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New Developments in Foreign Military Sales and Foreign Military Financing

DOD Issues New DFARS Rule On Continuation Of Essential Contractor Services To Support FMS Customers In Time Of Crisis

The U.S. Department of Defense ("DOD") has issued a new rule, effective March 5, 2010, regarding the continuation of essential contractor services (that is, those services that support "mission-essential functions") in time of crisis. 75 Fed. Reg. 10191 (Mar. 3, 2010). The rule establishes a new Defense Federal Acquisition Regulation Supplement ("DFARS") Subpart 237.76 and a new contract clause (DFARS 252.237-7023), both titled "Continuation of Essential Contractor Services."

The new DFARS subpart and clause require that, with regard to "essential contractor services," a term defined to include essential services provided to Foreign Military Sales ("FMS") customers, contractors must be prepared to continue to provide such services, in accordance with the terms and conditions of their contracts, during periods of crisis. (The FMS Program authorized by the Arms Export Control Act ("AECA"), 22 U.S.C. § 2751 *et seq.*, permits the DOD to purchase goods and services from U.S. companies in order to sell them to foreign governments.) Moreover, DOD contractors that provide services that have been identified as essential must have a written plan to ensure the continuation of those services in crisis situations. Finally, as directed by the contracting officer, such contractors must participate in training, exercises, and drills associated with Government efforts to test the effectiveness of the continuity of operations procedures and practices.

GAO Rules In Favor of FMS Contractor In Dispute With DOD Over Protest Costs

The Government Accountability Office ("GAO") has rejected assertions made by the U.S. Army Materiel Command (the "Army") that it is not authorized to reimburse a contractor under the FMS Program for its costs incurred in pursuing a successful GAO bid protest. *Alsalam Aircraft Co. - Costs*, B-401298.3 (Nov. 5, 2009), 2009 CPD ¶ 208.

In this case, the Army solicited proposals to provide aircraft operations support services to the government of Saudi Arabia under the FMS Program. After the Army awarded

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the contract to a competitor of Alsalam Aircraft Co. (the “protester”), the protester filed a successful GAO bid protest. Subsequently, the protester sought reimbursement of its protest costs, based on the GAO Bid Protest Regulations that entitle a successful protester to its protest costs in certain circumstances. 4 C.F.R. § 21.8(e). While the Army did not contest that the circumstances for reimbursing the protester were present, the Army argued that the protester’s request for costs should nonetheless be dismissed because the FMS procurement under discussion did not involve any appropriated funds and the Army, therefore, was barred under the AECA from using appropriated funds to cover costs associated with an FMS procurement, such as protest costs.

In the instant case, the government of Saudi Arabia was using its own funds to purchase the aircraft operations support services. Under the AECA, the U.S. Government is authorized to collect such funds in advance to be deposited in a trust fund so that they can be used by the U.S. Government to fund the procurement for the foreign government, “without requirement for charge to any [Congressional] appropriation or contract authorization,” 22 U.S.C. § 2762(a).

In rejecting the Army’s arguments, the GAO ruled that: (1) its past decisions had held that funds in an FMS trust account have the character of appropriated funds; (2) the AECA does not bar use of appropriated funds in connection with FMS procurement; and (3) the AECA expressly authorizes an agency to recover costs associated with an FMS procurement (including protest costs) from the FMS customer.

DSCA Issued Revised Guidelines for Foreign Military Financing of Direct Commercial Contracts

The Defense Security Cooperation Agency (“DSCA”), an arm of the DOD, has issued revised Guidelines for Foreign Military Financing (“FMF”) of Direct Commercial Contracts (“DCC”), dated August 2009 (“Guidelines”), to replace the former January 2005 version of the Guidelines. (The DSCA has revised the Guidelines several times since they were first published in 1984.) The FMF Program, which is administered

by the DSCA, provides for financial assistance to friendly foreign governments, in the form of loans or grants, to purchase defense products and services in the United States. FMF funding may be used to finance FMS, a transaction in which the DOD sells defense products and services to a foreign government, as well as DCCs.

Unlike FMS cases, DCC sales are accomplished directly between foreign governments and U.S. companies and, therefore, the U.S. Government is not a party to such contracts. Instead, the Guidelines require that, as a condition of providing U.S. Government financing, the U.S. company must also enter into a separate agreement with the U.S. Government, called a Contractor’s Certification and Agreement with the DSCA (“Certification”). In conjunction with the issuance of the revised Guidelines, the DSCA also issued a revised version of the Certification, also dated August 2009, which both became effective on October 1, 2009. The Guidelines contain the DSCA’s policies regarding how and in what circumstances it will permit FMF to be used for financing DCCs. The most important statutory requirement (established in 22 U.S.C. § 2791) is that FMF may not be used for procurement outside the United States. As reflected in the Guidelines, the DSCA interpreted this requirement to mean that: (1) FMF-funded purchases must only be from U.S. companies; (2) the products and services being purchased must be manufactured or assembled in the United States; and (3) the dollar value of the end items must consist of at least 50 % U.S.-origin content. Under the Guidelines, moreover, the DSCA will normally fund only the U.S.-origin value of the end item. The Certification contains various obligations that the U.S. company must undertake, as well as certifications regarding, among other things, the content of the products or services (U.S. vs. foreign), any offset costs included in the price, and payment of commissions.

Many changes were introduced in the revised Guidelines and Certification; however, most of them are of limited substantive impact. The main material changes are summarized below.

New Restrictions on Spare Parts Sales

A new provision (Section 7.C) was added imposing new restrictions on spare parts sales. One of the exceptions to the Guidelines' general principle that FMF may be used to fund only the U.S. content of end items is that the DSCA may permit FMF coverage for foreign content that is included in U.S. commercially-available off-the-shelf ("COTS") items, provided that the dollar value of the foreign content is less than 50% of the dollar value of the end item. Previously, it was possible to rely on this COTS exception for FMF funding of foreign content included in follow-on, stand-alone spare parts sales, even if the foreign content included in such spare parts was higher than 50%, provided that, when combining the dollar value of the original end item with that of the spare parts, the value of the foreign content *overall* was less than 50%. The new Guidelines require that follow-on, stand-alone spare parts sales must also meet separately the 50% U.S. content requirement.

Warranty Work

A new provision (Section 11) was added to the revised Guidelines stating that, to be considered U.S. content and thus eligible for funding with FMF, warranty work to be performed in the "host nation" (a term defined to mean the foreign country whose government is purchasing the goods or services under the DCC), or in any other place outside the U.S., must be done by U.S. personnel.

Host - Nation Content

A new provision (Section 12) was added to the revised Guidelines stating that all host-nation content must be identified as non-U.S. content and will not be approved for FMF funding without exception. This new section defines the term "host-nation content" as the value of any defense articles manufactured, assembled, or supplied by host-nation manufacturers or suppliers, or any services performed in the host nation by citizens or residents of the host nation. A corollary change was introduced in the revised Certification, requiring the contractor to identify separately any host-nation content that is included in the products or services being sold.

* * *

The previous version of the Guidelines was ambiguous as to whether FMF funding may be used to cover the cost of G&A-type work, such as that performed by a marketing office, or standard warranty services provided to the buyer automatically, without any extra charge (typically, during the first year after delivery), if the work is subcontracted to a host-nation company. New Sections 11 and 12 of the revised Guidelines clarify that, to be covered with FMF, work related to the FMF-funded contract that is done in the host nation must not be performed by host-nation companies, citizens or residents.

If you have questions about any of these items, please contact your regular Sidley Austin LLP contact.

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