if the LOA is financed wholly with customer cash or repayable foreign military finance credits.

(ii) The U.S. Government assumes no obligation to satisfy or administer the offset requirement or to bear any of the associated costs.

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225.7303-5 Acquisitions wholly paid for from nonrepayable funds.

(c) A U.S. defense contractor may not recover costs incurred for ~~to implement its~~ offset agreements with a foreign government or international organization if the LOA is financed with funds made available on a nonrepayable basis.

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ATTACHMENT 2

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