



August 3, 2015

Department of Defense
Defense Procurement and Acquisition Policy
Defense Acquisition Regulations System
3060 Defense Pentagon
Rom 3B941
Washington, DC 20301

ATTN: Mr. Mark Gomersall
Office of the Under Secretary of Defense for AT&L, DPAP/DARS

RE: Defense Federal Acquisition Regulation Supplement: Offset Costs (DFARS Case 2015-D028)

Dear Mr. Gomersall:

The Aerospace Industries Association (AIA) and our member companies welcome the opportunity to provide comment on DFARS Case 2015-D028, the Interim Rule revising DFARS 225.7303-2 to provide instruction to contracting officers on how to address cost when an offset obligation is a condition of a Foreign Military Sale (FMS). Offsets are a reality of executing security cooperation programs overseas with foreign governments, and it is critical that U.S. defense contractors and the U.S. Government reach a clear and unambiguous understanding on the nature of offset costs and how contracting officers (COs) are to handle them within FMS contracts. Such an understanding will help facilitate these programs with our allies and partners overseas, many of whom require offset when purchasing U.S. military platforms and technology.

AIA is supportive of the U.S. Government's goal to add clarity on the evaluation of offset costs within an FMS contract. We concur with the U.S. Government's determination in this proposed rule that indirect offsets are to be deemed reasonable for the purposes of FAR part 31 and 15 (see comments below) and will require no further analysis by a CO. We note this clarification affirms existing legal, regulatory, and policy requirements that limit the review requirements for commercial offset agreements.

Having said that, this policy needs additional guidance since U.S. law does not distinguish between direct or indirect offsets. We expect the U.S. Government will continue to abide by its' long-standing position that "no agency of the US Government shall encourage, enter directly into, or commit U.S. companies to any offset arrangement in connection with the sale of defense goods or services to foreign governments." (See Defense Production Act Amendments (DPAA) of 1992 (P.L. 102-558, Title I, Part C, Sec. 123.) We strongly recommend that an affirmation of this policy be added to this proposed rule, re-emphasizing this policy is applicable to all offset agreements (both "direct" and "Indirect"). This will alleviate the burden on COs to determine the type of offset project to determine what level of review to apply. Such analysis would apply an additional level of complexity that is unnecessary, outside the scope

of Department of Defense and CO expertise, and contrary to U.S. legal and policy requirements. Furthermore, such an affirmation will ensure that contractors have the requisite flexibility to work with the foreign customer in determining and executing individual offset projects that will fulfill the overall obligation.

Additionally, we recommend for improved consistency in distinguishing between direct and indirect offset costs, that definitions be added to the proposed rule. This is critical in that it is important to recognize that foreign customers implement their offset policies in accordance with their national policies. Satisfaction of these unique requirements may require flexibility in how direct and indirect offsets are defined. Also, consider that direct offset arrangements may involve complex terms similar to indirect offset transactions, which require a sophisticated understanding of international commercial markets.

Definitions

The U.S. Government has several, separate definitions of “direct” and “indirect” offsets in use, and it is critical that industry and the U.S. Government agree upon one, consistent definition to be used by all U.S. Government stakeholder agencies. While the definitions used by these agencies may generally be in agreement, the language used by the Departments to define “direct” and “indirect” offset varies, which can potentially lead to confusion between a CO and contractor on how to classify an offset project. We note that the definitions included in the recently published PGI 225.7303-2 should be included in this harmonization effort, to avoid confusion and future complications when implementing this regulation. We suggest the following definition, which is consistent with the various definitions in use by the U.S. Government today, be used by all stakeholder agencies:

Indirect offset: An offset transaction unrelated to the article(s) or service(s) exported or to be exported pursuant to the military export sales agreement.

Please note, however, that while useful for the contracting officer to understand the specifics of an offset agreement and the distinction between direct and indirect offset transactions, we emphasize our position that defining offset type does not modify existing limitations on the U.S. Government’s role in offset negotiation and satisfaction. Therefore, while it is important that the U.S. Government have a consistent definition it uses to define different types of offset projects, under current U.S. law this Interim Rule should be made applicable to all offset agreements, regardless of classification.

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

1. “All offset costs that involve benefits provided by the U.S. defense contractor to the FMS customer that are not included in the contract for the item being purchased under the LOA (indirect offset costs) are deemed reasonable for purposes of FAR **parts 15 and 31...**”

AIA suggests making the Interim Rule applicable to FAR part 15, as well as FAR part 31.

2. “...provided that the U.S. defense contractor submits to the contracting officer a **signed offset agreement or other documentation...**”

AIA requests clarification on what forms of documentation will be acceptable to the CO. Frequently the contractor will be able to document the legal, contractual or policy requirement for offsets (e.g. published guidelines) and infer the dollar value. A signed, specific offset agreement rarely pre-dates the LOA. As such, this requirement could effectively negate much of the benefit of the Interim Rule. If a

country's offset guidelines allow for both direct and indirect projects, but the defense contractor and foreign government will not decide on the specific mix of direct vs indirect projects until after the LOA is signed, then the CO will not be able to deem any portion of the offset budget as reasonable because the indirect portion is not yet identified and approved. The challenge of providing an offset agreement or documentation pre-LOA actually argues for the previously stated position that both direct and indirect offset costs should be deemed reasonable.

In considering what "...other documentation..." will be deemed acceptable, AIA recommends the following language be added to this clause to assist both parties in determining acceptable documentation requirements. However, this should not be viewed as an exhaustive list, and there may be other documentation that should be deemed acceptable: **"...signed offset agreement or other documentation, which may include, but is not limited to, the FMS customer's offset guidelines, requirements, regulations or law, policy, or historical requirements..."**

3. **"...the FMS customer has made the provision of an indirect offset of a certain dollar value obligation valued as a percentage of the contract value a condition of the FMS acquisition, or has historically required such obligation.**

AIA suggests that the language "indirect" and "of a certain dollar value" be removed and the above language be inserted to add clarity for contracting officers when they encounter an offset budget estimate in an FMS contract. Often the type of offset projects to be implemented will not yet be specified and the dollar value associated with an offset budget in an FMS contract is an estimate. The exact nature and value of the individual projects that will help fulfill the overall offset obligation remains to be negotiated and finalized between the contractor and the foreign customer at the time of submission of the proposal. Indeed there are instances when a contractor only has historical precedence to use as a reference point when estimating the overall value of its potential offset obligation when the main FMS contract is signed with a foreign customer.

The current wording could be construed to mean that the FMS acquisition, specifically the RFP (since the FMS contract will not have offset provisions in it), must call out any/all specific indirect offset project(s) before they can come under the provisions of this interim rule. Since that is not how offset requirements are prescribed, this type of rule interpretation may be counterproductive. An LOR/RFP specification will conventionally set forth an overall offset requirement (e.g. a total offset obligation equivalent to X% of the equipment contract price) that is to be implemented in accordance with the purchasing country's offset guidelines. Those guidelines won't specify that a "direct offset" or an "indirect offset" is required. It will set forth the condition under which a contractor can offer direct or indirect offset projects and it is then the contractor's discretion to offer direct offset projects, indirect offset projects, or some combination of the two (to be ultimately approved, in some cases years later, by the purchasing country's offset authority). So beyond just an overall obligation to perform offsets, there will be no direct link in the FMS acquisition process between the foreign customer and any specific/individual direct or indirect offset project(s).

4. **"FMS customers are placed on notice through the LOA that indirect offset costs are deemed reasonable without any further analysis by the contracting officer. If the FMS customer requires additional information on offsets, they should discuss directly with the seller."**

AIA suggest the above language be inserted to emphasize that all offset obligations/projects are negotiated between the contractor and the foreign customer.

AIA and our member companies concur with the clarification on the evaluation of indirect offset costs made through this interim rule and, as stated in these comments, believe the scope of this rule should be expanded to include all offset arrangements. Due to the nature and complexity of offset agreements under FMS agreements, it may not be possible to distinguish between a direct and indirect offset cost at the time an FMS contract is signed, and the budget estimate included in the signed contract is generally based on the estimated cost of fulfilling an overall offset obligation, with little to no clarification on which percentage will be applied to direct or indirect projects. This determination remains to be negotiated between the U.S. contractor and the foreign customer.

The changes outlined above are in keeping with current FMS contracting practices, and will greatly improve the predictability and efficiency of the FMS contracting process. AIA remains committed to working with the U.S. Government, DOD and AT&L to ensure that to the extent possible USG officials have full transparency into the offset agreements included in FMS transactions and COs have sufficient information and training to understand the nature of these transactions. We thank you for considering our comments.

Best Regards,

A handwritten signature in black ink, appearing to read "Remy Nathan", with a long horizontal flourish extending to the right.

Remy Nathan
Vice President – International Affairs
Aerospace Industries Association