DEFENSE SECURITY COOPERATION AGENCY

WASHINGTON, DC 20301-2800

15 JUN 2000

In reply refer to:
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MEMORANDUM FOR DEPUTY UNDER SECRETARY OF THE ARMY
(INTERNATIONAL AFFAIRS)
ATTN: SAUS-IA-DSZ
DEPARTMENT OF THE ARMY

DIRECTOR, NAVY INTERNATIONAL PROGRAMS OFFICE
DEPARTMENT OF THE NAVY

DEPUTY UNDER SECRETARY OF THE AIR FORCE
(INTERNATIONAL AFFAIRS)
DEPARTMENT OF THE AIR FORCE

DIRECTOR, DEFENSE LOGISTICS AGENCY

DIRECTOR, NATIONAL IMAGERY AND MAPPING AGENCY

DIRECTOR, DEFENSE THREAT REDUCTION AGENCY

DIRECTOR, DEFENSE REUTILIZATION AND MARKETING SERVICE

DEPUTY DIRECTOR FOR SECURITY ASSISTANCE,
DEFENSE FINANCE AND ACCOUNTING SERVICE -
DENVER CENTER

DIRECTOR, DEFENSE CONTRACT MANAGEMENT AGENCY

SUBJECT: Firm Fixed Price (FFP) and Not to Exceed (NTE) Letters of Offers and Acceptance

REFERENCE: DSCA White Paper, 26 Jan 99, "Pricing, Finance and USG Cost Recovery"

As part of our FMS reinvention efforts, I initiated a staff study focused on exploring the efficacy of expanded use of Firm Fixed Price (FFP) and Not to Exceed (NTE) price estimates in Letters of Offer and Acceptance (LOAs). We did this because customers expressed concern that price uncertainties associated with LOA estimates make it very difficult for countries to budget for FMS purchases.

Findings of this effort are not revolutionary. We discovered that the basic underpinnings of in-place legislation and policy are sound and provide us more flexibility than we initially

expected. Still, there is room for improvement in this area if we take advantage of available authorities.

We first examined current regulatory guidance on quotation of Not to Exceed (NTE) and Firm Fixed Prices (FFP), past programs that have employed NTE pricing and DoD contract experience in support of FMS programs. We learned that 80% of all FMS contracts let in 1999 in support of LOAs, were, in fact, firm fixed price. It is important to note, however, that most of the work associated with negotiating and concluding these firm fixed price contracts was done after the LOAs were signed.

We next looked at any cases where most or all of an LOA was offered to a customer on an FFP/NTE basis. We found only one such case—the Dutch Apache Helicopter—where 92% of the case value was quoted on a NTE basis (the remaining lines were estimates). We found that the Army (Apache) and Navy (Cobra) expended significant resources to create a non-standard LOA, which incorporated a significant number of commercial terms and conditions. This resulted in one of the most expensive set of LOAs ever offered by the USG, involving a level of effort costing several million dollars. This effort was financed entirely with FMS administrative funds with no guarantee the U.S. would win the competition. Clearly, if procedures were implemented to develop NTE prices for LOAs of all major programs, this would have a substantial impact on security cooperation resources, which are essentially a "zero sum game."

We also reviewed the legal and regulatory authorities that support use of Firm Fixed Price price quotations for LOAs. No legal authorities exist to provide FFP LOA quotations for articles where the source of supply is from new procurement. However, authorities are present in Section 21 of the Arms Export Control Act and Section 0703 of the DoD Financial Management Regulation ("DoDFMR"), DoD 7000.14-R, to quote firm fixed prices for defense articles sold from stock (except for Working Capital Fund items). Such prices are not subject to further adjustment providing the purchasing nation accepts the LOA before the expiration date. Offers of such sales are to be coordinated with the DoD Component comptrollers, the DSCA and the OUSD Comptroller.

As a result of the above, the following guidance on use of FFP and NTE LOAs is effective immediately:

1. Absent financial arrangements to mitigate risks associated with FFP quotations, FFP LOAs for new procurement of articles and services will not normally be used. This does not preclude a FFP contract being negotiated in support of a signed LOA.

2. Maximum use will be made of FFP sales from stock in accordance with paragraph 070303 of Chapter 7, Volume 15 of the "DoDFMR." LOAs for FFP sales from stock shall include the following: "Additional Term and Condition for Firm Fixed Price Sale of Articles from the Stocks of the Department of the (*identify the military department*): Pricing data presented herein are firm for this LOA (***or** in the case of specific line items only, "for line item numbers xxx of the LOA"*) and will not be changed, provided this LOA is accepted before its expiration date."

3. Use of NTE prices for lines of LOAs for new procurement will be used on a "by exception" basis and only with the prior approval of the Director DSCA. Generally, NTE LOAs will be approved only to support U.S. competitiveness, as required.

4. Customers may request an NTE LOA. However, customers will bear any incremental costs to develop a NTE LOA through an FMS case for defense services. Implementing agencies will forward such requests, to include an estimate of the incremental costs to develop the NTE LOA, to Director DSCA for approval.

Prevailing legal and financial policy experience on what may be permissible dealing with firm fixed price offers (there exists no guidance for "not to exceed" offers since this is a coined term) has evolved on a case-by-case basis. As a consequence, during briefings and presentations of findings and recommendations on this staff study, a number of questions were frequently asked concerning the details, scope and attendant procedures that have been used to develop this policy. Attached is a two-page list of frequently asked questions with answers designed to clarify a number of points.

As we gain insights and more experience in the expanded use of eligible FFP and NTE LOAs, we will revisit this guidance to determine if new legal or regulatory authorities are required to fulfill our mission.

MICHAEL S. DAVISON, JR.
LIEUTENANT GENERAL, USA
DIRECTOR

Attachment
As stated

Frequently Asked Questions

Use of Firm Fixed Price (FFP) and Not to Exceed (NTE) Letters of Offer and Acceptance (LOAs)

The following questions were frequently asked during briefings and presentations made on the DSCA investigation into the expanded use of FFP and NTE LOAs:

Q. Can firm fixed price LOAs be generated for new procurements?
No, except in very exceptional circumstances. The USG can neither gain nor lose money on an LOA. Such exigencies could require establishment of a revolving fund, which, in turn, would require new legislation. One of the findings of the FFP/NTE query was that new legislation is not warranted at this time.

Q. For NTE LOAs, are all LOA costs to be treated on a Not to Exceed basis?
A. No. Only those costs that are to be listed as separate lines <u>under contract</u> are eligible for NTE treatment within the LOA. Other non-contractual LOA lines, will be treated as estimates. These include but are not limited to such items as training, technical assistance, technical manuals, and program management. For example, in the case of the Dutch Apache LOA, three commercial contracts for airframe, engine and avionics were rolled into the LOA and represented 92% of the total value of the LOA.

Q. Can consumables or depot maintenance services (or any defense articles or services that fall within the purview of the Defense Working Capital Fund) be sold on a firm fixed price basis?
A. No, unless shipment or services can be provided immediately or the items are sold "as is, where is." While the prices for such goods and services are relatively stable over any given fiscal year, they are not fixed, and therefore entail uncertainties and unacceptable risks, which preclude offering them on the basis of fixed price quotations.

Q. Can anything from stock other than "as is, where is" defense articles be sold FFP?
A. No. In cases where refurbishment of defense articles is required (either in-house or contractor), this generates risks that cannot be legally be incurred.

Q. Besides Excess Defense Articles (EDA) or SDAF (Special Defense Acquisition Fund) origin defense articles, what is left to sell from stock?

A. We have frequent occasion to sell munitions from stock to customers, particularly during times of emergency (Kosovo Air Campaign). The Implementing Agencies also conduct sales from stock of items considered "long in inventory, such as howitzers and the like."

Q. In the absence of a competition, how should IAs process customer requests for furnishing an NTE for LOAs?
A. IAs should: 1) ask the customer to include the NTE request in their LOR; 2) evaluate whether there are sufficient IA in-house resources available to develop the NTE LOA; 3) query interested contractors as to their interest in participating in the requested NTE LOA; 4) estimate the total SA community resources required to develop the NTE; and 5) furnish a cover letter to Director, DSCA that contains the IA recommendation. Director DSCA will issue approval to proceed/not proceed along with any attendant decisions on resource allocation.

Q. What are the rules about selling something fixed price from stock that needs replacement?
A. The answer is found in para. 070303, Volume 15, Chapter 7 of the DoD Financial Management Regulation: "DoD Components are authorized to quote firm fixed prices for items to be sold from stock....A firm fixed price may be quoted only for: 1. An actual or estimated replacement price for a procurement funded end item, including ammunition, or major items to be sold from inventory as authorized in paragraph 070302.C2, provided the price is based on budgetary data or contractor quotation." Note that this section goes on to specify that: "Letters of Offer (other than for training) which specify firm pricing must be coordinated, at a minimum with the Military Comptrollers, DSCA, and the Office of the Comptroller, DoD."