

ALERT

DOD Issues Final Rule on Counterfeit Electronic Parts

May 6, 2014

On Tuesday, May 6, the U.S. Department of Defense (DOD) issued its final rule on Detection and Avoidance of Counterfeit Electronic Parts, which implements Section 818 of the 2012 National Defense Authorization Act (NDAA) and Section 833 of the 2013 NDAA. See 79 Fed. Reg. 26091 (May 6, 2014). DOD's final rule reflects several significant changes from the initial rule it proposed a year ago (which we analyzed [here](#)), responding to a number of industry concerns.

The final rule is complex and will have far-reaching impact on DOD's supply chain; it is accompanied by a lengthy preamble explaining the many changes DOD adopted. Among the key changes in the final rule:

- **DOD revised a key new term to be added to DFARS 202.101, dropping the proposed term "counterfeit part" and replacing it with "counterfeit electronic part."** The change clarifies DOD's intent to limit the scope of the final rule to only counterfeit **electronic** parts, not other items in the DOD supply chain. Commenters had expressed concern that the initial proposed term "counterfeit part" was ambiguous and could have been construed more broadly than DOD's mandate in Sections 818 and 833.
- **DOD revised the definition of "counterfeit electronic part" to expressly acknowledge an intent element.** Under the final rule, a counterfeit electronic part is one that has been "**knowingly** mismarked, misidentified, or otherwise misrepresented" (emphasis added). This responds to industry concerns that the scope of the rule could have swept up unintentional production, packaging, or marking errors that

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were not designed to mislead the buyer.

- **DOD adopted a more manageable standard for determining when an electronic part is suspected of being counterfeit and within the scope of the rule.** In the final rule, DOD defined “suspect counterfeit electronic part” to include electronic parts “for which *credible evidence . . . provides reasonable doubt that the electronic part is authentic*” (emphasis added). The proposed rule had not included any “credible evidence” (or similar) standard for measuring the information available to contractors in assessing whether electronic parts may be counterfeits. DOD stated in the final rule’s preamble that these revisions emphasize the “fact-based approach” contemplated for identifying and detecting counterfeit parts and acknowledged that “[i]t is not practical or cost effective to test in every case of a suspected counterfeit.” The credible evidence standard should provide contractors with better guidance on when the rule’s detection, avoidance, reporting, and quarantining obligations apply, as well as when the rule’s cost allowability restrictions would prevent the contractor from recovering costs of the part and any rework.
- **DOD invited greater flexibility for contractors to implement “risk-based” systems for detecting and avoiding counterfeit parts.** The final rule implements a new DFARS clause 252.246-7007, which requires covered contractors (*i.e.*, those with contracts subject to the Cost Accounting Standards (CAS)) to implement business systems to detect and avoid counterfeit electronic parts. The final rule recognizes that such systems need not be “one-size-fits-all,” and expressly acknowledges that contractors may adopt “risk-based policies and procedures” for the system. (The same language appears in DFARS 246.870-2(b)). In the preamble, DOD suggested that this risk-based approach recognizes that contractors who rely on original equipment manufacturers and other trusted suppliers have a lower risk profile that affects how they should be required to manage supply chain risks of counterfeit electronic parts.
- **DOD revised the DFARS 252.246-7007 clause to clarify that the clause must be flowed down to all subcontracts at all tiers, including subcontracts for commercial items and commercial-off-the-shelf (COTS) items.** Although the clause applies directly to only a limited set of prime contracts covered by the CAS, DOD confirmed in the preamble to the final rule that “[a]ny electronic part procured by a CAS-covered prime contractor is . . . subject to the restrictions concerning counterfeit and suspect counterfeit parts, without regard to whether the purchased part is a commercial or COTS item.” Consequently, DOD will require prime contractors with covered contracts to impose the requirements for detection and avoidance of counterfeit parts throughout their supply chains for those covered contracts.

The final rule also defines “obsolete part” as a new term, and includes three additional requirements for a contractor’s compliant detection and avoidance systems, among other changes from last year’s proposed rule. Given the significant changes adopted in the final rule, but DOD’s unwillingness to issue a revised proposed rule for further industry comment, there will likely be an adjustment period for government and industry to grow into the new requirements in the final rule. Nevertheless, the final rule takes effect today, May 6, 2014, so contractors must take immediate steps to comply.

