

ALERT

DOD Public Meeting Reveals New Insights on the Future of the Counterfeit Electronic Parts Detection and Avoidance Requirements

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On Friday, June 28, the Office of Defense Procurement Acquisition Policy (DPAP) held a public meeting to discuss the Department of Defense's (DOD) proposed rule on contractor procedures to detect and avoid counterfeit electronic parts. *See, e.g.*, 78 Fed. Reg. 28,780 (May 16, 2013); *see also* Wiley Rein May 21, 2013 alert. The proposed rule, which implements Section 818 of the 2012 National Defense Authorization Act (NDAA) and Section 833 of the 2013 NDAA, would modify the Defense Federal Acquisition Regulation Supplement (DFARS) to require many contractors to implement processes to detect and avoid counterfeit electronic parts in the defense supply chain.

During the meeting, DOD revealed the Government's plan to eventually implement the proposed counterfeit electronic parts detection and avoidance processes more broadly, both by expanding the scope of coverage of the proposed DFARS rule to include a larger segment of defense contractors, and through a potential Federal Acquisition Regulation (FAR) rule that would require similar procedures government-wide. Defense Contract Management Agency (DCMA) representatives expressed concern that backlogs and resource constraints could delay its ability to review and approve DOD contractors' counterfeit detection and avoidance processes under the proposed rule. The public meeting also provided industry participants another opportunity to raise significant concerns about the scope and perceived ambiguities in the proposed rule.

Government representatives at the meeting included the DPAP Deputy Director for Program Development and Implementation, the Deputy Director of DOD's Office of Defense Acquisition Regulations System,

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the Executive Director of DCMA and the Executive Director of DCMA Quality Assurance. The summary below addresses key comments shared during the meeting by DOD and industry representatives.

Incremental Implementation by DOD. The current proposed rule applies directly to approximately 400 DOD contractors that are subject to the Cost Accounting Standards (CAS). Those contractors would be required to implement counterfeit electronic parts detection and avoidance procedures as part of their approved purchasing systems, which DCMA would review in contractor purchasing system reviews (CPSRs). DPAP stressed that this approach was not meant to punish the large CAS-covered contractors, but rather symbolized that DPAP was looking to these contractors for leadership in this arena. DPAP representatives disclosed DOD's plan to gradually expand the scope of the proposed rule to directly include a substantially larger number of DOD contractors. Specifically, DOD intends to expand the scope of the proposed rule (or implement new follow-on rules) to include approximately 1,200 additional DOD contractors that perform time and materials or cost-reimbursable contracts that are not subject to CAS. DOD also anticipates extending the rule to other contractors that perform work requiring high-quality parts, components or systems.

New FAR Rules. Although Section 818 addressed DOD acquisition procedures and required revisions only to the DFARS, DOD representatives indicated that the FAR Councils are expected to propose two new rules (FAR Case 2013-002, Expanding Reporting of Non-conforming Items, and FAR Case 2013-032, Higher Level Contract Quality Requirements) that would extend counterfeit electronic parts detection and avoidance requirements, including GIDEP reporting obligations, to non-DOD contractors. No estimate was provided on when the proposed FAR rules would be forthcoming. Contractors expressed frustration during the meeting that without clear guidance on the ultimate breadth of the Government's plan to implement new detection and avoidance requirements, they were unable to effectively comment on the current proposed DFARS rule.

Using CPSRs to Enforce Detection and Prevention Procedures. Both DCMA and industry members expressed concern about the plan to use CPSRs as DOD's tool to review the adequacy of contractors' procedures to detect and avoid counterfeit electronic parts. After a final rule is implemented, DCMA expects a lag before it can clear CPSR backlogs and develop the resources needed to conduct new reviews of counterfeit procedures, but noted that there is no existing guidance for DOD or contractors on how to proceed during the interim. Industry representatives are concerned that using the CPSR as an enforcement mechanism could result in a contractor's entire purchasing system being deemed unacceptable based on a single counterfeit electronic part (or "suspect" counterfeit), essentially requiring covered contractors to guarantee 100% counterfeit-free delivery.

Persistent Industry Concerns. Industry representatives used the public meeting as a forum to raise a number of concerns that echo criticisms of the proposed rule raised in written comments and discussions in other industry fora:

- *Definitional Problems:* Contractors remain concerned about perceived shortcomings in the terminology and definitions used in the proposed rule—including terms like "suspect counterfeit parts" and "legally authorized source"—which could result in overbroad application of the proposed rule and could

potentially cause any non-conforming electronic part to be treated as a counterfeit. Contractors are also concerned about the lack of definitions for potentially critical terms such as "trusted supplier." DPAP attempted to justify the terminology in the proposed rule, noting that it was the product of multiple drafts circulated by DOD, Department of Homeland Security, Department of Justice and other Government stakeholders and represented viewpoints of various Government agencies.

- *Minimal Practical Guidance:* Contractors expressed concern about the perceived lack of practical guidance in the proposed rule. Specific areas in which contractors desire more guidance include how to identify trusted suppliers; who bears the costs of investigating a suspected counterfeit if it turns out not to be counterfeit; and whether (and how) compliance costs would be reflected in Low Price Technically Acceptable (LPTA) procurements.
- *Exceptions:* Especially in light of the DOD's commitment to expanding the scope of the proposed rule to include other, non-CAS covered contractors, there were concerns regarding the absence of any exceptions in the proposed rule for small businesses or commercial item contracts.
- *Timing of the Final Rule:* The majority of commentators appeared to agree that the proposed rule is not ready for final implementation and urged DPAP to extend the rulemaking process for at least another 12 months so that industry concerns can be more fully developed and considered.

Written comments on the proposed rule are due by July 15, 2013.

Wiley Rein summer associate George Petel contributed to this alert.