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[redacted]

ATTORNEY-CLIENT PRIVILEGED
HIGHLY CONFIDENTIAL--SENSITIVE CONTRACTING INFORMATION

Memorandum

VIA ELECTRONIC MAIL

To: [redacted], armasuisse

cc: [redacted]

From: [redacted]

Date: March 1, 2024

Re: Analysis of Price Adjustment Risk in the Swiss Government's FMS Purchase of F-35A Aircraft and Related Weapons and Services

I. Introduction

We understand that the Swiss Confederation, through armasuisse (the "Swiss Government"), has entered into foreign military sale ("FMS") transactions with the United States Government ("USG") to purchase thirty-six F-35A aircraft and Operating and Support ("O&S") sustainment for the aircraft from 2027 to 2040, as well as the Joint Direct Attack Munitions, AIM-9X Sidewinder Missiles, and targeting cell capability.

The Swiss Government requires an assessment of whether the USG could request a price increase for the F-35A aircraft, O&S, and the related weapons under the governing laws. The Swiss law firm Homburger AG provided us the available contract documents and a memorandum, translated to the English language, summarizing the transaction background and relevant concerns. As of the date of this memorandum, we are unaware whether the USG has made a price-increase request or if the Swiss Government is evaluating the risk of such a potential request in the future.

In short, the normal rule in FMS transactions is that the USG makes best efforts to provide the defense articles and services at the estimated price listed in the contract documents, but because U.S. law prohibits the USG from incurring a loss on an FMS transaction, any increased costs are passed along to the foreign customer. This analysis applies to the O&S and related missiles. However, the contract documents for the F-35A aircraft contain special provisions that state the aircraft will be provided for the stated firm fixed price. Under U.S. law, fixed prices are enforced except in rare circumstances not likely to occur with the F-35A. The law offers certain, limited ways the U.S. contractor

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could seek a price increase under such a contract, but doing so is difficult and generally requires that the USG be the cause of the contractor's cost increases, such as USG interference in contract performance. Even if the U.S. contractor could convince a U.S. court or administrative tribunal that it deserves a price increase, the ability of the USG to pass along that price increase to the Swiss Government is unclear. On the one hand, the USG will argue that U.S. law prohibits it from incurring a loss on the transaction; on the other hand, the Swiss Government would argue that the FMS contract documents' statements regarding firm fixed pricing is enforceable. Ultimately, such a dispute would likely be resolved diplomatically, as the USG would retain possession of the aircraft in the event of such a dispute and the FMS contract documents prohibit seeking dispute resolution in a tribunal or via a third party negotiator.

We view the likelihood of such a dispute to be low, given that firm fixed price contracts are, except in rare circumstances unlikely to occur here, enforced in U.S. government contracting, and that the FMS contract documentation gives the Swiss Government the right to examine the U.S. contractor agreements. The Swiss Government should exercise this right to ensure the agreements are in fact firm fixed priced, and should exert pressure on the USG to vigorously defend against any contractor claim for an increase to the stated fixed price.

II. Legal Background

A. Brief Overview of FMS Transactions

The Arms Export Control Act ("AECA") permits foreign governments to purchase U.S. defense articles or services through the FMS program. 22 U.S.C. § 2762. Under the FMS program, the USG procures defense articles or services, then subsequently sells the procured items or services to a foreign government. *Id.* Sales under the FMS program are subject to USG review, and usually Congressional notification. 22 U.S.C. § 2776. The Department of State ("DOS") manages the FMS approval process, while the Department of Defense ("DOD") coordinates implementation of FMS deals through the Defense Security Cooperation Agency ("DSCA"). DSCA describes the rules and procedures governing FMS transactions and other Security Assistance authorized by the AECA in the Security Assistance Management Manual ("SAMM"). *SAMM* § C0.1; DSCA's *The Green Book*, ed. 42, available at https://www.dscu.edu/m/green-book, at 5-1.

Because the AECA requires the FMS purchaser to "pay the full amount" of the procurement contract, the FMS program operates on a "no profit, no loss" basis—the USG neither charges profit on the transaction, nor may it not incur debt on a transaction. *Id.*; *SAMM* § C9.3.1; *Green Book* at 8-13.

In this back-to-back transactional structure in which the FMS purchaser acquires U.S. defense articles or services indirectly with the USG acting as the intermediary, two

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documents govern an FMS sale. First, the USG enters into a procurement contract with the selected U.S. company that will provide the product or service. This contract is subject to the normal laws and regulations that govern all U.S. procurement contracts. *See Green Book* at 8-17. Second, a Letter of Agreement ("LOA") is written by the USG and formally accepted by the foreign government counterpart. *See SAMM* § C5.4. The LOA is a government-to-government agreement that outlines the terms of the transaction, including the items and services to be provided, the cost, and an estimated timeframe for doing so. *Id.* Each LOA contains the standard "Letter of Offer and Acceptance Standard Terms and Conditions" ("T&C"), which the DSCA publishes in SAMM. *Id.* § C5.4.7.1. An LOA may also feature Notes and Supplemental Information that provides more detail as to items or services being offered. *Id.* § C5.4.7.2.

An LOA is a binding contract. Once signed by the USG and the foreign government, an LOA "is a government-to-government agreement." *SAMM* § C5.4.16. That is, an FMS LOA is a "binding contractual agreement[] between [the USG] and an authorized international partner." *Green Book* at 5-1. The USG recognizes LOAs as "a unique agreement that is developed under the authority of the Arms Export Control Act (AECA)," and an LOA documents a "bilateral government-to-government agreement between the USG and the international partner," in which "*the USG commits itself* to provide certain defense items or services and the international partner commits to abide by the specific terms and conditions associated with the sale and to make specified financial payments." *Id.* at 8-1 (emphasis added). The USG describes LOAs as having six basic elements that make LOAs "enforceable by law as a contract."

(1) offer by the USG;
(2) acceptance by the international partner;
(3) consideration—the parties' exchange of U.S. defense articles or services for monetary payment;
(4) competent parties representing the USG and the foreign government, respectively;
(5) lawful purpose as authorized by the AECA; and
(6) clear terms and conditions as identified in the LOA Standard Terms and Conditions and Notes.

Id. at 8-1 – 8-3.

Despite the intent for LOAs to be enforceable, the issue is, to our knowledge, rarely litigated. Because LOAs are government-to-government agreements, it is possible that disputes occur outside the U.S. courts system or otherwise not in the public domain. We have located only three U.S. court decisions that substantively address the enforceability of LOAs:

- In *Secretary of State for Defence v. Trimble Navigation Ltd.*, 484 F.3d 700, 708 (4th Cir. 2007), a foreign government FMS customer sued the U.S. contractor for delivering nonconforming goods. The Fourth Circuit reasoned that the British Ministry of Defence may not sue a U.S. contractor because doing so would contravene the purpose of the AECA, which places the USG as the intermediary in the transaction. In the alternative, the Fourth Circuit held that an LOA provision required the FMS purchaser to resolve discrepancy issues with the USG under a prescribed Supply Discrepancy Report process, so the purchaser could not sue the contractor directly. This case, therefore, by inference, holds that LOA provisions (at least those imposing a dispute resolution process) are enforceable.
- In *BAE Systems Technology Solution & Services, Inc. v. Republic of Korea's Defense Acquisition Program Administration*, 884 F.3d 463 (4th Cir. 2018), *as amended* (Mar. 27, 2018), the Republic of Korea and a U.S. contractor entered into a side agreement whereby the U.S. contractor agreed to use its "best effort" to complete an FMS transaction at the estimated price. The USG later increased the transaction price for unspecified reasons, and the FMS transaction fell apart. The contractor sued seeking a declaration that it had not breached any obligation to Korea and that Korea could not sue it to recover the price difference. The Fourth Circuit held that foreign governments may not sue U.S. contractors related to FMS transactions. The court decision contains the following relevant quotes:
    - "Nor can the two sovereigns sue each other for failure to perform on the government-to-government contract: their only recourse is to hold bilateral consultations."
    - "[I]n an FMS transaction, the U.S. government retains control over price. Although the sovereign-to-sovereign agreement contains an initial price estimate, the foreign government must pay whatever the U.S. government contends the transaction costs—even if that amount exceeds the previous estimate."
- In *United Technologies Corp. v. United States*, 830 F.2d 1121 (Fed. Cir. 1987), the court found that the LOAs in a series of FMS transactions contained "not to exceed" prices that the USG represented it had obtained from the contractor. The contractor brought a lawsuit seeking to directly charge the FMS foreign government customer for increased costs, under a regulation providing for charging of research and development costs. The court refused, finding that the "government-to-government agreements required [] that the sales to the [foreign government customer] would be accorded the same prices…as the sales to the USG." While this case considered now-repealed versions of regulations and LOA language, it provides another example where a court enforced an LOA.

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It is notable that none of these three cases involve direct sovereign-to-sovereign litigation. While an LOA is intended to be a binding contract, enforcement of an LOA's provisions will likely need to be done through diplomatic channels.

B. Firm Fixed Price Contracts with the U.S. Government

The same pricing rules that apply to standard U.S. government procurements also apply to FMS transactions. *SAMM* § C6.3.1 (providing that the USG shall procure articles and services for FMS transactions in the same way that the USG would procure the items for itself); *see also* Defense Federal Acquisition Regulation Supplement ("DFARS")[1] 225.7303(a) (U.S. procurement law regulation requiring FMS cases to be priced "using the same principles used in pricing other defense contracts").

Firm fixed price contracts in U.S. government procurement entail a fixed price that is not usually "subject to any adjustment on the basis of the contractor's cost experience in performing the contract." Federal Acquisition Regulation ("FAR") 16.202-1. Under a firm-fixed price contract, the contractor bears "the maximum risk and full responsibility for all costs," and the intent is for the price to the U.S. government customer to remain as stated. *Id.*

This rule has certain exceptions. In order to invoke an exception and receive an increase to a stated firm fixed price, the contractor must follow a specified disputes process and receive a determination from a decision-maker (either a court or an administrative tribunal) that the exception applies.[2] This is a high bar that is not usually successful, absent atypical circumstances. The following list is non-exhaustive, but it illustrates the types of circumstances that might warrant a price increase of a firm fixed price contract. As you can see, the theme of most of these exceptions is that a change to a fixed price will be allowed when the USG itself took action that increased the price.

- A constructive change has occurred: that is, the USG required the contractor to perform work not covered by the original scope of work. *See, e.g.*, *LB&B Assocs. Inc. v. United States*, 91 Fed. Cl. 142, 154 (2010); *In Re Mangi Env't Grp., Inc.*, AGBCA No. 2005-101-1, 06-1 BCA ¶ 33,233; *Miller Elevator Co. v. United States*, 30 Fed. Cl. 662, 678 (1994).

[1] The Federal Acquisition Regulation (and its agency-specific supplements, such as the DFARS) governs all U.S. government procurements.

[2] Under the Contracts Disputes Act, a U.S. contractor seeking adjustment in price or terms of a procurement contract must first submit a certified claim to the agency contracting officer. If the contracting officer denies the claim, the contractor may appeal the decision to the U.S. Court of Federal Claims ("COFC") or the relevant agency's Board of Contract Appeals ("Board"). The ruling by either the COFC or the Board may be appealed to the Court of Appeals for the Federal Circuit, then to the United States Supreme Court. *See* Cibinic *et al.*, ADMINISTRATION OF GOVERNMENT CONTRACTS, Ch. 13 (5th ed. 2015).

- The USG provided defective plans or specifications, and as a result, the contractor incurred additional costs. *See, e.g.*, *E. Coast Repair & Fabrication, LLC v. United States*, 199 F. Supp. 3d 1006, 1079-80 (E.D. Va. 2016).
- The USG delayed the contractor's work, causing the contractor to incur higher than expected or necessary costs. *See, e.g.*, *ADT Constr. Grp., Inc.*, ASBCA No. 57322, 15-1 BCA ¶ 35,893.
- The USG failed to disclose relevant information about the contract. *See, e.g.*, *Am. Ordnance LLC*, ASBCA No. 54718, 10-1 BCA ¶ 34,386.
- The USG hindered or failed to cooperate in a way that increased the contractor's performance costs. *See, e.g.*, *Lakeshore Eng'g Servs., Inc. v. United States*, 110 Fed. Cl. 230, 240 (2013), aff'd, 748 F.3d 1341 (Fed. Cir. 2014).
- The USG and the contractor made a so-called "mutual mistake." Price adjustment for mistake is available when (1) parties had a mistaken belief about a fact; (2) the mistaken belief was a basic assumption about the contract; (3) mistake had a material effect on the bargain; and (4) the contract did not place the risk of the mistake on the party seeking the price adjustment. *See, e.g.*, *Lakeshore Eng'g Servs., Inc. v. United States*, 110 Fed. Cl. 230, 241 (2013), *aff'd*, 748 F.3d 1341 (Fed. Cir. 2014). Courts are reluctant to allow a price adjustment based on mutual mistake in fixed firm price contracts because such contracts "clearly place[] the risk of any mistake regarding increased performance costs" on the contractor," thus failing the fourth prong of mutual mistake. *Id.* (quoting *Lindsay v. United States*, 41 Fed. Cl. 388, 391 (1998); *Foley Co. v. United States*, 36 Fed. Cl. 788, 790 (1996)).
- Commercial impracticability: a contractor may meet a very high burden of proving that continued contract performance is commercially impracticable. This requires a showing that "'because of unforeseen events, [the contract] can be performed only at an excessive and unreasonable cost' or 'all means of performance are commercially senseless.'" *U.S. Aeroteam, Inc. v. United States*, No. 2021-2272, 2022 WL 2431626, at *4 (Fed. Cir. July 5, 2022) (quoting *Raytheon Co. v. White*, 305 F.3d 1354, 1367 (Fed. Cir. 2002)). For example, a firm fixed priced contractor has recovered costs under this theory where inclement winter weather (1) made it nearly impossible to recruit workers; (2) created exorbitant additional weatherproofing expenses; and (3) damaged the archaeological site that was the object of the contract. *GAI Consultants, Inc.*, ENGBCA 6030, 95-2 BCA ¶ 27,620. Proving commercial impracticability is a very high bar. *D.W. Clark, Inc.*, ASBCA, ¶ 45,562, 94-3 BCA ¶ 27,132 (loss of $20,000 on a $165,000 firm-fixed price contract insufficient to establish commercial impracticability); *see also American Combustion, Inc.*, ASBCA 43712, 94-3 BCA ¶ 26,961 (finding that even if the contractor performed a contract at a great cost, there will be no commercial impracticability if the cost was not exorbitant). Courts will also reject commercial

impracticability arguments where the contract allocates risk of high costs to the contractor. *Phylway Construction, LLC*, ASBCA 62961, 22-1 BCA ¶ 38,218 (refusing price increase due to commercial impracticability where the contract specifically addressed the disaster in question – high water levels).

- A federal statute provides for upward price adjustment of defense procurement contracts in extraordinary situations to "facilitate the national defense." FAR 50.101-1(a) (implementing Pub. L. 85-804). Heads of certain defense agencies, including those who procure on behalf of FMS purchasers, may establish a contract adjustment board to determine whether to modify a defense contract for price and other terms. FAR 50.101-2. Regulations provide that the mere "fact that losses occur under a contract is not a sufficient basis" for a price increase. DFARS 50.103-1. An upward price adjustment is allowed only in limited circumstances where a loss will "impair the productive ability a contractor" that is "found to be essential to the national defense" or the loss is caused by a Government action and "fairness may make some adjustment appropriate." FAR 50.103-2. The USG's contract appeals boards have rarely recognized these claims except under extraordinary situations, for example, where a critical defense contractor had been suffering catastrophic business losses from hyperinflation during the Oil Shock of the late 1970s. *See e.g.*, *Bristol Elecs. Corp.*, ASBCA No. 24792, 84-3 BCA ¶ 17,543. While price adjustment under FAR Part 50 procedures is a theoretical possibility, it is highly unlikely, as the U.S. contractor's viability as a business will not depend on the pricing of 35 aircraft sold to the Swiss Government.

In conclusion, absent these special circumstances, the USG and the U.S. court system generally enforces firm fixed price contracts. While an adjustment to fixed price contracts is theoretically available, as a practical matter efforts by contractors to adjust fixed prices are rarely successful. We note that U.S. press has highlighted that the USG, specifically the Air Force, has recently enforced large fixed price contracts even where the contractor suffered extreme losses.[3]

III. Summary of Applicable Agreements and Documents

We have received the LOA for the F-35A aircraft, LOAs for the O&S and weapons systems, and the USG Acknowledgement Letter and Insight Letter. The following Part summarizes portions of these documents relevant to our analysis.

[3] Michael Marrow, *Despite Huge Industry Losses, Air Force "Not Getting Rid of Fixed-Price Contracts": Hunter*, BREAKING DEFENSE (Feb. 12, 2024) https://breakingdefense.com/2024/02/despite-huge-industry-losses-air-force-not-getting-rid-of-fixed-price-contracts-hunter/.

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A. LOA SZ-D-SAA (the "LOA" or "F-35A LOA")

This LOA, dated October 28, 2021, states that it is an offer to sell the F-35A aircraft to the Swiss Government, as represented by the armasuisse. The LOA provides a total "estimated cost" of [redacted]. The LOA's list of "items to be supplied" expressly caveats line item costs and delivery dates as "estimates." *Id.* at 2. The LOA continues by listing an "estimated cost summary," totaling to [redacted], and an "estimated payment schedule." *Id.* at 8-9. The payment schedule states: "The USG reserves the right to *bill for additional amounts* if, during the execution phase, actual costs materialize at a rate that cannot be supported by the purchaser-based schedule." *Id.* at 9 (emphasis added).

The LOA contains seventy supplemental "Notes," most of which clarify the terms and conditions relating to each item to be supplied. *Id.* at 10-51. Note 55 is titled "F-35A Procurement for Switzerland" and provides additional pricing detail. *Id.* at 44. This note "confirms" that the USG purchases F-35A aircraft via "fix-priced contracts, which already accounts for inflation" and that the purchase of F-35A for the Swiss will use "the same contracts at the same fix-price." *Id.* Note 55 states in its entirety:

> This Letter of Offer and Acceptance (LOA) constitutes an agreement by the United States of America (USA), acting through the Secretary of the Air Force for International Affairs (SAF/IA) and the Swiss Confederation, acting through the Federal Office for Defence Procurement (armasuisse). On behalf of the USA, SAF/IA hereby confirms that the United States Government (USG) purchases F-35A Lightning II aircraft systems on fix-priced contracts, which already accounts for inflation. The USA further confirms to the Swiss Confederation those 36 F-35A Lightning II aircraft systems to be procured by the Swiss Confederation will be procured by the USG on the same contracts at the same fix-price, which is the same fix-price as the USG offered to armasuisse. The USG will sell these F-35A Lightning II aircraft systems under the LOA for the same fix-price, which also already includes, and will not be increased for, inflation and includes US government charges, US taxes, delivery costs and non-Swiss custom duties, to the Swiss Confederation. Any adjustments to the LOA scope will be agreed to by both the USA and Swiss Confederation. This note is in line with the standard terms and conditions within the LOA. This note will lapse (i) six months after both receipt of final payment has been confirmed by the SAF/IA and delivery of all the aircraft and performance of all services in accordance with the LOA has been confirmed by the Swiss Confederation, or (ii) if the LOA has not been countersigned by the Swiss Confederation, acting through armasuisse, by the LOA expiration date.

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Appended to the LOA is "Letter of Offer and Acceptance Standard Terms and Conditions" ("T&C"), which states in section 1.4 that "[t]he USG will use its best efforts to provide the items for the dollar amount and within the availability cited." *Id.* at 62. Section 4.1 provides that the Swiss Government will be billed for the cost that the USG incurred to acquire the supplied items:

> 4.1 The prices of items to be procured will be billed at their total cost to the USG. Unless otherwise specified, the cost of items to be procured, availability determination, payment schedule, and delivery projections quoted are estimates based on the best available data.

Id. at 64. Accordingly, in section 4.4.1, the Swiss Government represents that it will "pay to the USG the total cost to the USG of the items even if costs exceed the amounts estimated in this LOA." *Id.* Regarding dispute resolution, section 7.1 of the T&C emphasizes that the LOA is "subject to U.S. law and regulation, including U.S. procurement law." *Id.* at 66. Section 7.2 requires the USG and the Swiss Government to "resolve any disagreement regarding this LOA by consultations between the USG and the Purchaser and not to refer any such disagreement to any international tribunal or third party for settlement." *Id.*

B. LOAs for O&S and Weapons Systems

The LOAs for O&S and Weapons Systems contain largely similar terms except regarding pricing: while these LOAs also contain a "total estimated cost" and an "estimated payment schedule," they do not specify that these costs are in any way "fixed." There is no "Note" similar to "Note 55" of the aircraft LOA that elaborates on a firm fixed price arrangement. Read together with the standard T&C appended to these LOAs that states that "[t]he prices of items to be procured will be billed at their total cost to the USG," this means that the O&S and Weapons Systems costs will be passed onto the Swiss Government, with no guarantee that the price will be the same as that stated in the LOAs beyond the USG's "best efforts" to do so.

C. USG Insight Letter

On November 9, 2021, the USG, through the F-35 JPO FMS Lead, transmitted a letter to the Swiss Government titled "Switzerland Insight Into F-35 Contracting" and stated that the USG will share "as much contracting information as possible" with the Swiss Government. The information to be shared includes the draft contract language related to the procurement of F-35A aircraft from U.S. contractors for the Swiss Government, and the Insight Letter states that armasuisse will be able "to add comments in drafts prior to finalization." The Letter states that the USG will "[p]rocure Swiss aircraft on fix price enterprise contracts which factor in inflation, in order to sell them on to Swiss Government at the same fix price as the U.S. Government offered to armasuisse." *Id.* The Letter concludes that the USG will "[s]hare with armasuisse projected obligations entering

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negotiations and the settled negotiated price." The Letter does not specifically mention O&S or the associated Weapons Systems.

D. USG Letter Re Procurement of F-35A Lightning II Aircraft Systems

On December 7, 2021, the USG, through the DCSA, issued a letter titled "Procurement of F-35A Lightening II Aircraft Systems." In the letter, DCSA reiterated the firm fixed price nature of the FMS agreement in the F-35A LOA:

> The US and Swiss governments are bound by the terms of the Letter of Offer and Acceptance (LOA) which confirms the agreement on the purchase of the 36 F-35 aircraft by Switzerland as a fixed price contract, which factors in inflation. The prices correspond to the Best and Final Offer submitted by the U.S. government in the procurement process.

The Letter also provides that the Swiss Government has the right to inspect the contract that the USG enters for the F-35A aircraft before it is signed:

> Prior to signing the enterprise contracts among the US government and the manufacturer, the Swiss government will have insight to and may comment on those contracts in which their interests are represented. This will allow the Swiss government to verify that these contracts also reflect the LOAs with Switzerland and the offer submitted by the U.S. government to Switzerland in the procurement process with the revised payment schedule, and to propose adjustments if needed.

The Letter concludes by again stating "the US government confirms that the acquisition is based on fixed-price contracts, which reflect the offered terms and that Switzerland will procure the aircraft from the U.S. government for the same fixed price." This Letter also does not specifically mention O&S or the associated Weapons Systems.

IV. Legal Analysis

As detailed below, we think there is low risk that the U.S. contractor will be able to increase the fixed price for the F-35A because the limited circumstances allowed under U.S. law for price increases are unlikely to be present. We do think, however, the risk of price increases for the O&S and Weapons Systems is significant. This risk could be mitigated if the USG uses fixed price pricing for this contract as well.

A. Risk of Price Increase Under F-35A LOA with its Fixed Price Provision

It is generally very difficult for a U.S. contractor to receive a price increase on a fixed price contract, absent some sort of USG malfeasance or interference with contract performance. As explained above, the regulations and interpretive case law (and our

experience) are clear that fixed price contracts are intended to be, in fact, fixed price. In order to obtain a price increase, the U.S. contractor would have to engage, and succeed, in a regulated disputes process and ultimately obtain a ruling from either a court or an administrative tribunal that one of the limited circumstances meriting a price increase in firm fixed price contracts exists. As noted above, the U.S. contractor could successfully make an argument for a price increase in very limited circumstances. The mere fact that inflation has occurred is not sufficient to support a price increase. Instead there must generally be some action by the USG that caused the price increase. Given that the F-35 program is mature, and the specifications for the aircraft are not changing, we think this risk is low.

The contract documents associated with this FMS transaction for F-35As are furthermore clear that the USG intends these fixed price principles to apply to its relationship with the Swiss Government. These contract documents are noteworthy because they deviate from the normal rule. *See, e.g.*, *SAMM* § C5.2.1.3 ("Firm Fixed Price (FFP) responses will not normally be provided.").[4] Therefore, the background law regarding fixed price contracts generally and the contract documents in this transaction together make clear that the intent is for the price for the F-35As (in contrast to the weapons systems and O&M, discussed below) to in fact be fixed at the amount stated in the LOA.

A price increase might hypothetically result if the U.S. contractor is able to surmount these obstacles, successfully complete the disputes process, and obtain a ruling that a price increase is warranted. In that unlikely scenario, the USG would be obligated by law to pass along that price increase to the Swiss Government (because statutorily the USG cannot incur a loss on an FMS sale).[5] We also note that the USG is likely to point to ambiguities in the LOA as support for its ability to do so. Note 55, the provision with the fixed price language, also states, "This note is in line with the standard terms and conditions within the LOA." *Id.* The T&C states that "price of items to be procured will be billed at their total *cost* to the USG." LOA at 64, § 4.1. It also provides that the Swiss Government agrees to "pay to the USG the total cost to the USG of the items even if costs exceed the amounts estimated in this LOA." *Id.* at 75, § 4.4.1. And, the LOA on its first page still represents that the price offered to the Swiss Government on the first page is an "Estimated Cost." *Id.* at 1. While Note 55 is clear, the rest of the LOA contains provisions that the

[4] For example, in a standard FMS transaction, the USG may unilaterally modify prices on a defined order line, *see SAMM* C6. T8, because the "the information in an LOA constitutes the USG's best estimate of what an item or service will cost . . . . If that estimate changes (as an example, due to a shortage of a particular item causing a slowdown in overall production), the USG may need to adjust the LOA accordingly." DSCA, *Foreign Customer Guide* at 19 (July 2018).

[5] The AECA, which authorizes FMS transactions, requires that the purchasing country "provides the United States with a dependable undertaking" to pay the "full amount" of the underlying acquisition contract "*which will assure [the USG] against* ***any loss*** *on the contract*." 22 U.S.C. § 2762(a). Accordingly, DCSA operates the FMS program to be operated on a "no-profit, no-loss" basis. *SAMM* § C9.3.1.

USG could invoke to support an attempt to recover a price increase from the Swiss Government.

B. Risk of Price Increase Under O&S and Weapons Systems LOAs

As laid out above, the O&S and Weapons Systems LOAs do not contain any special guarantees of a fixed price. Accordingly, the normal rule that the USG will use best efforts to complete the transaction at the stated price applies. The Swiss Government could mitigate the risk of a price increase by encouraging the USG to negotiate firm fixed contracts with its U.S. suppliers; however, U.S. industry might be resistant to such contract terms, especially for the O&S services. Nonetheless, it might be worth exploring with the USG if fixed prices can be used for at least a portion of the O&S and Weapon Systems functions. We note that while the Insight Letter does not expressly provide the Swiss Government the right to inspect these contracts, the Swiss Government could assert that the right should exist as they are part of the overall acquisition of the F-35A aircraft. We also note that the contractor's Best and Final Offer ("BAFO") that the LOA's estimated price is purportedly based on is not binding on that contractor, presuming the contract contains cost-reimbursement elements. That is, while a fixed price BAFO is binding on the contractor, a BAFO in a cost reimbursement scenario is necessarily subject to changes in the actual amount of costs the contractor incurs.

C. Availability of Remedies in Case of a Price Increase

Any dispute between the USG and the Swiss Government over a price increase would need to be resolved diplomatically. Section 7.2 of the LOA requires the USG and the Swiss Government to "resolve any disagreement regarding this LOA by consultations between the USG and the Purchaser and not to refer any such disagreement to any international tribunal or third party for settlement." A U.S. court has recognized that this standard FMS LOA provision is enforceable. *See BAE Sys. Tech. Sol. & Servs., Inc. v. Republic of Korea's Def. Acquisition Program Admin.*, 884 F.3d 463, 476 (4th Cir. 2018), *as amended* (Mar. 27, 2018) ("A foreign state cannot sue the United States for failure to perform pursuant to the sovereign-to-sovereign agreement, including with respect to price. The foreign state's only recourse is to consult with the U.S. government.").

Ultimately, such a dispute is likely to be resolved diplomatically. The USG will have custody of the aircraft, and will have a good argument that statute prohibits it from incurring a loss on an FMS transaction. The Swiss Government will have compelling arguments that the LOA expressly states the contract is at a fixed price; however, the LOA also prohibits the Swiss Government from seeking enforcement of the LOA in an international tribunal. While the LOA language is clear that the intent of the parties is for the transaction is to be fixed priced, any resolution will likely lie outside of contract law. Again, we view this as a low likelihood contingency, as in order for such a dispute to arise,

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the U.S. contractor must successfully convince either a court or administrative tribunal that the legal requirements for a price increase at met, which is a high burden.

We also note that the USG has strong incentives to fight against any price increases. The overseas sale of the F-35 is very important to the USG's national security strategy, and a price increase for any customer could significantly impact the success of its efforts to have more foreign militaries use the F-35.

V. Conclusion

We view the risk of a price increase on the F-35A FMS transaction as low. The O&S and associated weapons transactions do not contain specific fixed price language, and accordingly, under U.S. law the USG will pass along any price increases to the Swiss Government. However, the F-35A LOA makes clear that the USG intends to enter into a fixed price contract to purchase the F-35A aircraft, and under U.S. law, such fixed price contracts are, with rare exceptions, enforceable. If, however, the contractor is able to demonstrate that one of the very limited circumstances permitting a price increase in fixed price contracts exists, then the USG will likely attempt to charge the Swiss Government the increased price, because U.S. law prohibits the USG from suffering a loss on an FMS transaction. The Swiss Government will have good arguments that the LOA and its fixed price provisions are binding, but it is unclear whether the Swiss Government can enforce the LOA, as it requires disputes be settled mutually and prohibits appeal to an international tribunal or third party. Any such dispute will therefore likely be resolved diplomatically.

The Swiss Government may mitigate its limited risk of a price adjustment on the F-35A price adjustment in the following ways:

- Enforce its "insight right" to review the USG's contract with its contractor and ensure the contract is in fact fixed price.
- Request the USG provide notification should the contractor request a price increase.
- Place pressure on the USG to vigorously defend any such request for a price increase (including, as appropriate, by offering litigation support).