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DEPARTMENT OF DEFENSE

Defense Acquisition Regulations System

48 CFR Parts 202, 215, 225, and 252

[Docket DARS-2015-0027]

RIN 0750-AI59

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

AGENCY: Defense Acquisition Regulations System, Department of Defense (DoD).

ACTION: Proposed rule.

SUMMARY: DoD is issuing a proposed rule amending the Defense Federal Acquisition Regulation Supplement (DFARS) to implement a section of the National Defense Authorization Act for Fiscal Year 2016 related to costs associated with indirect offsets under foreign military sales agreements.

DATES: Comments on the proposed rule should be submitted in writing to the address shown below on or before **[Insert date 60 days after date of publication in the FEDERAL REGISTER]**, to be considered in the formation of a final rule.

ADDRESSES: Submit comments identified by DFARS Case 2015-D028, using any of the following methods:

- o Federal eRulemaking Portal: <http://www.regulations.gov>.

Search for "DFARS Case 2015-D028." Select "Comment Now" and

follow the instructions provided to submit a comment. Please include "DFARS Case 2015-D028" on any attached documents.

- o Email: osd.dfars@mail.mil. Include DFARS Case 2015-D028 in the subject line of the message.

- o Fax: 571-372-6094.

- o Mail: Defense Acquisition Regulations System, Attn: Mr. Mark Gomersall, OUSD(AT&L)DPAP/DARS, Room 3B941, 3060 Defense Pentagon, Washington, DC 20301-3060.

Comments received generally will be posted without change to <http://www.regulations.gov>, including any personal information provided. To confirm receipt of your comment(s), please check www.regulations.gov, approximately two to three days after submission to verify posting (except allow 30 days for posting of comments submitted by mail).

FOR FURTHER INFORMATION CONTACT: Mr. Mark Gomersall, telephone 571-372-6099.

SUPPLEMENTARY INFORMATION:

I. Background

This proposed rule expands on interim rule guidance and incorporates the requirements of section 812 of the National Defense Authorization Act (NDAA) for Fiscal Year (FY) 2016.

DoD published an interim rule in the Federal Register (80 FR 31309) on June 2, 2015. The comment period closed on August 3, 2015. The interim rule revised DFARS 225.7303-2, Cost of Doing

Business with a Foreign Government or an International Organization, by providing guidelines to contracting officers when an indirect offset is a condition of a foreign military sales (FMS) acquisition. Specifically, the interim rule set forth that all offset costs that involve benefits provided by the U.S. defense contractor to the FMS customer that are unrelated to the item being purchased under the Letter of Offer and Acceptance (LOA) (indirect offset costs) are deemed reasonable for purposes of FAR part 31 with no further analysis necessary on the part of the contracting officer, provided that the U.S. defense contractor submits to the contracting officer a signed offset agreement or other documentation showing that the FMS customer has made the provision of an indirect offset of a certain dollar value a condition of the FMS acquisition. FMS customers are placed on notice through the LOA that indirect offset costs are deemed reasonable without any further analysis by the contracting officer.

II. Discussion and Analysis

DoD reviewed the public comments submitted in response to the interim rule in the development of this proposed rule. A discussion of the comments and the changes made to the rule as a result of those comments is provided, as follows:

A. Summary of significant changes

Section 812 of the NDAA for FY 2016 amended 10 U.S.C. 2306a(b)(1) to state that submission of certified cost or pricing data shall not be required in the case of a contract, a subcontract, or modification of a contract or subcontract to the extent such data—

(i) Relates to an offset agreement in connection with a contract for the sale of a weapon system or defense-related item to a foreign country or foreign firm; and

(ii) Does not relate to a contract or subcontract under the offset agreement for work performed in such foreign country or by such foreign firm that is directly related to the weapon system or defense-related item being purchased under the contract.

This proposed rule amends DFARS 215.403-1(b), Exceptions to Certified Cost or Pricing Data Requirements, and adds DFARS clause 252.215-70XX, Requirements for Certified Cost or Pricing Data for Foreign Military Sales Indirect Offset Agreements, to incorporate the revisions implemented in section 812.

Additionally, this proposed rule relocates the language at DFARS Procedures, Guidance, and Information (PGI) 225.7303-2(a)(3) into DFARS 225.7303-2(a)(3) for clarity. In response to public comments, the rule also adds: (1) definitions of “offset” and “offset costs” at 202.101, and (2) the appropriate reference to Federal Acquisition Regulation (FAR) part 15 and

deletes the phrase "of a certain dollar value" in DFARS 225.7303-2(a)(3).

B. Analysis of public comments

Comment: One respondent is supportive of the U.S. Government's goal to add clarity on the evaluation of offset costs within an FMS contract, and concurs with the U.S. Government's determination in this rule that indirect offsets are to be deemed reasonable for the purposes of FAR parts 15 and 31.

Response: Noted.

Comment: One respondent recommended that the determination of reasonableness in this rule be made applicable to all offset agreements, both "direct" and "indirect."

Response: DFARS 225.7301(b) requires that the U.S. Government conduct FMS acquisitions under the same acquisition and contract management procedures used for other defense acquisitions. This requires the contracting officer to adhere to FAR regulations concerning the negotiation of contracts and subcontracts (FAR part 15) and contract cost principles (FAR part 31), and thus attest to the reasonableness of FMS contract prices. Contracting officers must follow these regulations even though no DoD-appropriated funds are being used to pay for the effort. While DoD contracting officers have no insight to pricing of the indirect offset, and shall not 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, it is reasonable to maintain the requirement that contracting officers determine that prices are fair and reasonable for direct offsets, as they directly tie to the FMS end item(s).

Comment: One respondent recommended that the rule include definitions of direct and indirect offsets. The respondent recommended that the DFARS define indirect offset as "an offset transaction unrelated to the article(s) or service(s) exported or to be exported pursuant to the military export sales agreement."

Response: A definition of offsets is provided at DFARS 202.101 for clarity.

Comment: A number of respondents suggested making the rule applicable to FAR part 15, as well as FAR part 31.

Response: The rule is clarified to state that indirect offset costs are deemed reasonable for purposes of FAR part 15 as well as FAR part 31.

Comment: One respondent requested that the rule clarify what forms of documentation will be acceptable to the contracting officer. 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. However, a

signed, specific offset agreement rarely predates the LOA. Further, a country's offset guidelines may allow for both direct and indirect projects, but the defense contractor and foreign government might not decide on the specific mix of direct versus indirect projects until after the LOA is signed. As such, this requirement could effectively negate much of the benefit of the rule. The respondent suggested that the rule clarify acceptable documentation as a "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."

Response: While the costs associated with such indirect offset agreements are deemed reasonable for purposes of FAR parts 15 and 31 with no further analysis necessary on the part of the contracting officer, the U.S. defense contractor must still provide evidence of a signed offset agreement or other documentation showing that the FMS customer has made the provision of an indirect offset a condition of the FMS acquisition to support this determination. While this rule does not define the specific documentation required, such documentation must support the specific FMS acquisition.

Comment: One respondent stated that 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 only an estimate. The respondent recommended that the rule be revised to clarify how contracting officers will consider offset costs when 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.

Response: This is precisely why this rule is necessary. DoD contracting officers are not provided the information necessary to negotiate cost or price of the indirect offsets, particularly with respect to price reasonableness determinations. Therefore, indirect offset costs are deemed reasonable for purposes of FAR parts 15 and 31 with no further analysis necessary on the part of the contracting officer.

Comment: One respondent suggested that a sentence stating that "if the FMS customer requires additional information on offsets, they should discuss directly with the seller" be inserted to emphasize that all offset obligations/projects are negotiated between the contractor and the foreign customer.

Response: Since a determination of fair and reasonable pricing is established for indirect offset costs, the statement that FMS customers are placed on notice through the LOA that indirect offset costs are deemed reasonable without any further

analysis by the contracting officer is included in DFARS 225.7303-2(a)(3).

Comment: One respondent stated that by deeming indirect offset costs to be reasonable, the rule appears to conflict with FAR 31.201-3(a), which states, "No presumption of reasonableness shall be attached to the incurrence of costs by a contractor." The apparent conflicting language may create confusion in the field as contracting officers attempt to execute the FAR and DFARS rules and guidance regarding reasonableness. The respondent recommended amending FAR 31.201-3(a) to acknowledge the existence of a DFARS exception to the rule of no presumption of reasonableness with respect to indirect offset costs.

Response: It is unnecessary and inappropriate to amend the FAR to acknowledge the existence of DFARS supplementary language. The FAR System consists of the FAR, which is the primary document, and agency acquisition regulations that implement or supplement the FAR. The DFARS implements or supplements the FAR to incorporate DoD policies, procedures, contract clauses, solicitation provisions, and forms that govern the contracting process or otherwise control the relationship between DoD and contractors or prospective contractors. To include a FAR reference for each occurrence of an agency supplement to the FAR would be unwieldy. Further, since this is

a DFARS rule, making such a reference in the FAR would be out of scope for this rule.

Comment: One respondent questioned whether the contractor's costs associated with administering offset agreements are also deemed reasonable for the purposes of FAR part 31 with no further analysis by the contracting officer.

Response: Unlike the specific indirect offset costs, contracting officers do have insight into the administration costs associated with direct and indirect offset agreements. Therefore, costs associated with administering indirect offset agreements are not deemed reasonable without further analysis under this rule.

Comment: One respondent stated that offset agreements often include values associated with "offset credits" that may or may not be representative of the costs of the supplies or services being acquired or performed. The respondent suggested clarifying the meaning of the term "certain dollar value" and questioned whether that term refers to the "offset credit" value that is included in the offset agreement, or whether the offset agreement needs to set out the anticipated cost of the actual supplies or services being contracted for under the FMS contract.

Response: The phrase "of a certain dollar value" has been removed as a clarifier to the documentation requirements to

indicate the existence of an indirect offset agreement as a condition of an FMS acquisition.

III. Applicability to Contracts at or Below the Simplified Acquisition Threshold and for Commercial Items, Including Commercially Available Off-the-Shelf Items

This rule proposes to create a new clause: DFARS 252.215-70XX, Requirements for Certified Cost or Pricing Data for Foreign Military Sales Indirect Offset Agreements. DoD plans not to apply this clause to contracts at or below the simplified acquisition threshold or to commercial items, including commercially available off-the-shelf items.

IV. Executive Orders 12866 and 13563

Executive Orders (E.O.s) 12866 and 13563 direct agencies to assess all costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety effects, distributive impacts, and equity). E.O. 13563 emphasizes the importance of quantifying both costs and benefits, of reducing costs, of harmonizing rules, and of promoting flexibility. This is not a significant regulatory action and, therefore, was not subject to review under section 6(b) of E.O. 12866, Regulatory Planning and Review, dated

September 30, 1993. This rule is not a major rule under 5 U.S.C. 804.

V. Regulatory Flexibility Act

DoD does not expect this rule to have a significant economic impact on a substantial number of small entities within the meaning of the Regulatory Flexibility Act, 5 U.S.C. 601, et seq. However, an initial regulatory flexibility analysis has been performed, and is summarized as follows:

This rule amends the DFARS to clarify requirements related to indirect offset costs associated with Foreign Military Sales offset agreements.

The objective of this rule is to expand on the DFARS interim rule published in the Federal Register (80 FR 31309) on June 2, 2015, and implement the requirements of section 812 of the National Defense Authorization Act for Fiscal Year 2016.

DoD does not expect this rule to have a significant economic impact on a substantial number of small entities within the meaning of the Regulatory Flexibility Act, 5 U.S.C. 601, et seq. because indirect offset agreements are not incorporated into FMS contracts with small entities and the DFARS amendments merely clarify that contracting officers are not responsible for making a determination of price reasonableness for indirect offset agreements for which they have no purview.

This rule does not add any reporting or recordkeeping requirements. The rule does not duplicate, overlap, or conflict with any other Federal rules. There are no known significant alternatives to this rule.

DoD invites comments from small business concerns and other interested parties on the expected impact of this rule on small entities.

DoD will also consider comments from small entities concerning the existing regulations in subparts affected by this rule in accordance with 5 U.S.C. 610. Interested parties must submit such comments separately and should cite 5 U.S.C 610 (DFARS Case 2015-D028), in correspondence.

VI. Paperwork Reduction Act

The rule does not contain any information collection requirements that require the approval of the Office of Management and Budget under the Paperwork Reduction Act (44 U.S.C. chapter 35).

List of Subjects in 48 CFR Parts 202, 215, 225, and 252

Government procurement.

Jennifer L. Hawes,

Editor, Defense Acquisition Regulations System.

Therefore, 48 CFR parts 202, 215, 225, and 252 are proposed to be amended as follows:

1. The authority citation for parts 202, 215, 225, and 252 continues to read as follows:

Authority: 41 U.S.C. 1303 and 48 CFR chapter 1.

PART 202—DEFINITIONS OF WORDS AND TERMS

2. In section 202.101, add in alphabetical order definitions of "offset" and "offset costs" to read as follows:

202.101 Definitions.

* * * * *

Offset means a benefit or obligation agreed to by a contractor and a foreign government or international organization as an inducement or condition to purchase supplies or services pursuant to a foreign military sale (FMS). There are two types of offsets: direct offsets and indirect offsets.

(1) A direct offset involves benefits or obligations, including supplies or services, that are related to the item being purchased. For example, as a condition of a foreign military sale, the contractor may require or agree to permit the customer to produce in its country certain components or subsystems of the item being sold. Generally, direct offsets must be performed within a specified period, because they are integral to the deliverable of the FMS contract.

(2) An indirect offset involves benefits, including supplies or services, that are unrelated to the item being purchased. For example, as a condition of a foreign military sale, the

contractor may agree to purchase certain manufactured products, agricultural commodities, raw materials, or services required by the FMS customer, or may agree to build a school or road.

Indirect offsets may be accomplished without a clearly defined period of performance.

Offset costs means the costs to the contractor of providing any direct or indirect offsets required (explicitly or implicitly) as a condition of a foreign military sale.

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PART 215—CONTRACTING BY NEGOTIATION

3. In section 215.403-1, revise paragraph (b) to read as follows:

215.403-1 Prohibition on obtaining certified cost or pricing data (10 U.S.C. 2306a and 41 U.S.C. chapter 35).

(b) Exceptions to certified cost or pricing data requirements. (i) Follow the procedures at PGI 215.403-1(b).

(ii) Submission of certified cost or pricing data shall not be required in the case of a contract, subcontract, or modification of a contract or subcontract to the extent such data relates to an indirect offset.

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4. In section 215.408, add paragraph (6) to read as follows:

215.408 Solicitation provisions and contract clauses.

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(6) Requirements for certified cost or pricing data for foreign military sales offset agreements. Use the clause at 252.215-70XX, Requirements for Certified Cost or Pricing Data for Foreign Military Sales Indirect Offset Agreements, in solicitations and contracts that contain the provision at FAR 52.215-20, Requirements for Certified Cost or Pricing Data and Data Other Than Certified Cost or Pricing Data, when it is reasonably certain that-

(i) The contract is expected to include costs associated with an indirect offset; and

(ii) The submission of certified cost or pricing data or data other than certified cost or pricing data will be required.

PART 225-FOREIGN ACQUISITION

225.7301 [Amended]

5. Amend section 225.7301 in paragraph (a) by removing "defense articles" and adding "supplies" in its place.

6. In section 225.7303-2, revise paragraph (a)(3) to read as follows:

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

(a) * * *

(3) Offsets. For additional information see 225.7306.

(i) An offset agreement is the contractual arrangement between the FMS customer and the U.S. defense contractor that

identifies the offset obligation imposed by the FMS customer that has been accepted by the U.S. defense contractor as a condition of the FMS customer's purchase. These agreements are distinct and independent of the LOA and the FMS contract.

Further information about offsets and LOAs may be found in the Defense Security Cooperation Agency (DSCA) Security Assistance Management Manual (DSCA 5105.38-M), chapter 6, paragraph 6.3.9. (<http://samm.dsca.mil/chapter/chapter-6>).

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

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

(iv) Indirect offset costs are deemed reasonable for purposes of FAR parts 15 and 31 with no further analysis necessary on the part of the contracting officer, provided that the U.S. defense contractor submits to the contracting officer a signed offset agreement or other documentation showing that the FMS customer has made the provision of an indirect offset a condition of the FMS acquisition. FMS customers are placed on notice through

the LOA that indirect offset costs are deemed reasonable without any further analysis by the contracting officer.

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PART 252—SOLICITATION PROVISIONS AND CONTRACT CLAUSES

7. Add section 252.215-70XX to read as follows:

252.215-70XX Requirements for Certified Cost or Pricing Data for Foreign Military Sales Indirect Offset Agreements.

As prescribed in 215.408(6)(i), use the following clause:

REQUIREMENTS FOR CERTIFIED COST OR PRICING DATA FOR FOREIGN
MILITARY SALES INDIRECT OFFSET AGREEMENTS (DATE)

(a) Definition. As used in this clause—

Offset means a benefit or obligation agreed to by a contractor and a foreign government or international organization as an inducement or condition to purchase supplies or services pursuant to a foreign military sale (FMS). There are two types of offsets: direct offsets and indirect offsets.

(1) A direct offset involves benefits or obligations, including supplies or services, that are related to the item being purchased. For example, as a condition of a foreign military sale, the contractor may require or agree to permit the customer to produce in its country certain components or subsystems of the item being sold. Generally, direct offsets must be performed within a specified period because they are integral to the deliverable of the FMS contract.

(2) An indirect offset involves benefits, including supplies or services, that are unrelated to the item being purchased. For example, as a condition of a foreign military sale the contractor may agree to purchase certain manufactured products, agricultural commodities, raw materials, or services required by the FMS customer, or may agree to build a school or road. Indirect offsets may be accomplished without a clearly defined period of performance.

(b) Exceptions from certified cost or pricing data requirements. Notwithstanding the requirements of Federal Acquisition Regulation (FAR) 52.215-20, Requirements for Certified Cost or Pricing Data and Data Other Than Certified Cost or Pricing Data, in the case of this contract or a subcontract, and FAR 52.215-21, Requirements for Certified Cost or Pricing Data and Data Other Than Certified Cost or Pricing Data—Modifications, in the case of modification of this contract or a subcontract, submission of certified cost or pricing data will not be required to the extent such data relates to an indirect offset (10 U.S.C. 2306a(b)(1)).

(End of clause)

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