

FOREIGN MILITARY SALES CONTINGENT FEES - - A CHANGE?

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All negotiated United States Government (USG) contracts, in excess of the simplified acquisition threshold and for other than commercial items, are required by statute to contain a warranty that the contractor has not retained any person or agency to solicit or obtain contracts on a contingent fee basis; there is an exception to this warranty for a *bona fide* employee or agency relationship.¹ To implement this statutory requirement, the Federal Acquisition Regulation (FAR) mandates that a "Covenant Against Contingent Fees" clause be included in applicable solicitations and contracts.² Subparagraph (a) of that clause is a succinct statement of the law:³

"The Contractor warrants that no person or agency has been employed or retained to solicit or obtain this contract upon agreement or understanding for a contingent fee, except a *bona fide* employee or agency. For breach or violation of this warranty, the Government shall have the right to annul this contract without liability or, in its discretion, to deduct from the contract price or consideration, or otherwise recover, the full amount of the contingent fee."⁴

¹ 10 U.S.C. § 2306(b), for Department of Defense contracts. See also 41 U.S.C. § 254(a), for other government contracts.

² The statutory basis for the contingent fee warranty applies only to negotiated contracts, but it has been applied as a matter of policy to all federal procurements, including sealed bid contracts. FAR 3.403.

³ FAR 52.203-5, COVEANT AGAINST CONTINGENT FEES (APR 1984).

⁴ The clause and FAR contain a definition for most of the key terms used in this clause. The term "contingent fee" is defined to mean "any commission, percentage, brokerage, or other fee that is contingent upon the success that a person or concern has in securing a Government contract". A "bona fide employee" means a person, employed by a contractor and subject to the contractor's supervision and control as to time, place, and manner of performance, who neither exerts nor proposes to exert improper influence to solicit or to obtain Government contracts nor holds out as being able to obtain any Government contract or contracts through improper influence." A "bona fide agency" is similarly defined as "an established commercial or selling agency, maintained by a contractor" for the purpose of securing business, that neither exerts nor proposes to exert improper influence to solicit or obtain Government contracts nor holds itself out as being able to obtain any Government contract or contracts through improper influence". "Improper influence" is broadly defined to mean any influence that would tend to induce a Government employee or officer to make a contract

Recently there has been a fair amount of change with respect to contingent fees in federal government contracts. A proposed rule, to revise FAR 3.404, was published on 13 November 1995.⁵ FAR 3.404(b) once required the Contracting Officer to insert the provision at FAR 52.203-4, "Contingent Fees Representation and Agreement", in most solicitations. That provision required offerors to provide information on contingent fee arrangements. When the representation was answered affirmatively, the offeror was then to provide a completed Standard Form (SF) 119, "Statement of Contingent or other Fees". The proposed rule, which became final on 24 September 1996, deleted the requirement to provide information on contingent fee arrangements and the submission of the SF 119.⁶

To conform the Defense Federal Acquisition Regulation Supplement (DFARS) to the contingent fees provisions adopted in the FAR, the Director of Defense Procurement issued an interim rule, effective on 17 January 1997, to eliminate the requirement for a government review of a prospective contractor's contingent fee arrangement for foreign military sales (FMS) contracts.⁷ An amendment to this interim rule was proposed on 5 June 1997.⁸ As it is currently written, the interim acquisition rule makes several changes. First, DFARS 225-7303-4 guidance on contingent fees has been completely revised. It had asked the contractor to identify any sales commission or fees when it submitted price and availability data for a FMS case. Such fees were then to be justified and supported through submission of SF 119 to the Contracting Officer. This DFARS provision also directed that the Chief of the Contracting Office to approve the Contracting Officer's determination that there was a *bona fide* employee or agency relationship and that the fee was reasonable. These justifications and review requirements have been eliminated by the interim acquisition rule. Second, based upon public comments received on the interim rule, it is now proposed to eliminate the current \$50,000 ceiling on contingent fees. If adopted, DFARS would permit payment of a

decision "on any basis other than the merits of the matter". See, FAR 3.401.

⁵ 60 Federal Register 57140, November 13, 1995 [FAR case 93-009].

⁶ 61 Federal Register 39188, July 26, 1996.

⁷ 62 Federal Register 2616, January 17, 1997.

⁸ 62 Federal Register 30831, June 5, 1997. Public comments on the proposed rule to the interim rule [elimination of the \$50,000 limitation] may be submitted on or before 4 August 1997. DFARS Case 96-D021 should be cited in the comment.

contingent fee in excess of \$50,000 per FMS case, when the foreign customer approves the payment in writing before contract award. As amended, the new DFARS 225.7303-4 would read:

"(a) Except as provided in paragraph (b) of this subsection, contingent fees are generally allowable under defense contracts provided that the fees are paid to a bona fide employee or a bona fide established commercial or selling agency maintained by the prospective contractor for the purpose securing business (see FAR Part 31 and FAR Subpart 3.4).

(b)(1) Under DoD 5105.38-M, Security Assistance Management Manual, Letters of Offer and Acceptance for requirements for the governments of Australia, Taiwan, Egypt, Greece, Israel, Japan, Jordan, Republic of Korea, Kuwait, Pakistan, Philippines, Saudi Arabia, Turkey, Thailand, or Venezuela (Air Force) must provide that all U.S. Government contracts resulting from the Letters of Offer shall prohibit the payment of contingent fees unless the payments have been identified and approved in writing by the foreign customer before contract award (see 225.7308(a)).

(2) For FMS to countries not listed in paragraph (b)(1) of this subsection, no payment of contingent fees in excess of \$50,000 per FMS Case shall be made under a U.S. Government contract, unless payment has been identified and approved in writing by the foreign customer before contract award."

Finally, there is a complete rewrite of the solicitation clause found at DFARS 252.225-7027. It now provides:

"RESTRICTIONS ON CONTINGENT FEES FOR FOREIGN MILITARY SALES

(a) Except as provided in paragraph (b) of this clause, contingent fees, as defined in the Covenant Against Contingent Fees clause of this contract, are generally an allowable cost, provided that the fees are paid to a bona fide employee or to established commercial selling agencies maintained by the Contractor for the purpose of security business.

(b) For foreign military sales, unless the contingent fees have been identified and payment approved in writing by the foreign customer before contract award, the following contingent fees are unallowable costs under the contract:

(1) For sales to the Government(s) of _____, contingent fees in any amount.

(2) For sales to Governments not listed in paragraph (b)(1) of this clause, contingent fees in excess of \$50,000 per foreign military sale case."

Besides indicating the recent acquisition changes, this article will place them in their proper FMS context.

Let us first review briefly the federal law with respect to contingent fees in government contracts. There has been a long-standing federal policy against the employment of agents on a contingent fee basis to secure government contracts. In Tool Company v. Norris⁹, the Supreme Court refused to enforce an agreement for compensation to procure a Civil War arms contract. In that case Justice Field declared:

". . . All contracts for supplies should be made with those, and with those only, who will execute them most faithfully, and at the least expense to the Government. Considerations as to the most efficient and economical mode of meeting the public wants should alone control, in this respect, the action of every department of the Government. No other consideration can lawfully enter into the transaction, so far as the Government is concerned. Such is the rule of public policy; and whatever tends to introduce any other elements into the transaction is against public policy. That agreements, like the one under consideration, have this tendency, is manifest. They tend to introduce personal solicitation and personal influence, as elements in the procurement of contracts; and thus directly lead to inefficiency in the public service, and to unnecessary expenditures of public funds."¹⁰

In the subsequent case of Oscanyan v. Arms Company¹¹, Justice Field applied the policy expressed above to preclude the Turkish consul-general in New York from obtaining a commission on the sales of weapons to the Turkish government. The federal policy against contingent fees was enforced by an Executive Order during World War II.¹² Subsequently, and in

⁹ 69 U.S. 45 (1864).

¹⁰ Id., at p.54. This stringent view gradually evolved into a rule that, in the absence of a statute or regulation, courts would enforce contingent fee contracts except when an attempt to introduce personal solicitation and personal influence into dealings with the government is actually intended or in fact results. See, Racquet Club, Inc. v. Lipper, 373 F.2d 753, 754 (1st Cir., 1967) and the cases cited therein.

¹¹ 103 U.S. 261 (1880); See also, Hazelton v. Skeckells, 202 U.S. 71 (1906); Valdes v. Larrinaga, 233 U.S. 705 (1914); and United States v. Mississippi Valley Generation Co, 364 U.S. 520, 550 n14 (1961).

¹² Executive Order No. 9001 of December 27, 1941, 6 Federal Register 6787. However, variations of the present covenant against contingent have been included in federal government contracts since World War I. See, Acme Process Equipment Co. v. United States, 347 F.2d. 538, 549 n.10 (Ct. Cl. 1965).

furtherance of this federal policy, Congress enacted two statutes requiring the warranty against contingent fees.¹³

It should also be noted that the purpose of the statutory contingent fee warranty, as implemented by FAR Subpart 3.4, is to prevent the attempted or actual exercise of improper influence by third parties over the federal procurement system; the warranty does not preclude the payment of all contingent fees - - only those made for the purpose of improperly obtaining a federal contract.¹⁴ In Browne v. R&R Eng'g Co.¹⁵, the court held that contingent fee services in connection with a proposed contract that did not involve any dealings with officials responsible for the award of contracts were not prohibited. Further, the fact that no improper influence can be established does not result in a finding that the agent is bona fide; it is only a factor to be weighed with the totality of the evidence.¹⁶

The Arms Export Control Act (AECA) imposes disclosure requirements with respect to agent fees and other payments in connection with FMS contracts and direct commercial contracts for the sale of defense articles and services to foreign governments.¹⁷ The AECA, as implemented by the International Traffic in Arms Regulations (ITAR)¹⁸, requires applicants for exports license and FMS contractors to disclose whether they or their "vendors have paid, or offered or agreed to pay . . . [f]ees or commissions in an aggregate amount of \$100,000 or more."¹⁹ The ITAR broadly defines "fees and commissions" as any payment made to a person for the "solicitation or promotion or otherwise to secure the conclusion of a sale of

¹³ Section 4(a) of the Armed Service Procurement Act of 1947, 62 Stat. 21, 23 (1947) - the statutory predecessor for 10 U.S.C. § 2306(b); and section 304(a) of the Federal Property and Administrative Services Act of 1949, 63 Stat. 377, 395 (1949) - the statutory predecessor for 41 U.S.C. § 254(a).

¹⁴ Puma Industrial Consulting v. Dual Associates, Inc., 808 F.2d 982 (2nd Cir. 1987); Qunn v. Gulf & Western Corp., 644 F.2d (2nd Cir. 1981); E&R, Inc. - - Claim for Costs, B-255868.2, May 30, 1996, 96-1 CPD ¶ 264; and Howard Johnson Lodge - Reconsideration, B-244302.2, March 24, 1992, 92-1 CPD ¶ 305.

¹⁵ 264 F. 2d 219 (3rd Cir. 1959).

¹⁶ FAR 3.408-2(c); and Acme Process Equipment Co. v. United States, 347 F. 2d. 538, 547-553 (Ct. Cl. 1965), reversed on other grounds, 385 U.S. 138 (1966). See also, John Cibinic, Jr. and Ralph C. Nash, Jr., *Administration of Government Contracts*, 108-111 (1995).

¹⁷ Section 39 AECA, 22 U.S.C. § 2779.

¹⁸ 22 CFR Parts 120 - 130.

¹⁹ 22 CFR § 130.9(a)(1)(ii), (b)(2).

defense articles or defense services."²⁰ The ITAR specifically exclude the following categories of payments from the definition of "fees and commissions": (a) certain political contributions, (b) normal salaries to regular employees, (c) general advertising or promotional expenses, and (d) payments made solely for the purchase of specific goods or technical, operational, or advisory services that are not disproportionate the value of the goods or services actually furnished.²¹ If the fees or commission in the aggregate meet the \$100,000 threshold, the export license applicant or FMS contractor must make a detailed disclosure to the Department of State.²² In addition, if an individual fees or commission exceed \$50,000 there is a further reporting requirements.²³

The AECA also provides that the President by regulation may "prohibit, limit, or prescribe conditions" with respect to such commissions and fees as he determines will further the purposes of the Act.²⁴

In addition, the AECA substantially repeats the same conditions as expressed in the contingent fee warranty for FMS contracts. It declares:

"No such contribution, gift, commission, or fee may be included, in whole or in part, in the amount paid under any procurement contract . . . [for FMS], unless the amount thereof is reasonable, allocable to such contract, and not made to a person who has solicited, promoted, or otherwise secured such sale, or has held himself out as being able to do so, through improper influence. For the purposes of this section, "improper influence" means influence, direct or indirect, which induces or attempts to induce consideration or action by any employee or officer of a purchasing foreign

²⁰ 22 CFR § 130.5(a)(2).

²¹ 22 CFR § 130.5(b).

²² 22 CFR §§ 130.9(a)(1), (b)(2), and 130.10.

²³ 22 CFR § 130.10(a)(4), (b).

²⁴ 22 U.S.C. § 2779(b) ("The President may, by regulation, prohibit, limit, or prescribe conditions with respect to such contributions, gifts, commissions and fees as he determines will be in furtherance of the purposes of this Act.").

This appears to be the statutory authority for the prohibition on use of Foreign Military Financing to pay "commissions or contingent fees" in connection with direct commercial sales financed with funds appropriated by Congress. See, paragraph 8, Table 902-6 "Guidelines for Foreign Military Financing of Direct Commercial Contracts", DoD 5105.38-M, *Security Assistance Management Manual*, page 902-47 (Change No. 7, 5 January 1996).

government or international organization with respect to such purchase on any basis other than such consideration of merit as are involved in comparable United States Procurements."²⁵

But there is a difference between the contingent fee warranty contained in federal government contracts from the comparable one expressed in the AECA for FMS contracts. The emphasis in the latter is on the improper influence to obtain the requirement for rather than improper efforts to obtain the actual government contract to satisfy the requirement.

Provisions to be used in FMS cases for contingent fees are expressed in section 80103 of the *Security Assistance Management Manual (SAMM)*²⁶. Based upon the FAR changes for contingent fee noted above in this Article, substantial changes need to be made to this whole section. The SAMM also contains a \$50,000 limitation on agent fees for direct commercial contracts financed with FMS credits.²⁷

Payments to a foreign sales agent may also have implications under the Foreign Corrupt Practices Act, if the agent is also a foreign government official or is used as a conduit to make payments to foreign government officials.²⁸

The contingent fee warranty changes, discussed in this Article, present some problems for the security assistance program. First, the elimination of the SF 119 removes almost the only practical means to enforce the contractual warranty. Indeed, the DFARS change, other than the elimination of \$50,000 cap, merely implements the already approved FAR change. Now, with these acquisition changes, the only way to determine whether a contingent fee is involved with an FMS contract is through the ITAR disclosures to State Department. Second, the possible elimination of the \$50,000 cap on contingent fees for FMS contracts raises an even more specific question. How is it possible to make the determination, under AECA, that the amount of the contingent fee in the FMS contract is reasonable? The apparent intent, of the proposed change to the interim DFARS rule, is allow the foreign customer to make the determination of reasonableness. But is that process authorized by AECA?

²⁵ 22 U.S.C. § 2779(c)

²⁶ Section 80103, DoD 5105.38-M, *Security Assistance Management Manual*, pages 801-4 through 801-6 (Change No. 2, 2 July 1990).

²⁷ Section 80103.F, DoD 5105.38-M, *Security Assistance Management Manual*, page 801-6 (Change No. 2, 2 July 1990).

²⁸ 15 U.S.C. §§ 78mm, 78dd-1, 78dd-2, 78ff.

Since all that appears to have been accomplished with most of the changes to the contingent fee warranty provisions in federal government contracts is the removal of the means for enforcement, it a little like the movie scene from *Young Frankenstein* where Gene Wilder as the doctor says, "Perhaps I could do something about your hump" and Marty Feldman, as Igor replies, "What hump?". I think the relevant question here is "what change".