On June 2, 2015, the US Department of Defense (DoD) issued an interim rule, effective immediately, amending the Defense Federal Acquisition Regulation Supplement (DFARS) to clarify requirements related to costs associated with indirect offsets under Foreign Military Sales agreements. Comments on the interim rule are due on or before August 3, 2015.

The interim rule revises DFARS 225.7303-2, “Cost of doing business with a foreign government or an international organization” by adding paragraph (a)(3)(iii) to provide guidelines to contracting officers when an indirect offset is a condition of a Foreign Military Sales (FMS) acquisition.

DoD’s FMS program allows foreign customers to request, and pay for, through inclusion of the cost in the FMS Letter of Offer and Acceptance (LOA) and DoD contract, offsets that are directly related to the FMS end items (i.e., “direct offsets”), as well as offsets that are not directly related to the end item (i.e., “indirect offsets”).

The rule’s preamble states that DoD recognizes the need to have offsets embedded in DoD FMS contracts, noting that FMS programs maintain and strengthen relationships in partner nations and further US national security. It further states, however, that the decision whether to engage in indirect offsets and responsibility for negotiating and implementing these offset arrangements ultimately reside with the FMS customer and the contractor itself. Therefore, the preamble highlights that the DoD contracting officer is not provided the information necessary to negotiate cost or price of indirect offsets, particularly with respect to price reasonableness determinations pursuant to FAR part 15. Accordingly, the interim rule provides that when the provision of an indirect offset is a condition of the FMS acquisition, and provided that the US defense contractor submits to the contracting officer an offset agreement or other substantiating document, the indirect offset costs are deemed reasonable for purposes of FAR Part 31.

The preamble further notes that it is essential that DoD implement this interim rule immediately to clarify that contracting officers are not required to make price reasonableness determinations on costs associated with indirect offsets under FMS agreements, which, while included in the FMS contract, fall outside the DoD contracting officer’s purview. It goes on to state that immediate implementation will allow DoD contracting officers to finalize pending negotiations for FMS contracts to support US allies and partners, and maintain bilateral relationships. One can speculate that this rule was implemented in part because of the large-run up of FMS procurements recently, particularly involving various customer countries in the Middle East. The rule will be a positive step towards making FMS procurements proceed more quickly, but could be controversial because of the specific requirement that the US prime contractor provide the contracting officer the offset agreement or other substantiating document, as it is possible provision of such materials in their entirety may spark confidentiality concerns.