Dear Ms. Williams:

On behalf of the American Bar Association (“ABA”) Section of Public Contract Law (“Section”), I am submitting comments on the referenced proposed rule.\(^1\) The Section consists of attorneys and associated professionals in private practice, industry, and Government service. The Section’s governing Council and substantive committees include members representing these three segments to ensure that all points of view are considered. By presenting their consensus view, the Section seeks to improve the process of public contracting for needed supplies, services, and public works.

The Section is authorized to submit comments on acquisition regulations under special authority granted by the ABA’s Board of Governors. The views expressed herein have not been approved by the House of Delegates or the Board of Governors of the ABA and, therefore, should not be construed as representing the policy of the ABA.\(^2\)

\(^1\) Mary Ellen Coster Williams, Section Delegate to the ABA House of Delegates, and Heather K. Weiner, member of the Section’s Council, did not participate in the Section’s consideration of these comments and abstained from the voting to approve and send this letter.

\(^2\) This letter is available in pdf format at http://www.americanbar.org/groups/public_contract_law/resources/prior_section_comments.html under the topic “Acquisition Reform and Emerging Issues.”
I. INTRODUCTION

The Department of Defense ("DoD") has proposed amending the Defense Federal Acquisition Regulation Supplement ("DFARS") to define the circumstances under which the costs would be allowable when attributable to counterfeit parts, suspect counterfeit electronic parts, and the cost of rework or other corrective action related to those electronic parts. The Section recognizes the significant concerns regarding counterfeit electronic parts in the defense supply chain that DoD is addressing through a series of related rulemakings. In addition to the regulation proposed under this Federal Register notice, DoD has related regulatory changes that are being addressed through separate rulemaking procedures.

Given the interrelated legislation and rulemaking processes, the Section believes that the final rule under this rulemaking should not be published until DoD has finalized its separate rulemaking to further implement requirements associated with detection and avoidance of counterfeit electronic parts. The Section encourages a comprehensive regulatory framework on the avoidance and detection of counterfeit electronic parts and allowable costs and that the final framework should be flexible enough to ensure that contractors and the Government have clear guidance.

The proposed rule is issued to implement Section 885(a) of the National Defense Authorization Act ("NDAA") for Fiscal Year 206, Pub. L. No. 114-92, which makes allowable "costs for counterfeit parts or suspect counterfeit parts and the cost of rework or corrective action that may be required to remedy the use or inclusion of such parts" under certain circumstances. In particular the proposed rule would amend DFARS 231.205-71(b) to provide for allowability as described in this letter.

The Section agrees on the need to clarify the allowability of costs for addressing counterfeit electronic parts and suspect counterfeit electronic parts in the defense supply chain. Accordingly, the Section recommends that the regulations specify, with as much detail as possible, the line between allowable and unallowable costs, with "bright lines" for costs that will remain allowable. Such bright lines, however, will not be fully defined until the rulemaking associated with DFARS 252.246-70XX is finalized. The Section respectfully requests that DoD address these various pieces of regulatory guidance in a consolidated and consistent manner to ensure that the Government and contractor communities are afforded a fulsome understanding of the proposed rule and regulatory framework.

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II. COMMENTS

A. The Section Encourages Comprehensive, Instead of Piecemeal, Regulation.

The proposed rule provides that costs may be recoverable if three elements are satisfied: (1) the contractor has an operational system to detect and avoid counterfeit parts and suspect counterfeit parts that has been reviewed and approved by DoD in accordance with DFARS 244.303 [proposed DFARS 231.205-71(b)(1)]; (2) the parts at issue are furnished as Government furnished equipment (“GFE”), or they are obtained by the contractor in accordance with “DFARS 252.246-70XX” [proposed (b)(2)]; and (3) the contractor “discovers” the counterfeit or suspect counterfeit electronic part and provides timely notice to the cognizant contracting officer(s) [proposed (b)(3)].

The proposed rule, however, hinges on regulations that have not yet been finalized and implemented. The two DFARS Cases noted above interrelate and overlap with DFARS Case 2016-D010, especially as to definitions. For example, proposed DFARS 231.205-71(b)(1) provides that the contractor must have an operational system reviewed and approved to obtain access to the safe harbor for costs. Precisely what would be considered an “operational system,” who provides the needed approval, and how approval will be obtained is the subject of DFARS Case 2014-D005, which modifies the definitions of “authorized dealer” and “trusted supplier,” and which remains open. Similarly, proposed DFARS 231.205-71(b)(2) provides that a contractor must have electronic part(s) that were furnished as GFE or obtained by contractor in accordance with DFARS 252.246-70XX, a rule which is still pending. The proposed rule depends on the acceptability of the as yet determined DFARS clause 252.246-70XX. Finally, DFARS Case 2016-D013, which states that “trusted suppliers” are subject to approval (as well as review and audit) by DoD officials, remains an open and unresolved case.

In commenting on the combination of the DFARS cases, the Section proposes that the rules provide that “pending approval” be added to the definition of “trusted suppliers” and that contractor-designated “trusted suppliers” be assumed to be approved by the DoD officials until DoD notifies the designating contractor that the supplier is not approved. The Section submits that this revision is needed to allow some certainty in the process and to prevent contractors and their suppliers from having costs relating to detection and remediation deemed unallowable simply because DoD officials have not conducted and completed the approval process for a designated “trusted supplier.”

These cases should be considered and resolved together in a proposed rule with an opportunity for notice and comment on the entire rule. It is difficult for the Section, or any other party, to propose comprehensive comments because the DFARS Cases are being evaluated separately. Final resolution of any one of the outstanding DFARS Cases likely would impact the Section’s and potentially the public’s comments on this and other DFARS Cases currently outstanding.
The Section also is concerned that there may be a lack of consistency among the regulations issued by the Government and those standards promulgated by industry associations with regard to suspect counterfeit electronic parts. For example, the definition of a “suspect counterfeit electronic part” varies not only between the DFARS provision and industry standards, but also between different industry associations’ standards, such as the standards issued by SAE and the International and Independent Distributors of Electronics Association. Because industry standards (including applicable definitions) evolve to respond to market and other changes, a DFARS definition that is not tied to the definition in the industry standard applicable to a particular contractor could present significant compliance challenges for Government contractors. The Section recommends that DoD engage in additional dialogue with industry to establish the appropriate definitions on key terms set forth in the regulations addressing counterfeit electronic parts. By establishing standardized and widely accepted definitions of these key terms, the Government and contractors will be aligned on the compliance requirements.

B. The Proposed Rule Limits the Safe Harbor More Than Needed to Protect the Defense Supply Chain.


In the proposed DFARS 231.205-71(b) discussed above, the provision concerning when a contractor “discovers” the counterfeit electronic parts or suspect counterfeit electronic parts may not reflect the reality that electronic parts or components are frequently incorporated into subcontracted parts, components, and systems, that then are incorporated into larger components or systems. Because subcontractors are responsible for their own quality assurance and testing, a subcontractor at any level may make the actual “discovery” of a suspect counterfeit electronic part. In this situation, the subcontractor may not even know who the prime contractor is, let alone the name of the contracting officer for the prime contract, for purposes of reporting the suspect or actual counterfeit electronic part. Thus, it is possible that the reporting will be made from one subcontractor up through the supply chain. In this circumstance, the prime contractor will not “discover” the facts giving rise to a reportable event until it is informed of them by its lower-tier subcontractor(s), and the proposed regulation’s use of the term “discovers” could be interpreted to limit the availability of the safe-harbor provision to only the (sub)contractor that first identifies or “discovers” the actual or suspect counterfeit electronic part. The Section submits that this would be an unduly narrow definition. The Section recommends revising the definition so that prime contractors and all relevant subcontractor(s) are equally incentivized to timely identify and report their “discovery” by being afforded the safe harbor for making their respective reports whenever they become aware of the counterfeit or suspect counterfeit electronic part.
2. The Final Rule Should Consider Extending the Safe Harbor to GIDEP Alerts.

The Section similarly submits that the proposed rule should allow a contractor (and subcontractor) to have its costs considered allowable under the safe harbor when it reports timely and critical suspect counterfeit electronic parts information through the Government Industry Data Exchange Program (“GIDEP”). Two hypothetical scenarios exemplify why this safe harbor should be made available.

First, when a contractor reviews a GIDEP alert about a suspect counterfeit electronic part and determines that it has incorporated the part in its DoD products, that contractor should be incentivized to report. While this hypothetical situation might not fit a common understanding of the term “discovers,” this type of discovery should be afforded a safe harbor.

Second, where the Government discovers a suspect counterfeit electronic part, the Section submits that should not limit the ability of any contractor to qualify for allowable costs under the safe harbor. As counterfeit parts become increasingly sophisticated and difficult to identify without advanced forensic techniques, a closer partnership between industry and the Government will be necessary to identify these suspect counterfeit electronic parts and to disseminate this information throughout the DoD supply chain. The proposed rule does not adequately address the availability of the safe harbor to contractors when the discovery of the suspect counterfeit electronic part is made by the Government and the contractor discovers that it has the part and makes a report.

3. Broadening the Concept of “Discovers” Would Be Consistent with Underlying Policy Concerns.

To resolve these kinds of ambiguities in the trigger for reporting and qualifying for allowable costs, the Section recommends modifying the proposed regulation by replacing the term “discovers” with “learns of and acts upon.” This revised language would then encompass situations deserving of protection, such as those identified above. Use of the phrase “learns of and acts upon” also would create a reasonable means to qualify for the cost-allowability safe harbor, assuming all other conditions are met, for all contractors (and subcontractors) and encourage the exchange of information about these suspect counterfeit electronic parts.

Indeed, the Council may be creating a negative incentive if it maintains the narrow definition of “discovers” for the safe harbor trigger. As it is currently written, by providing a safe harbor only to the contractor that “discovers” the actual or suspect counterfeit part, the proposed rule could result in a “first to discover” race that would thwart the timely sharing of information that is critical to a safe supply chain. The definition might result in significant over-reporting of non-conforming electronic parts as well, by encouraging contractors and subcontractors to race to be the first one to “discover” the suspect counterfeit electronic part in order to qualify for the safe harbor. In such a scenario, entities might not take sufficient care to gather and analyze all of the necessary information in their haste to be the first to report.
C. The Proposed Rule Is Ambiguous as to How a Contractor Provides Timely Notice after Becoming “Aware” of Counterfeit or Suspect Counterfeit Electronic Parts.

The proposed rule also imposes a general awareness standard to define what constitutes a timely disclosure: “The contractor… (ii) Provides timely (i.e., within 60 days after the contractor becomes aware) notice to the cognizant contracting officer.” See Proposed DFARS 231.205-71(b)(3). The Section believes that awareness by the contractor is an insufficient and ambiguous term which does not accurately add or adequately refine the definition of the triggering event for a contractor to provide notice to the cognizant contracting officer. The Section recommends removing the phrase “becomes aware” and replacing it with the phrase “receives credible evidence.” The rule then would read: “The contractor . . . (ii) Provides timely (i.e., within 60 days after the contractor receives credible evidence) notice to the cognizant contracting officer(s).” The Section submits that the use of such a standard is one that contractors are already familiar with because it is used for reporting under the Mandatory Disclosure rule, Federal Acquisition Regulation 52.203-13 and 3.1003.

D. Clarifying the Notice Provisions Would Strengthen the Rule.

The proposed rule imposes notice requirements on contractors that seek recovery of costs associated with counterfeit or suspect counterfeit parts, including the costs of rework and/or corrective action that may be required. 81 Fed. Reg. 17055. Assuming that a contractor has sourced the parts at issue consistent with regulatory requirements (including the proposed rule from September 2015 noted above), contractors must provide “timely (i.e., within 60 days after the contractor becomes aware) notice to the cognizant contracting officer(s).” Proposed DFARS 231.205-71(b)(3)(ii). Such a notice requirement appears reasonable but the Section notes that further clarification in the final rule as to the personnel to whom the reports should be made and the application of the provision to subcontractor suppliers would strengthen the proposed rule and help encourage reports throughout the supply chain.

First, as currently drafted, the proposed rule is unclear as to which contracting officer notice must be provided—the contracting officer with whom the prime contractor has contractual privity or a contacting officer, if different, who is designated as a central point of contact to receive notice of a suspect counterfeit or counterfeit part. The most reasonable interpretation of “cognizant contracting officer(s)” would be a central point of contact and, for the prime contractor, the contract’s designated contracting officer, even if the identification of the suspect counterfeit electronic part occurred within the supply chain. Indeed, to the extent that subcontractors need to make a report, the relevant contracting officer for the particular prime contract may not be apparent to the lower tier subcontractors.

The Section favors a centralized reporting obligation by the discovering entity, as well as an obligation on the subcontractor to report through the supply chain to the prime contractor upon learning of a suspect or actual counterfeit part. The Section understands the desire to limit the delay in the receipt of reports of suspect or actual counterfeit parts but, at the same time, we believe it is important that the entire supply chain be made aware of a suspect or actual
counterfeit part. A centralized reporting portal such as is used by DoD for reports of cyber incidents or is envisioned for the Department of Homeland Security under the Cybersecurity Information Sharing Act passed in December 2015 may provide a model. Further, using a central point of contact for reporting will allow the contracting officer to work in real time with the reporting contractor or subcontractor to determine the next steps for protecting the supply chain.

A consolidated reporting obligation to a central point of contact contracting officer decreases the potential for delay in identifying a suspect or actual counterfeit electronic part issue. Such a consolidated approach also would avoid different contracting officers reaching potentially conflicting determinations. Instead of taking action to protect the supply chain, a multiple report approach, without any centralized point of contact to report to, could distract both the reporting contractor and the Government from the desired outcome of addressing the risk from the part under scrutiny. Such multiple reports also could increase the likelihood of disparate direction to the reporting contractor, confusion as to which parts are at issue, and resulting delays in remediation.

Second, clarification as to which level of contractor in the supply chain must provide notice to the Government to meet the test for allowability would result in a more orderly implementation of the proposed rule. In larger supply chains, it is often subcontractors that first identify a suspect counterfeit part. That subcontractor likely does not know who the contracting officer is on the prime contract or how to contact him or her. If the subcontractor provides timely notice to a designated point of contact and its higher tier contracting partner, the Section believes that this should bring them within the safe harbor and make their costs allowable. Indeed, if the intent is to encourage reports and diligence on the part of contractors with respect to suspect and counterfeit parts, an approach that could result in recovered costs may act as an incentive to report for those subcontractors operating on a cost basis. Revisions to the proposed rule to clarify this point would be helpful.

III. CONCLUSION

The Section appreciates the opportunity to provide these comments and is available to provide additional information or assistance as you may require.

Sincerely,

David G. Ehrhart
Chair, Section of Public Contract Law

cc:
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