

2012-2013

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Attn: Ms. Meredith Murphy

July 22, 2013

Re: DFARS Case 2012-D055, Detection and Avoidance of Counterfeit Electronic Parts, 78 Fed. Reg. 28780 (May 16, 2013)

Dear Ms. Murphy:

On behalf of the Section of Public Contract Law of the American Bar Association ("the Section"), I am submitting comments in the above-referenced matter. The Section consists of attorneys and associated professionals in private practice, industry, and Government service. The Section's governing Council and substantive committees contain 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 Association's Board of Governors. The views expressed herein have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and, therefore, should not be construed as representing the policy of the American Bar Association.¹

I. BACKGROUND

Counterfeiting has long affected governments, businesses, and consumers. In April 2013, at the most recent World Customs Organization ("WCO") Global Congress on the subject of counterfeit parts, the Secretary of the WCO reported that

the proliferation of actors involved in the production, distribution and sale of counterfeit and pirated goods has now reached a scale unforeseen a decade ago. These

¹ This letter is available in pdf format under the topic "Acquisition Reform and Emerging Issues" at: <http://apps.americanbar.org/contract/federal/regscomm/home.html>.

individuals or organized networks pay little or no attention to the rule of law, fair business practices, legitimate wealth and job creation, national borders, consumer safety or public health. They are innovative and to thwart them we must out-innovate them. We must work to bring increased transparency to every intentional supply chain transaction, disrupt illicit production and distribution, continue to rigorously pursue, prosecute and dismantle networks and, most importantly, we must do much more to educate consumers. These remain formidable challenges and this Congress gives us the opportunity to pull together experiences, knowledge and ideas,²

For the federal contracting community, the infiltration of suspect and counterfeit parts into the supply chain has become a considerable concern.³ This is compounded by the risk that counterfeit parts may include malware or malicious code that poses cybersecurity risks as well as other counterfeit part performance risks.⁴

² <http://www.iccwbo.org/News/Articles/2013/Seventh-Global-Congress-on-Combating-Counterfeiting-and-Piracy-opens-in-Istanbul/> .

³ A single definition of the term “counterfeit part” or “counterfeit materiel” has not been globally or definitively established. The term has received varying definitions. For example, the Government Accountability Office (“GAO”) defined the term “counterfeit parts” as “the misrepresentation of a part’s identity or pedigree.” U.S. Government Accountability Office Report, GAO-10-389, *Defense Supplier Base, DoD Should Leverage Ongoing Initiatives in Developing its Program to Mitigate Risk of Counterfeit Parts* (2010) (“2010 GAO Report: Mitigate Risk of Counterfeit Parts”). DoD, in August 2009, endorsed a definition that includes both fake parts and genuine parts that have been recycled but which are offered as new. See SAE International, *SAE Aerospace Standard 5553, Counterfeit Parts; Avoidance, Detection, Mitigation and Disposition* (April 2009) (defines counterfeit for the aerospace industry and endorsed by DoD). Subsequently, however, SAE International has worked to revise AS 5553 and to develop new standards, such as AS6081 (Counterfeit Electronics Parts: Avoidance Protocol, Distributors) and ARP6178 (Fraudulent/Counterfeit Electronic Parts: Tool for Risk Assessment of Distributors), which take a different tack. The new standards, and AS5553a, as revised, do not include in the definition of a “counterfeit part” one that is previously used and is authored as new. It may be a contract violation or even “fraud” to represent as new a genuine part that was previously used, but such expert sources question whether it is appropriate to treat such a part as “counterfeit.” DoD on April 26, 2012, issued DoD Instruction (DoDI) 4140.67, *DoD Counterfeit Prevention Policy*, that applies beyond electronic parts to all forms of “counterfeit materiel.” The operative definition there is that “counterfeit materiel” is “[a]n item that is an unauthorized copy or substitute that has been identified, marked, or altered by a source other than the item’s legally authorized source and has been misrepresented to be an authorized item of the legally authorized source.” DoDI 4140.67 at Glossary, p. 11, available at: <http://www.dtic.mil/whs/directives/corres/pdf/414067p.pdf>.

⁴ It has been recognized there is an “intersection between concerns about counterfeit electronic parts, information assurance, software assurance and “anti-tamper” regimes.” Robert Metzger, “New DoD Counterfeit Prevention Policy: Resolves Responsibilities Within DoD But Leaves Many Contractor Questions Unresolved,” Federal Contracts Report (May 2013); see also; Investigative Report on the U.S.

Concerns regarding counterfeit parts in the Government's defense supply chain led to the enactment of Section 818 of the National Defense Authorization Act ("NDAA") for Fiscal Year ("FY") 2012 requiring DoD to issue regulations regarding the definition, prevention, detection and reporting of actual or suspected counterfeit parts in the defense procurement supply chain.⁵ Section 818(d) further requires the Department of Homeland Security ("DHS") to create a "risk-based methodology" to enhance targeting of counterfeit electronics parts imported into the U.S. Section 818(d) also mandates that DHS consult with DoD as to sources of counterfeit and suspect counterfeit electronics parts purchased by DoD in the supply chain to address counterfeit supply chain risks.⁶

Because "[a]lmost anything is at risk of being counterfeited, including fasteners used on aircraft, electronics used on missile guidance systems, and materials used in body armor and engine mounts,"⁷ counterfeit parts in the defense supply chain pose safety and national security risks, and "drive up the cost of defense systems,"⁸ the Section published a white paper in advance of DoD's issuance of the required regulations to implement Section 818, in order to provide perspectives from a broad cross-section of the government contracting community on key considerations associated with implementing the legislation's stated goals of avoiding, detecting, and addressing counterfeit parts in the defense supply chain.⁹ The white paper points out that the problem of counterfeit parts is an evolving one. There are a variety of factors that have rendered the defense supply chain susceptible to counterfeit parts. First, many deployed U.S. defense systems utilize components that are military and commercial-grade obsolete parts, *i.e.* parts that are no longer made by the original equipment

National Security Issues posed by Chinese Telecommunications Companies Huawei and ZTE, House Permanent Select Committee on Intelligence Report. (October 8, 2012).

⁵ National Defense Authorization Act for Fiscal Year 2012, Pub. L. No. 112-81, § 818.

⁶ In addition to DoD and DHS, Section 818(g) provides that the Secretary of Treasury also has a role in this effort and is given specific permission to disclose to trademark rights holders certain information on detained suspect counterfeit shipments. Section 818(g)(1). Jurisdiction over Lanham Act enforcement was retained by Treasury when the Customs Service and Border Patrol were transferred to DHS to form CBP.

⁷ *Defense Supplier Base DoD Should Leverage Ongoing Initiatives in Developing Its Program to Mitigate Risk of Counterfeit Parts*, GAO Report 10-389 (March 2010) ("2010 GAO Report: Mitigate Risk of Counterfeit Parts").

⁸ S. Comm. on Armed Servs., *Inquiry into Counterfeit Electronic Parts in the Department of Defense Supply Chain*, S. Rep. No. 112-167, at iv (2012) ("SASC Report: Counterfeit Electronic Parts").

⁹ A complete copy of the white paper may be found on line at http://www.americanbar.org/content/dam/aba/administrative/public_contract_law/aba_pcl_taskforce_on_counterfeit_part_white_paper.authcheckdam.pdf.

manufacturer (“OEM”) or its authorized dealers.¹⁰ If the OEM or underlying Original Component Manufacturer (“OCM”) (OEM and OCM hereinafter referred to as “OM”) ceases production, the continuing need for obsolete or out-of-production parts often forces DoD and its contractors to purchase replacement parts from independent distributors, brokers or other sources, creating an increased risk that counterfeit parts may be introduced into the DoD supply chain.¹¹

Second, counterfeiters have become more sophisticated and continually refine their tactics and processes in order to avoid detection.¹² Counterfeiting is not limited to “simple” parts, and concern has been expressed publicly that even recent vintage, complex parts still in production might be “cloned” by sophisticated actors. Counterfeiting is not considered an illegal enterprise in certain countries, and certain governments permit open counterfeiting, creating a stable environment from which counterfeiters can operate to “manufacture,” distribute and sell counterfeit parts openly in public markets or via the Internet without disclaimers or disclosures.¹³ In addition to foreign sources, there are domestic activities that contribute to counterfeit supply.

Third, “[t]here are dozens of Internet sites that specialize in the trade of electronic parts, with a large number of China-based distributors posting parts for sale.”¹⁴ Moreover, not only are there many potential counterfeiters to detect and avoid, but because counterfeits may be made in one country and shipped to other countries to be integrated into, or shipped and used in, other parts, equipment, or systems, there are

¹⁰ *The Committee’s Investigation into Counterfeit Electronic Parts in the Department of Defense Supply Chain: Hearing Before S. Comm. on Armed Servs.*, 112th Cong. (2011) (“SASC Hearing: Counterfeit Electronic Parts”) (Statement of Sen. Carl Levin) (noting that “The defense community is critically reliant on a technology that obsolesces itself every 18 months, is made in unsecure locations and over which we have absolutely no market share influence”).

¹¹ The Senate Armed Services Committee’s (“SASC”) investigation concluded that “unvetted independent distributors are the source of the overwhelming majority of suspect parts in the defense supply chain.” SASC Report: Counterfeit Electronic Parts at v. Thus, some care is appropriate in considering the role of distributors and parts brokers. There are examples of independent distributors and brokers who take care to avoid purchase of or distribution of counterfeit electronic parts and who strive to be treated as responsible and trusted sources of supply of parts not otherwise available. The continuing demand for parts that are obsolete or out-of-production means that distributors and brokers have a role to play in sustainment of equipment that requires such parts. The legal regime to enforce Section 818 should not exclude all such sources even though additional controls and protective measures should accompany their use.

¹² *Id.* (quoting Vivek Kamath, Vice President of Supply Chain Operations at Raytheon Company). Strategies used by counterfeiters include, but are not limited to, the “mix[ing of] counterfeit parts with authentic parts, in a method called ‘sprinkling’ to increase the chance that the counterfeits will avoid detection.” *See* SASC Hearing: Counterfeit Electronic Parts (Statement of Sen. Carl Levin).

¹³ SASC Report: Counterfeit Electronic Parts at vi.

¹⁴ SASC Hearing: Counterfeit Electronic Parts (Statement of Sen. Carl Levin).

multiple places within the supply chain in which counterfeits might be introduced – intentionally or unintentionally. Thus, the white paper posited that promotion of the twin goals of detection and avoidance should of necessity involve government working with industry and the public contracts bar to establish flexible, but appropriate standards for the identification and reduction of risks of counterfeit parts within the supply chain to suit the divergent industries and to address the different types of contractors that comprise the defense industrial base.

Since the enactment of Section 818, Congress also passed counterfeit parts provisions in the NDAA for FY 2013, including Section 833 which revised the safe harbor provisions of Section 818.¹⁵ Additional legislation affecting counterfeit parts matters is under consideration in the current Congress.¹⁶ Because this is a changing area, we believe that regulations ultimately implemented should be flexible enough to ensure they address these changes and provide contractors and the Government clear guidance in addressing counterfeit parts matters.

II. COMMENTS

A. Preliminary Matters

The Section applauds the DAR Council for issuing proposed regulations that afford the public the opportunity to provide comments on this important issue in advance of interim or final regulations. As noted below, the Section has a number of comments that we believe will assist the DAR Council in clarifying ambiguities and potential confusion and improving the final regulation.

In addition, at the public meeting on the proposed regulations, DAR Council representatives stated that the Intellectual Property Enforcement Coordinator (“IPEC”) had issued a report regarding this requirement and that this report had formed the underpinnings of the DoD proposed regulation and the two Federal Acquisition Regulation (“FAR”) cases to be included in the framework for addressing DoD counterfeit detection and avoidance requirements under Section 818. When members of the public requested copies of this report, they were advised that the report had been forwarded to the White House for release, but that the White House had not yet acted upon the request. This report would appear to include findings that relate to this rulemaking and likely contains information regarding the need for certain terms and the likely impact of the regulations. Accordingly, the Section believes that the final rule

¹⁵ NDAA for FY 2013, Pub. L. No. 112-239, 126 Stat. 1632 (Jan. 3, 2012).

¹⁶ *See, e.g.*, H.R. 1960, NDAA for FY 2014, Sections 811 (Additional Contractor Responsibilities in Regulations Relating to Detection and Avoidance of Counterfeit Electronic Parts) and 812 (Additional Amendment to Detection and Avoidance of Counterfeit Electronic Parts), passed by the House on June 14, 2013.

would benefit from awaiting release of this report and allowing additional public comment prior to finalization of the proposed regulation.

B. Background Section of Proposed Rule

The Background section of the proposed rule states that DoD is proposing a partial implementation of the current counterfeit parts legislation. As a result, the proposed rules do not address all of the requirements of Sections 818 or 833. Instead, as Government representatives explained at the June 28, 2013 public meeting on this DFARS Case, in addition to this proposed DFARS rule, the FAR Council is working on two FAR Cases that will address DoD counterfeit parts requirements: FAR Case 2013-002, which is expected to expand reporting of non-conforming items, and FAR Case 2012-032, which is expected to modify the current regulations on higher-level contract quality requirements. The DAR Council advised at the meeting that the combined set of FAR and DFARS rules will establish the framework for implementation of Section 818, as amended by Section 833 of the FY13 NDAA.

The Section believes that the overall regime for addressing counterfeit parts would be improved by coordinated publication of proposed rules that would allow the public and industry to provide public comment with the benefit of all of the proposed regulations affecting counterfeit parts before them. When these concerns were identified at the public meeting, members of the DAR and FAR Councils who participated in the meeting indicated that they understood these concerns and would take steps to attempt to coordinate these three cases in the future. The Section supports such efforts to coordinate and recommends that DoD refrain from issuing a final rule on this Case until the three cases have been published in the Federal Register and public comment has been received. We believe such coordinated treatment will facilitate the issuance of final rules aimed at achieving the laudable goals of preventing counterfeit electronic parts from entering the supply chain, detecting counterfeit parts, and maintaining a sound, viable defense supply chain.

In particular, the Section notes that the proposed rules address criteria for a contractor's system to detect and avoid counterfeit electronic parts, including the requirements to use and qualify trusted suppliers and to timely report and quarantine counterfeit electronic parts and suspect counterfeit electronic parts. They do not, however, address the significant components that will comprise an "acceptable" system such as:

- Trusted supplier requirements
- Factors to be used in qualifying trusted suppliers
- The required reporting mechanism, including its timing, the consequences of reporting, and the parties to be involved in such reporting

The Section believes that these components should be addressed in any final rule as part of the essential avoidance and detection system that DoD will review under a business systems-type of audit. The Section encourages the FAR and DAR Councils to

continue the exchange between industry and the Government with public meetings and the notice and comment process on this DFARS Case and future related regulations that would form the Government's overarching regulatory framework for addressing the counterfeit parts issue.

C. Discussion Section of the Proposed Rule

1. Definitions

The proposed rule includes multiple terms and definitions of terms associated with counterfeit parts matters. The Section believes that the final rule would be improved by coordinating the proposed definitions and terms with the definitions and terms employed by other agencies, such as DHS (which administers Customs and Border Patrol ("CBP") rules and regulations on the topic of counterfeits)¹⁷ and National Aeronautics and Space Administration ("NASA") (which administers its own regulations).¹⁸ Such coordination would help ensure that contractors have a clear understanding of how these various definitions and regulations work together and provide a full understanding of contractors' compliance obligations. The Section also believes that the final rule would benefit from clarification of the terms and definitions at issue.

(a) Contractor Responsibilities

With regard to contractor responsibilities for detection and avoidance of counterfeit electronic parts or suspect counterfeit electronic parts, the Section notes that many of the contractors that may be affected by the proposed regulation are not currently subject to the FAR and DFARS regulations requiring an approved purchasing system. Accordingly, as stated more fully within these Comments, the Section believes that counterfeit electronic parts detection and avoidance systems should not be subsumed as part of the contractor's purchasing system requirements.

(b) Unallowability of Costs of Rework and Corrective Action

Proposed DFARS provision 231.205-71 would "prohibit contractors from claiming, as a reimbursable cost under DoD contracts, the cost of counterfeit electronic parts or suspect electronic parts or the cost of rework or corrective action that may be required to remedy the use or inclusion of such parts." Although the Discussion section of the proposed rule identifies specific criteria that must be met to enable these contractor costs to be reimbursed, the listed criteria are potentially inconsistent with the provisions of Section 833 and proposed DFARS clause 252.231.205-71(c)(1) – (3). In particular, the Discussion section indicates that the determination of allowability of these costs hinges on a two-part test: (1) the contractor has a DoD-approved operational

¹⁷ See, e.g., 19 C.F.R. Parts 133 and 151.

¹⁸ See, e.g., NASA procurement regulations supplement, 48 C.F.R. § 1800.

system¹⁹ or the electronic parts at issue were provided as government-furnished property; and (2) timely notice must be provided. By contrast, the statute and proposed DFARS clause 252.231.205-71(c)(1) –(3) provide a test that might be interpreted as a three-part test to be applied by DoD: (1) the contractor has a DoD-approved operational system; and (2) the parts at issue were provided as government-furnished property; and (3) timely notice must be provided. The Section believes that the proposed rule’s use of three subordinate clauses separated by semicolons, with the word “and” between the last two clauses, creates an ambiguity.²⁰ There is also a distinct potential that courts will interpret the word “and” between the second and third clauses as creating a conjunctive relationship, such that the test consists of three prongs, *all* of which must be satisfied.²¹ Accordingly, we recommend that DoD address these potential ambiguities in formulating its final rule. The Section further recommends that the regulations specify with as much precision as possible the line between allowable and unallowable costs, with “bright lines” for costs that will remain allowable because either the part is ultimately deemed not to be counterfeit, or the part is Government Furnished Equipment (“GFE”), or a safe harbor provision is applicable.

(c) Government’s Role

The Supplementary Information section states that the Government’s role in reviewing and monitoring the contractor’s counterfeit electronic parts compliance system will be addressed as part of a contractor’s purchasing system review. The Section believes that this limited role may be too narrow considering that the Government is required to take a risk-based approach to minimize the impact of counterfeit electronic parts or suspect electronic counterfeit parts under the direction of Section 818(b)(2).

¹⁹ Notably, the proposed rule does not define “Government-approved operational system.” The Section recommends that the regulation be revised to clarify whether this refers to the contractor’s counterfeit electronic parts avoidance program, purchasing system, quality system, or some combination of the contractor’s business systems.

²⁰ See *United States v. Clifford*, 197 F. Supp. 2d 516, 520 (E.D. Va. 2002) (finding that the use of the word “or” between the final two of three subordinate clauses “alone suggests that there is an ambiguity in whether the subjective clauses should be accorded the disjunctive interpretation or the conjunctive interpretation.”)

²¹ See *Nichols v. Nat’l Union Fire Ins. Co. of Pittsburgh, PA*, 509 F. Supp. 2d 752, 757-58 (W.D. Wis. 2007) (“It is common practice to omit conjunctive and disjunctive connectors (‘and’ and ‘or’) between all items in a series except the last two. The whole series assumes the conjunction or disjunction placed between the last two items in the series. Thus, ‘you must do A, B, and C’ means ‘you must do A and B and C.’”)

2. Executive Order Nos. 12866 and 13563

Section III of the Supplementary Information section of the proposed rule calls for an analysis of whether this is a significant regulatory action and whether it is a major rule under 5 U.S.C. § 804.

A major rule is one that “has resulted in or is likely to result in – (A) an annual effect on the economy of \$100,000,000 or more; (B) a major increase in cost or prices for consumers, individual industries, Federal, State, or local government agencies, or geographic regions; or (C) significant adverse effects on competition, employment, investment, productivity, innovation, or on the ability of United States-based enterprises to compete with foreign-based enterprises in domestic and export markets.”²² Given the Government’s estimate of the number of contractors that will be impacted by this rule, the Section believes that DoD should re-examine whether this rule would be a major rule. At the June 28, 2013 public meeting, the Government indicated that it believes 400 contractors will be impacted directly by the regulation, with a potential for expansion to contractors with flexibly-priced contracts that potentially will increase the number to 1200 impacted contractors. The Section believes that these figures may be understated as a result of the flowdown requirement to all subtiers, which would implicate tens of thousands of domestic and foreign companies in the DoD supply chain. Further, the proposed rule appears to expand the requirement to have acceptable purchasing systems beyond the current set of contractors subject to the purchasing system requirements in FAR Part 44. Each of these would impose significant increased costs of doing business for Government and industry, and impact U.S.-based enterprises in a number of areas identified in Section 804. For this reason, we believe DoD should consider revisiting whether this rule is a major one.

3. Regulatory Flexibility Act Analysis

The proposed rule states that DoD does not expect the proposed rule to have a significant economic impact on a substantial number of small entities because the rule will apply only to contracts that are subject to the Cost Accounting Standards (“CAS”), and small entities are exempt from CAS requirements at both prime contract and subcontract levels. The Section recommends that DoD revisit this conclusion in light of the flowdown requirements in the proposed regulations.²³

²² 5 U.S.C. § 804(2).

²³ If these requirements do not apply to small entities because they are exempt from CAS, the cost allowability provisions would be inequitably applied because the costs of replacement and re-work associated with counterfeit parts entering the DoD supply chain will be allowable if the DoD supplier is a small business or otherwise exempt from CAS (such as a commercial item supplier or a contractor that has accepted a contract subject to CAS but does not have a CAS trigger contract), but unallowable for those suppliers that are “covered contractors,” but which do not meet the standards necessary to take advantage of the safe harbor.

Regarding the impact on small businesses, DoD observes that there is “the *potential* for an impact on small entities in the supply chain of a prime contractor with contracts subject to CAS.”²⁴ This statement, however, may understate the impact of the proposed rule on small businesses. In particular, because covered contractors are required to flow down the counterfeit avoidance and detection requirements to subcontractors at every tier, it is likely that small business will be affected by the requirements of the proposed rule.

DoD also states: “The impact [on small entities] should be negligible as long as the small entity is not supplying counterfeit electronic parts to the prime contractor.”²⁵ The Section is concerned that DoD may not have considered the expenses a small entity – or *any* entity in the defense supply chain – must incur to ensure that it is *not* supplying counterfeit electronic parts. These expenses include increased training of personnel, enhancements to the entity’s purchasing, quality, and material management systems, and increased demands for indemnification for liability associated with the costs of investigating or remediating counterfeit or suspect counterfeit electronic parts that escape detection even under a rigorous anti-counterfeiting program. The potential impact is particularly significant because the regulation appears to impose a strict liability standard on covered contractors that effectively will be flowed down to their subcontractors at all tiers.

The Section believes, in short, that the proposed rule could require all affected companies to incur substantial overhead costs in establishing the necessary compliance systems, including small business concerns that may be several tiers below the CAS-covered prime contracts and that will certainly have a smaller base over which to distribute or recover those types of costs. Thus, the costs associated with establishing counterfeit electronic parts avoidance and detection systems could have a disproportionate impact on small businesses within the defense supply chain.

Moreover, small businesses may not be able to absorb unallowable costs or to provide the level of indemnification that higher-tier contractors or the Government may require. In this regard, the lack of a meaningful “safe harbor” provision in the proposed regulations may discourage small business participation in the defense supply chain.

Further, even if a small business is able to implement a robust, DoD-approved counterfeit electronic part avoidance and detection system, the small entity will have no protection from potentially enterprise-threatening liability if a counterfeit or suspect counterfeit part nevertheless “escapes” into the product delivered to DoD. In this regard, it is foreseeable that higher-tier companies covered by the strict liability provisions of the rule will flow down and likely demand indemnification from small

²⁴ 78 Fed. Reg. at 28,782 (emphasis added).

²⁵ *Id.*

businesses for potential rework/remediation liability. These costs could far exceed the economic value of the parts supplied.

If every purchase order presents potential significant liability for small businesses, many small businesses may opt out of the defense supply chain altogether. This would deprive DoD of the innovation and efficiencies small businesses have historically provided. An exodus of small businesses from the defense supply chain also would make it more difficult for DoD and large defense contractors to meet their congressionally-mandated small business goals, goals that reflect the importance of small businesses as engines of economic development and job growth. Indeed, the Section notes that DoD recognized the importance of small businesses in the defense supply chain in the Better Buying Power 1.0 initiative, citing a need to “[i]ncrease dynamic small business role in defense marketplace competition.”²⁶ In its Better Buying Power 2.0, DoD continues to recognize the importance of small business participation as a vehicle to innovate and produce cost savings and to direct that DoD “[i]ncrease small business roles and opportunities: Small businesses, as both prime contractors to the Department and sub-contractors within the supply chain, are effective sources of innovation and reduced cost. The Department will continue its emphasis on improving small business opportunities.”²⁷

Accordingly, the Section respectfully urges DoD to reconsider the impact these requirements may have on small business concerns within the defense supply chain. The Section further recommends that DoD carefully consider comments from small business concerns and industry groups regarding the impact of the proposed rule on small businesses in drafting the final rule so as to mitigate potentially negative effects on small businesses while still promoting Section 818’s broader goals of counterfeit electronic parts avoidance and detection.

²⁶ Memorandum to DoD Acquisition Professionals from Under Secretary of Defense (Acquisition, Technology and Logistics), “Better Buying Power,” at 10 (Sept. 14, 2010).

²⁷ Memorandum of Undersecretary of Defense (Acquisition, Technology & Logistics), “Better Buying Power 2.0: Continuing the Pursuit of Greater Efficiency and Productivity in Defense Spending,” at Attachment 2, Description of Initiatives (Nov. 13, 2012). In addition to these points, the Memorandum provides for DoD to:

Increase use of market research: This BBP 1.0 initiative requires additional work. We are establishing a market research portal to enhance market research and facilitate small business opportunities.

Increase small business participation: A number of steps in this area have been implemented; however, we believe that the increased use of small businesses in service contracting can be a source of additional cost saving and we will continue to emphasize the participation of small businesses in this area.

4. Paperwork Reduction Act Analysis

DoD estimates that 90 respondents annually will be impacted and that the rules, which apply to a contractor's purchasing system, will not impose additional information collection requirements. At the June 28, 2013 public meeting, by contrast, the Defense Contract Management Agency ("DCMA") noted that 400 large CAS covered contractors and a total of 1200 CAS or modified CAS covered contractors now are subject to Contractor Purchasing System Review ("CPSR") requirements and would be subject to audits to determine their compliance with the new DFARS counterfeit electronic parts detection and avoidance requirements as part of future CPSR audits.

Assuming that DoD's estimate (that 90 respondents annually will provide submissions to the Government) refers to submissions in response to CPSR audits, it could take over a decade to complete even the first round of enhanced CPSRs for the potential pool of 1200 covered contractors. If DCMA conducts 90 audits per year, DCMA may be unable to complete audits of all 1200 CAS and partial CAS covered contractors now subject to CPSR audits for a first-time audit of their counterfeit parts enhancements to the CPSR system. In addition, DoD's estimate does not appear to factor the cost and paperwork associated with the enhanced CPSRs for the other potentially impacted subcontractors, which could number in the tens of thousands. Furthermore, it does not appear to take into account the Government's benchmark rule that CPSRs are to be conducted every three years once the ACO has determined that a CPSR is necessary.²⁸ Accordingly, the Section recommends that DoD re-evaluate the Paperwork Reduction Act analysis.

D. Proposed Part 202

1. Introduction

Part 202, Definitions of Words and Terms, of the proposed rule contains a number of defined and undefined terms that should be clarified. The Section further recommends that DoD align the terms used in rules with other regulations and actions DoD will take to address counterfeit parts, including the yet-to-be released regulations that will govern reporting of suspect and confirmed counterfeit parts.

2. DoD Proposed Definition of "Counterfeit Part" and Related Terms

DoD has proposed to label a part as "counterfeit" if that part is:

- (1) An unauthorized copy or substitute part that has been identified, marked, and/or altered by a source

²⁸ FAR 44.302(b).

other than the part's legally authorized source and has been misrepresented to be from a legally authorized source;

- (2) An item misrepresented to be an authorized item of the legally authorized source; or
- (3) A new, used, outdated, or expired item from a legally authorized source that is misrepresented by any source to the end-user as meeting the performance requirements for the intended use.

The term "legally authorized source" is defined as:

Legally authorized source means the current design activity or the original manufacturer or a supplier authorized by the current design activity or the original manufacturer to produce an item.

A "suspect counterfeit part" is defined as:

Suspect counterfeit part means a part for which visual inspection, testing, or other information provide reason to believe that a part may be a counterfeit part.

DoD's proposed definitions of the operative terms are critical because Section 818(c)(2)(A) makes contractors subject to this rule responsible "for detecting and avoiding the use or inclusion of counterfeit electronic parts or suspect counterfeit electronic parts in such products and for any rework or corrective action that may be required to remedy the use or inclusion of such parts." Thus, many obligations that arise under the proposed rule turn on whether a part is a "counterfeit" or a "suspect counterfeit" electronic part, as these terms are defined. Because Section 818(c)(2)(B) provides that "the cost of counterfeit electronic parts and suspect counterfeit electronic parts and the cost of rework or corrective action that may be required to remedy the use or inclusion of such parts are not allowable costs under [DoD] contracts," these definitions may also have a cost impact. Reporting and quarantining obligations apply to "counterfeit parts and suspect counterfeit electronic parts" under Section 818(c)(4). Under Section 818(e)(2), contractors are obligated to improve systems to detect and avoid "counterfeit electronic parts and suspect counterfeit electronic parts." Under Section 818(b)(4), contractors are potentially exposed to suspension or debarment should they repeatedly fail "to detect and avoid counterfeit electronic parts."

For these reasons, the definitions of "counterfeit electronic part" and "suspect counterfeit electronic part" have overarching importance to the operation of the rule. The bullets below identify potential ambiguities in the definition. We believe the final

rule would benefit from a clarified definition of “counterfeit part” to address these issues.

- The definition omits any “intent” element such that inadvertent delivery of a counterfeit part by a bona fide source could give rise to liabilities and other obligations that should be limited to situations where there is evidence of intent to mislead, defraud or deceive.
- The definition may have an unintended effect to deter or preclude purchases from legitimate and responsible distributors and brokers who may become qualified to act as a “trusted supplier” (although the proposed DFARS rule does not define a “trusted supplier” or impose requirements on qualification or use), thus impairing competition and likely increasing prices.
- The definition treats as “counterfeit” parts that are genuine but which are out of specification or suffer from quality deficiencies; such instances may raise quality assurance or warranty issues, but the Section does not believe such parts should be defined as “counterfeit.”
- The definition introduces uncertainty regarding “legally authorized sources” and how such a determination is to be made. The final rule would benefit from further definition of what is a “legally authorized source” and how a “legally authorized source” is identified.
- The definition goes beyond the counterpart definition of “counterfeit materiel” in DoD Instruction (“DoDI”) 4140.67, “DoD Counterfeit Prevention Policy.”²⁹ Because these definitions are designed to achieve a common purpose, the Section recommends that DoD consider this DoDI in formulating a final rule.
- Aspects of the definitions are dependent on undefined terms.
- The definition does not conform to the current approach of relevant industry standards.

To address these issues, the Section suggests that DoD engage in further collaboration with industry and other government components to clarify the definition of “counterfeit parts.”³⁰ We further recommend that DoD coordinate this DFARS

²⁹ DoDI 4140.67, DoD Counterfeit Prevention Policy (April 26, 2013), available at: <http://www.dtic.mil/whs/directives/corres/pdf/414067p.pdf>.

³⁰ Although not part of the Section 818 requirements, the Section is aware that other agencies, such as NASA, have regulations addressing counterfeit parts. The use of common terms between and among the

rulemaking with other pending efforts to implement Section 818, including the pending FAR Cases noted above.

3. The Definitions Exclude Key Concepts and Could Lead to Undesired and Unintended Consequences

Fundamentally, the definition of a “counterfeit” part should align with the prevailing understanding of the word “counterfeit,” namely, as applied here, that an electronic part is “counterfeit” if it is an exact or approximate imitation of the original or authorized part with the intention to deceive or defraud. The proposed definition in the draft DFARS provision excludes the “intent element” except to the limited extent that a counterfeit is “misrepresented” to be from a legally authorized source, to be an authorized item of the legally authorized source, or to meet the performance requirements for the intended use. The term “misrepresented,” presents its own ambiguities, however, because it is unclear whether it requires a fraudulent intent or whether it also covers an innocent or inadvertent mischaracterization.

The Section recommends that DoD adopt the following definition of “counterfeit part”

“Counterfeit Part” means:

- (1) an unauthorized (a) copy, (b) imitation, (c) substitute, or (d) modified electronic part, which is knowingly or recklessly misrepresented by any source or supplier to any customer as a specified genuine electronic part of an authorized manufacturer; or
- (2) an electronic part which has been installed and operated in an end item, and is knowingly or recklessly misrepresented by any source or supplier to any customer.

First, the Section believes this recommended definition aligns with emerging industry standards.³¹ For example, part (1) of the proposed DFARS definition

DFARS and FAR and these other agencies would be useful to ensure a common understanding of measures to address counterfeit parts and improve efficiencies.

³¹ In fact, Title 18 of the United States Code criminalizes trafficking in all kinds of counterfeit goods or services, including counterfeit military goods or services. And, Section 2320 of Title 18 defines “counterfeit goods or services” as goods or services that bear a counterfeit mark. “Counterfeit mark” is defined as a *spurious mark* used on or in connection with trafficking in the goods, services, packaging or documentation, that is applied to or used in connection with the goods, services, packaging or documentation, for which the mark is registered with the U.S. Patent and Trademark Office (USPTO). The mark must be identical to or substantially indistinguishable from the mark registered with USPTO, the use of which is likely to cause confusion, mistake or to deceive. “Counterfeit military good or

corresponds to the definition of “counterfeit” in AS5553 as DoD originally approved it in August 2009.³² Since then, the organization responsible for this Standard, SAE, has proposed a revision, AS5553a, that uses a different definition. AS5553a now distinguishes among parts that are “suspect,” “fraudulent” and “counterfeit.”³³ The AS5553a definitions are more nuanced, less likely to include parts that were not produced with intent to defraud or deceive, and more likely to fulfill the purposes of the statute without avoidable disruptive effects. Thus, we believe they serve as an appropriate baseline for the proposed rule.

Second, the Section recommends that DoD review the use of the term “authorization” in the definition. The proposed DFARS definition emphasizes the “authorization” of a particular part – a concept absent from the proposed AS5553a definition. “Authorization,” however, invites and may require investigation into who had or retains the legal authority over the pedigree or provenance of a particular part. Such a requirement could be unduly burdensome. Because the essential characteristic of a “counterfeit” part is that it has been made or inserted or allowed into the supply chain with an intent to deceive the buyer or user into believing it is original or genuine, an investigation into “authorization” also appears unnecessary.

Third, the proposed DFARS definition of “legally authorized source” is also ambiguous. The DFARS rule describes a “legally authorized source” in connection with “the current design activity or the original manufacturer or a supplier authorized by the current design activity or the original manufacturer to produce an item.”³⁴ It is unclear, however, how or who is to determine whether a source is “legally authorized.”

service” is defined as a good or service that uses a counterfeit mark on or in connection therewith and is *falsely* identified or labeled as meeting military specifications or is intended for use in a military and national security application. 18 U.S.C. § 2320 (emphasis added).

³² Part (1) of the definition of the proposed rule states that an “unauthorized copy” is a “counterfeit part” but there is no accompanying definition of “unauthorized copy.” If this approach is retained, the rule should clarify the term. Does it mean identification as an approved source, for instance, on a source control drawing? Does it refer to contractual limitations in subcontracts, licenses, or dealership agreements? How does “legally” authorized differ from mere authorization? If the authorizing entity is empowered to sanction production, what is needed for it to do so “legally”? Where sources come into possession of original parts through legitimate purchase and sale transactions, may they supply a part for a particular usage without documentation of “authorization” from the original manufacturer or current design activity? What would be sufficient documentation? This latter question is significant because the proposed rule does not address gray market transactions.

³³ Under AS5553a, a “fraudulent part” is any suspect part misrepresented to the customer as meeting the customer’s requirements. This would include, for example, “previously used parts represented as new,” as addressed by Section 818(b)(2).

³⁴ Neither the term “current design activity” nor “original manufacturer” is defined. The proposed rule also does not identify how the design activity is appointed, or how a contractor can identify which is the “current” such activity. If these terms are used in the final regulation, the Section recommends that DoD define them.

Furthermore, the focus in the definition upon original design or manufacturing sources introduces ambiguity about the treatment of the millions of parts made by original component manufacturers that are in circulation worldwide and are purchased legally by responsible brokers and distributors. There is continuing demand for such parts, such as when there are no alternatives available from original sources or their authorized distributors. Therefore, the Section believes that greater clarity as to which entities are “legally authorized” as well as better definition of “trusted supplier” would enhance the clarity of the final rule.³⁵ We further believe the definition of “legally authorized source” should be sufficiently flexible to address the concerns raised in these comments.

Fourth, we believe the proposed DFARS definition could be clarified. Part (3) of DoD’s proposed definition treats as “counterfeit” a “new, used, outdated, or expired item from a legally authorized source that is misrepresented by any source to the end-user as meeting the performance requirements for the intended use.” Part (3) is potentially overbroad and could encompass any non-conforming parts – even new, unused, genuine parts from the OM – that are discovered to have a quality issue.³⁶ Such parts are not, however, “counterfeit.” Accordingly, the Section recommends that DoD adopt its proposed definition of “counterfeit part” in lieu of the definition set forth in the current proposed rule.

Section 818 was not intended to treat ordinary quality issues as a “counterfeit parts” concern. Such an interpretation runs the risk of disrupting the carefully-crafted system of quality assurance and interfere with the operation of contractual quality and warranty terms. Moreover, treating genuine, but nonconforming parts, as “counterfeit” raises additional concerns because “counterfeit” parts are subject to potential disallowance of replacement costs as well as of costs of investigation, repair and remediation.³⁷ Accordingly, the Section recommends that DoD consider the Section’s

³⁵ Section 818(c)(3) instructs industry to purchase electronic parts, “whenever possible,” from the preferred class of “original manufacturers,” their “authorized dealers,” or from “trusted suppliers” who obtain such parts exclusively from the original manufacturers or authorized dealers. Section 818(c)(3)(D) recognizes that there will be other sources of supply (referred to as “additional trusted suppliers”) because required parts will not always be available from the preferred class of “original manufacturers, “authorized dealers” or “trusted suppliers.” The proposed DFARS rule does not define or establish a process to qualify a “trusted supplier.” Accordingly, DoD should also define “trusted supplier.”

³⁶ For example, the non-conforming part may have been supplied with a certificate of conformance representing that it meets the performance requirements for the intended use. Indeed, it may be sufficient for the representation to be implicit, by shipment in the context of a contract with certain specific requirements, which is true of most parts.

³⁷ The third part of the definition of “counterfeit part” includes items that are “outdated” or “expired.” Neither attribute, however, means that a part is “counterfeit” in the sense that it is a fake, prepared with a fraudulent purpose, by someone other than the original or authorized source. Although it may violate a contract requirement, or even be fraud, to deliver a part that is “outdated” or “expired,” that does not necessarily mean that the part is a “counterfeit.” Moreover, the terms “outdated” and “expired” appear to

proposed revised definition, which we believe focuses more directly on the risk Congress directed DoD to address: non-genuine parts that are fraudulently altered or re-marked so that they can be passed off as something they are not.³⁸

In addition, the proposed DFARS definition, with three parts, goes beyond and differs from the definition of counterfeit materiel in DoDI 4140.67. The Section believes that DoD should strive for consistency, and apply to contractors the same definition of “counterfeit” that DoD applies internally. Although the Section, as noted, has reservations about part (1) of the proposed DFARS definition of a “counterfeit part,” it is largely consistent with the definition of “counterfeit materiel” in DoDI 4140.67. The proposed DFARS regulation, however, contains two additional categories of “counterfeit” parts. It is not clear why DoD believes that contractors should apply and be held accountable for significantly broader definitions of “counterfeit parts” and “suspect counterfeit parts” than DoD would apply to its internal counterfeit prevention policies. Accordingly, the Section recommends the revised definition of “counterfeit part” set forth above.

4. The Definition of “Suspect” Counterfeit Should Be Clarified

The proposed rule provides that a “suspect counterfeit part” is one “for which visual inspection, testing, or other information provide reason to believe that a part may be a counterfeit part.” Section 818 applies broadly both to “counterfeit electronic parts” and to “suspect counterfeit electronic parts.” Costs of “suspect,” as well as confirmed, counterfeit parts are unallowable. A “suspect” counterfeit part, the Section believes, should be one for which there is reasonable cause under the circumstances to believe a part is counterfeit, based on either (1) physical inspection of the part, or (2) credible evidence from other sources. As explained above, costs to remedy ordinary defects should not be disallowed because of mere suspicion or unsupported allegation that the part might be “counterfeit.” Ultimately, in most cases, a part that comes to be “suspect” of being a counterfeit will be determined either to be “counterfeit” or not. In the former case, consistent with the statute, the costs of replacement and of remedial activities are unallowable. If a part is a “suspect” counterfeit part, but its status cannot be resolved, then the costs also are unallowable under the statute. Where a “suspect” part proves *not* to be “counterfeit,” however, then the costs should be allowable. Conceivably, ordinary quality problems could emerge that are treated initially as “suspect” counterfeit parts but which, after investigation, are proven otherwise. Once a questioned part is not a “suspect” counterfeit part, Section 818 does not apply. We recommend that the rule follow this same application of Section 818. In addition, we believe that industry should have the authority, consistent with evolving industry standards, to make a

mean the same thing. For these additional reasons, we recommend that DoD consider revising the definition of “counterfeit part” as suggested in these comments.

³⁸ Section 818 instructed DoD that its definition of counterfeit electronic parts should include “previously used parts represented as new.” We believe our suggested definition of “counterfeit part” meets this intent.

determination whether a part is a “suspect” counterfeit part, and that the proposed rule should clarify the contractor’s role, any processes that should be followed, and the Government’s involvement and role.

In sum, given the great importance of definitions to the statutory and regulatory scheme, and the serious consequences of an item falling within the definition of a “counterfeit” electronic part or a “suspect” counterfeit electronic part, the Section believes that the final rule would be improved by greater clarification of these definitions (and the Section’s proposed definition of “counterfeit part”), reconciliation with industry standards, coordination with DoD’s internal definitions, and coordination with regulations, yet to be issued, that also will implement Section 818. We further recommend that given the complexities of this issue, DoD would benefit from issuing a revised proposed rule and soliciting additional public comment.

E. Proposed Part 246—Quality Assurance, Contractor Responsibilities for Avoidance and Detection of Counterfeit Electronic Parts or Suspect Counterfeit Electronic Parts

Under the proposed rule, contractors are required to establish and maintain an acceptable counterfeit parts detection and avoidance system. This is a key feature of the regulation as a failure to maintain an acceptable system may result in disapproval of the contractor’s purchasing system by the contracting officer and/or a withholding of payments.³⁹ The proposed rule lists nine minimum elements that a counterfeit parts detection and avoidance system must address. With regard to Element 1 (Training), Element 2 (Inspection and Testing), and Element 4 (Mechanisms to enable traceability of parts to suppliers), the Section encourages the drafters to continue what appears to be a conscious effort to avoid specifying a “one size fits all” approach to meeting the rule’s requirements and to continue to espouse rules that afford contractors flexibility to tailor their controls to their business and the counterfeit part risk that they may face. Comments on other elements are noted below.

1. Element (3): Processes to abolish counterfeit parts proliferation

The Section recognizes that this provision is taken directly from the statutory language in Section 818. Nonetheless, the Section believes that it is broadly understood that the risk and presence of counterfeit parts cannot be abolished in their entirety. Accordingly, it does not appear realistic to promulgate a zero-tolerance standard in which a contractor’s system must be able to abolish the risk of introduction of any counterfeit parts and thereby abolish counterfeit parts proliferation. Counterfeits have evolved to such an extent that even the most diligent, scrupulous inspection could still fail to identify every possible type of counterfeit. Moreover, different types of parts, and the varied uses of parts, may raise differing levels of risk and requirements for

³⁹ See Proposed DFARS 246.870-2.

processes to prevent counterfeit parts proliferation. The Section believes that the regulation or applicable DoD guidance should make clear that this element will be satisfied if a contractor has a system that meets applicable industry standards for detecting and avoiding based on a risk-based approach.

2. Element (5): Use and qualification of trusted suppliers

Section 818(c)(3)(A) of the FY 2013 NDAA directed DoD to issue regulations:

requir[ing] that, whenever possible, the Department and Department contractors at all tiers . . . obtain electronic parts that are in production or currently available from the original manufacturers of the parts or their authorized dealers, or from trusted suppliers who obtain such parts exclusively from the original manufacturers of the parts or their authorized dealers.

Section 818(c)(3)(A)(ii), 818(c)(3)(C), and 818(c)(3)(D) also require that the DoD establish its own trusted supplier program and provide that contractors, to obtain electronic parts that are not in production or currently available in stock, may establish their own trusted supplier programs.

The proposed rule's treatment of trusted suppliers, however, does not provide guidance concerning trusted suppliers beyond what Congress had already provided. DFARS clause 252.246-70XX also is unclear on contractor requirements for trusted supplier programs. Therefore, we believe that the rule should include guidance on what would need to be included in a trusted supplier program. Furthermore, under proposed DFARS 246.870-2(a), DoD would mandate that "[c]ontractors are required to establish and maintain an acceptable counterfeit electronic part avoidance and detection system. Failure to do so may result in disapproval of the purchasing system by the contracting officer and/or withholding of payments." Given the substantial remedies available to DoD – possible payment withholds for not having an "acceptable" system and unallowable costs relating to remedying counterfeit or suspect counterfeit parts delivered to the Government – we believe that more guidance is needed as to those attributes that would make an avoidance and detection system "acceptable."

Issuance of DoD's specific guidance to contractors at this juncture, before the rule goes into effect, is important to the success of the regulatory scheme. There are thousands of deployed DoD systems that require parts for sustainment but for which there is no supply availability from the original sources anymore. The rule requires industry to avoid counterfeits, even though it has no choice but to purchase from sources other than a "legally authorized source" parts that are no longer in production. Since industry will need to use other sources to procure these essential parts from entities that are in some way determined to be "trusted suppliers," a dialogue and

guidance on what will be deemed sufficient for an acceptable detection and avoidance system is imperative.

Section 818(c)(3)(D)(i)-(iii) also directed that DoD develop and implement regulations to “authorize Department contractors and subcontractors to identify and use additional trusted suppliers” subject to a number of key provisos, namely that (1) “the standards and processes for identifying such trusted suppliers comply with established industry standards,” (2) the contractor/subcontractor “assumes responsibility” for the authenticity of parts provided by these suppliers, and (3) the selection of the supplier remains subject to DoD review and audit. The Section appreciates that DoD is cognizant of the many industry standards that might shed light on the counterfeit electronic parts problem. DoD is properly sensitive to the fact that such standards are often highly specialized and tailored to a particular market segment, making them of less use to other market segments. DoD may fairly desire to avoid imposing a “one size fits all” solution in regulatory guidance that may prove unworkable depending on the particular market segment impacted.

Nevertheless, industry would benefit from DoD guidance on identifying and qualifying additional trusted suppliers.⁴⁰ In general, the Section believes that Congress intended that a “trusted supplier” should be one that can demonstrate that it has processes in place to evidence traceability to the OM or its authorized distributor chain. DoD’s guidance in this area is needed to ensure that industry can establish counterfeit parts prevention programs that meet DoD requirements. Further, such guidance would better assure predictability and consistency for contractors implementing or modifying their trusted supplier programs. Given the importance to both Government and industry of addressing this matter, the Section urges DoD to work in collaboration with industry to define the characteristics of an appropriate “trusted supplier” program and provide additional guidance. Moreover, because of the significance of this change to the purchasing system requirements (or as suggested in these comments, in a new counterfeit part detection and avoidance system), any standards imposed by DoD related to trusted suppliers should be subject to notice and comment by industry and part of a unified regulatory approach contemporaneous with a consideration of all of the FAR and DFARS cases addressing counterfeit parts matters.

We urge DoD to work with industry in a dialogue to establish the appropriate framework for addressing the issues associated with identifying, avoiding and mitigating counterfeit parts. In this regard, the Section believes it would be useful for

⁴⁰ Indeed, such guidance, before the rule goes into effect, would assist the success of the regulatory scheme. There are thousands of deployed DoD systems that require parts for sustainment but for which there is no longer supply availability from the original source. The rule requires industry to avoid counterfeits, but for parts that are no longer in production, a contractor may have no choice but to purchase from sources that are not “legally authorized source.” Because industry will need to use other sources to procure these essential parts from entities that are determined to be “trusted suppliers,” a dialogue and guidance on what will be deemed sufficient for an acceptable detection and avoidance system is imperative.

DoD to spearhead a working group with industry in order to seek to reach consensus regarding the appropriate requirements prior to implementation of final counterfeit part rules. Alternatively, we suggest that DoD refrain from establishing criteria that may differ from industry standards. Rather, we believe that DoD should strive for a counterfeit part prevention program that comports with applicable industry standards and also meets DoD program requirements and requirements for establishing trusted suppliers.

3. Element (6): Reporting and quarantining of counterfeit electronic parts and suspect counterfeiting parts.

A robust reporting process and Government-industry data exchange system represent critical, necessarily integrated tools in the anti-counterfeit efforts. For this reason, Section 818(c)(4), (5), and (e)(2)(a)(vi) directed revision of the DFARS to address reporting requirements, reporting methods, and reporting related civil liability protections. With respect to reporting, Section 818 envisioned that DoD would: (1) require covered contractors to report and quarantine counterfeit and suspect counterfeit electronic parts; (2) designate “appropriate Government authorities” to receive counterfeit parts reports; (3) designate a Government-Industry Data Exchange Program or “a similar program” to collect and disseminate counterfeit and suspect counterfeit parts reports to Government and industry; and (4) construct the civil liability safe harbor needed to permit robust reporting of counterfeit and suspect counterfeit parts.

The proposed rule addresses only the reporting issue, in part, and defers critical reporting issues and direction to other rulemaking efforts (e.g., FAR Case 2013-002 Expanding Reporting of Nonconforming Supplies) and perhaps later implementation. The issue of counterfeit reporting, however, does not appear to be readily separated into parts, and a multi-stage approach to reporting regulations may frustrate, not further, the collective anti-counterfeit goals of Government and industry by creating confusion and wasting resources. For instance, the proposed rule directs that contractors’ counterfeit compliance systems address “reporting and quarantining of counterfeit parts,” but the proposed rule does not address the level of reporting detail DoD expects or to whom at DoD or elsewhere the contractor (or subcontractor) should report. This lack of definition could render Section 818’s liability “safe harbor” uncertain. Moreover, without an integrated rulemaking as contemplated by Section 818, contractors may be faced with revising their compliance systems to address proposed DFARS 246.870-2 and 252.246-70XX and then revising them again (and retraining their employees) to address later reporting requirements from FAR Case 2013-002 or other pending related rulemakings.

Reporting requirements (both for the Government and the contractor) represent a critical feature of Section 818 to aid in the reduction of counterfeits entering the defense supply chain. The Section recommends, therefore, that DoD refrain from issuing partial reporting requirements that could create unnecessary and unintended cost, expense and risk.

F. Proposed DFARS Part 231--Contract Cost Principles and Procedures.

The Section fully supports DoD's intent to eliminate counterfeit electronic parts from the DoD supply chain. The Section believes, however, that while the proposed rule may make progress towards that goal, it likely will have material negative effects, particularly in the areas of increased costs. We believe these risks can be mitigated by aligning the proposed rules more closely with the enabling statute and existing statutes, regulations, and case law. As noted above, the Section recommends that the regulations identify with as much precision as possible the line between allowable and unallowable costs.

1. Cost Allowability and Proposed Penalties For "Expressly" Unallowable Costs

(a) The Proposed Rule Should Not Make Otherwise Allowable Rework Costs Unallowable

The proposed rule provides that the costs for rework or corrective action associated with suspect counterfeit electronic parts are "expressly" unallowable regardless whether the parts are, in fact, counterfeit. This portion of the proposed rule is inconsistent with the language of the enabling statute and existing regulations. In particular, costs associated with rework are generally allowable costs under the FAR.⁴¹ Furthermore, Section 818 only requires that contractors charge rework costs as unallowable costs when rework is "required to remedy" the use of a counterfeit or suspect counterfeit part. In the event that a suspect counterfeit electronic part proves to be a genuine part, there is no issue that requires remedy. As noted above, the Section believes that the rule should permit contractors to treat the associated costs as allowable in accordance with existing regulations.

As noted above, the proposed rule appears to treat certain nonconforming parts as "counterfeit" parts. Although contractors traditionally may treat rework costs associated with a nonconforming part as allowable costs, under the proposed rule, such costs would not only be unallowable, but would be subject to penalty as they have been identified in the proposed regulation as being "expressly" unallowable costs. As noted above, the Section recommends that DoD revise the definition of "counterfeit part." Alternatively, the Section recommends that the drafters modify part (3) to require that a legally-authorized source intentionally misrepresent the authenticity of the part for the part to be considered counterfeit. This will ensure that the rule does not have the unintended consequences of rendering common rework costs unallowable.

(b) Costs Associated with Counterfeit Electronic Parts Should Not Be "Expressly" Unallowable Costs Subject to Penalty.

⁴¹ See, e.g., FAR 52.246-3(f).

The proposed rule adds a new subsection, DFARS 231.205-71(c), that would make certain costs associated with counterfeit or suspect counterfeit electronic parts, including required rework costs, “expressly unallowable.” The distinction between an unallowable cost and an “expressly unallowable” cost is important because “expressly unallowable” costs are subject to penalties equal to the amount of the “expressly unallowable” costs submitted for reimbursement.⁴² The Section recommends that DoD remove the term “expressly” from the proposed rule because neither Section 818 nor Section 833 identifies these costs as “expressly unallowable” costs, a specific term of art that triggers penalties under the existing regulatory framework.⁴³

Specifically, Section 818 provides that “the cost of counterfeit electronic parts and suspect counterfeit electronic parts and the cost of rework or corrective action that may be required to remedy the use or inclusion of such parts are not *allowable* costs” (emphasis added). Section 818 does not make such costs “expressly unallowable.” Nor does Section 818 elsewhere provide for, or make reference to, penalties for submission of unallowable costs.

By changing the term “unallowable” (as used in Section 818 and 833) to “expressly unallowable” in the proposed rule, DoD has created penalty liability that Congress arguably did not direct in the enabling statute. In the context of regulatory action, we respectfully contend that DoD should not create additional liability in the form of penalties where Congress did not expressly direct it to do so.⁴⁴

Further, the proposed rule conflicts with existing statutes and regulations that define an “expressly unallowable” cost as a cost that is unmistakably unallowable. Both the FAR and CAS define an “expressly unallowable cost” as “a particular item or type of cost which, under the express provisions of an applicable law, regulation, or contract, is specifically named and stated to be unallowable.”⁴⁵ Preamble A to CAS 405 explains that “the [CAS] Board, in its definition of an ‘expressly unallowable cost,’ has used the term ‘expressly’ in the broad dictionary sense — that which is direct or unmistakable terms.”⁴⁶ For example, a contractor may never treat alcohol costs as allowable and alcohol costs are, therefore, expressly unallowable.⁴⁷

The proposed rule is contrary to this definition because it would impose penalties in situations where it may not be clear whether a contractor must treat certain costs associated with parts, rework, or replacement of parts as unallowable at the time of cost submission. For example, in some circumstances, the contractor may determine that parts received from a supplier are counterfeit only after the contractor has invoiced the associated costs to the Government. Similarly, a contractor may not know when a

⁴² See FAR 42.709, 52.242-3; 10 U.S.C. §2324(b); 48 C.F.R. § 9904.405.

⁴³ See, e.g., FAR 42.709-1.

⁴⁴ *Id.*

⁴⁵ FAR 31.001; 48 C.F.R. § 9904.405-30(a)(2).

⁴⁶ 38 Fed. Reg. 24,195 (Sept. 6, 1973).

⁴⁷ FAR 31.205-51.

nonconformity or other issue occurs whether the part at issue is, in fact, a counterfeit or suspect counterfeit electronic part. In such cases, where it is not “clear beyond cavil” that the costs are unallowable, the costs, even if unallowable, are not “expressly unallowable” and should not be subject to penalty. Thus, because the proposed rule would impose penalties on costs that are not “expressly unallowable” as that term is defined in existing statutes, regulations and case law, the Section recommends that DoD revise the proposed rule to remove the term “expressly” unallowable cost.⁴⁸

Finally, even under the proposed rule’s narrow safe harbor exception, a contractor, in certain circumstances, may treat costs associated with a counterfeit part as allowable. Case law establishes that costs that are allowable in some circumstances, but unallowable in other others, are not “expressly unallowable.” Consequently, even if the costs are unallowable, they are not “expressly unallowable” and may not be subject to penalty. For all these reasons, the Section recommends that DoD remove the term “expressly” unallowable from DFARS 231.205-71(c) in any final rule.

2. The Proposed Counterfeit Part Cost Allowability Provision Should Be Expressly Limited to CAS-Covered Contracts.

Section 818(c)(2) and (f)(1) require DoD to implement rules intended to eliminate counterfeit electronic parts under “covered contracts,” which are defined as CAS-covered contracts. Consistent with these provisions, the proposed rule requires inclusion of the contract clause at DFARS 252.246-70XX in CAS-covered contracts only. Nonetheless, there is no similar limitation on the applicability of the proposed cost principle contained in DFARS 231.205-71(c), which renders certain costs associated with counterfeit and suspect counterfeit electronic parts expressly unallowable. Thus, although the term “covered contractor” appears in DFARS 231.205-71(c), in addition to recommending the removal of the term “expressly,” the Section recommends that DoD clarify that the cost principle contained in the proposed rule applies only to CAS-covered contracts.

3. The Proposed Rule Would Apply to More Than Just CAS-Covered Contracts Mandated by Section 818.

Although Section 818 requires that DoD implement regulations addressing counterfeit electronic parts under CAS-covered contracts, the proposed rule appears to reach beyond CAS-covered contracts. Specifically, the proposed rule implements Section 818 primarily through new requirements relating to contractor purchasing systems. As a result, under the proposed rule, any contractor subject to the DFARS

⁴⁸ Moreover, as noted above, the proposed rule would impose penalties on costs associated with rework of suspect counterfeit electronic parts, regardless of whether the parts actually are counterfeit. Thus, contractors could be penalized for invoicing costs associated with a genuine part that the contractor incorrectly suspected to be counterfeit. Such penalties find no basis in the enabling statute and are contrary to existing law and regulation.

Business Systems Rule⁴⁹ and performing CAS-covered contracts containing the proposed counterfeit electronic parts clause will need to implement the proposed rule by making changes to its purchasing system. Short of maintaining two purchasing systems, such contractors will be required to use their purchasing system, including functions relating to the detection and avoidance of counterfeit electronic parts, on all contracts. Consequently, the proposed rule effectively applies DoD's proposed counterfeit electronic parts requirements to more than just CAS-covered contracts. The Section believes that such application could significantly increase contractor costs of performance in all contracts and was not specifically identified in the authorizing legislation. The Section therefore suggests that DoD reconsider the reach of this proposed implementation method to ensure that it does not extend beyond CAS-covered contracts. We also encourage DoD to clarify exactly which contractors will be subject to the new purchasing system requirements.

4. The Drafters Should Consider The Continuing Evolution of Counterfeit Parts Requirements.

A key component to implementation of any proposed rule addressing detection and avoidance of counterfeit electronic parts is inclusion of an appropriate safe harbor provision. The proposed rule includes a safe harbor that would enable contractors to claim, as a reimbursable cost under DoD contracts, the cost of counterfeit or suspect counterfeit electronic parts, or the cost of rework or corrective action that may be required only where: (1) the contractor has an approved system to detect and avoid counterfeit parts; (2) the counterfeit or suspect counterfeit electronic parts were provided as government-furnished property as defined in FAR 45.101; and (3) the contractor provides timely notice to the Government. This provision implements the modification to Section 818 made in Section 833 of the FY 2013 NDAA.

The proposed rule is not clear how this safe harbor will be implemented. The Background section of the proposed rule indicates that rework costs will be allowable in either of two circumstances: (1) the contractor has an approved business system and provides proper notice; *or* (2) the counterfeit parts were provided as government-furnished property *and* the contractor provides proper notice. Nevertheless, in the proposed cost principle at DFARS § 231.205-71(c), such costs would be allowable *only if* the contractor has an approved system, the counterfeit parts at issue were government-furnished property *and* the contractor provides proper notice. The Section recommends that DoD clarify this discrepancy.

Regardless, the safe harbor provision, as drafted, appears to omit potential government responsibility for counterfeit electronic parts. For example, it appears that the proposed rule would disallow, and provide for penalties for, costs associated with counterfeit parts provided by the Government as government-furnished property ("GFP") if the contractor does not have an approved system or does not provide proper

⁴⁹ See 77 Fed. Reg. 11355 (Feb. 23, 2012).

notice. The Section does not believe that the Government should hold contractors responsible for counterfeit electronic parts that the Government provides, particularly because contractors have no control over the Government's direct acquisition of supplies from third-parties. Further, as noted above, contractors that have not had the benefit of a contractor purchasing system review approving the contractor's system will be unable to avail themselves of the safe harbor.

Congress currently is considering a broader safe harbor provision. Specifically, the House Armed Services Committee's version of the NDAA for FY 2014, Sections 811 and 812, would significantly broaden the current safe harbor provision in Section 833 of the FY 2013 NDAA to allow contractors to bill for costs associated with replacing counterfeit electronic parts or suspect counterfeit electronic parts that were "procured from an original manufacturer or its authorized dealer, or from a trusted supplier." The Section encourages DoD to consider the fact that Congress continues to explore legislation in this area as it formulates its final rules.

G. Proposed Part 244—Subcontracting Policies and Procedures

The proposed revisions to DFARS Part 244, which governs subcontracting policies and procedures, would amend DFARS 244.303 to provide for an adequacy review of the contractor's counterfeit electronic part avoidance and detection system. The new proposed DFARS contract clauses at 252.244-7001 and 252.246-70XX would impose both broad prime contractor level anti-counterfeit purchasing system requirements and potentially uncertain subcontractor flowdown requirements. The comments that follow address integration issues that these provisions present.

1. The Section Recommends that DoD Refrain from Integrating Counterfeit Compliance Requirements into the Existing DFARS Purchasing System Provisions

The proposed rule adds DoD's counterfeit compliance requirements into the existing DFARS purchasing system provisions. At the June 28, 2013 public meeting, the DAR Council representative indicated that DoD proposed to add the counterfeit compliance system requirements to the existing contractor purchasing system provisions for efficiency and economy purposes. For the reasons below, the Section suggests that DoD reconsider this consolidation approach.

First, the purchasing system integration approach likely will delay and may deny the availability of the safe harbor to many contractors. A contractor only has access to rule's safe harbor if DoD has reviewed and approved the contractor's anti-counterfeit systems.⁵⁰ This effectively means that only those contractors which have a completed, successful CPSR may avail themselves of the safe harbor. DoD's CPSR processes have

⁵⁰ DFARS 231.205-71(c)(1).

suffered widespread delays due to budget issues and conflicting audit priorities. These delays may render the safe harbor illusory for many contractors.⁵¹

Second, the proposed rule contains an Alternate I provision for those entities that do not have the 52.244-2 Subcontracts clause in the contract. This alternate could expand the scope of the requirement that a “covered contractor” have an approved counterfeit detection and avoidance system to a requirement that such contractors also have an approved CPSR.⁵² The Section suggests that the proposed rule should be revised to clearly state DFARS 244.304-7001, Alt 1, subparagraph (b) does not expand the scope of the CPSR. Alternatively, DoD should re-visit the view that the counterfeit electronic parts audit program will be incorporated into the current business system rule audit and CPSR requirements.

Third, as presently drafted, contractor obligations with respect to flowdown requirements are ambiguous. DFARS 252.244-7001(c)(19) states the contractor’s purchasing system must:

Establish and maintain policies and procedures to ensure purchase orders and subcontracts contain mandatory and applicable flowdown clauses, as required by the FAR and DFARS, including terms and conditions required by the prime contract and any clauses required to carry out the requirements of the prime contract, including the requirements of 252.246-70XX, Contractor Counterfeit Electronic Part Avoidance and Detection System; ...

See also Proposed Rule at DFARS 252.244-7001(c)(1) (Alternate I).

This language could be read as requiring that DFARS 252.246-70XX be included in subcontracts, although the clause itself contains no flowdown language. The Section believes that DFARS 252.244-7001 should not include specific references to flowdown clauses because no other clauses are addressed this way, and in any event, it would be more appropriate to give contractors flexibility to fashion the specific

⁵¹ Further, CPSRs are conducted only on certain large contractors, and they are not done frequently enough to give a contractor the opportunity to demonstrate the adequacy of its counterfeit parts controls. CPSRs are generally performed only on contractors with annual sales of non-commercial items sales in excess of \$25 million (excluding contracts awarded on a competitive basis). FAR 44.302(a). When CPSRs are required, they are performed on a three-year or more infrequent basis. FAR 44.302(b). Because of government budget and manpower issues, it is not unusual for CPSRs to be delayed. Also, because the government uses a risk-based approach to selecting contractors for conducting CPSRs, contractors with low risk systems are less likely to receive more frequent CPSR’s. Given that a safe harbor is available only where, among other things, the contractor has “an operational system to detect and avoid counterfeit parts and suspect counterfeit electronic parts that has been reviewed and approved by DoD pursuant to 244.303,” this effectively means that only those contractors that have had a CPSR will be able to avail themselves of the safe harbor.” Proposed Rule at DFARS 231-205-71(c)(1).

⁵² *See, e.g.*, Proposed Rule at DFARS 244.304-7001, Alt. 1 and DFARS 244.305-71(b).

language for their flowdown provisions to address counterfeit parts matters. DFARS 252.246-70XX effectively does this by requiring the contractor to “address flow down of counterfeit avoidance and detection requirements to subcontractors” without specifically mandating the inclusion of the clause itself. Thus, the Section suggests that the rule would be improved by deleting the language in DFARS 252.244-7001 regarding flowdown and maintaining the language in DFARS 252.246-70XX regarding flowdown, to permit contractors and subcontractors to determine the appropriate flowdown language needed for their specific lower-tier subcontracts.

Although contractor purchasing systems are undoubtedly an aspect of a contractor’s counterfeit parts detection and mitigation controls, other aspects of a contractor’s management and compliance controls, including program management, engineering, contracts, and quality controls also play an important role in addressing counterfeit parts. Accordingly, we recommend that contractor counterfeit parts compliance and its criteria be made a separate program much like the Ethics Compliance Program was set up as a separate program. Adopting this approach accomplishes the legislative intent of Section 818 without disrupting the existing purchasing system criteria. If DoD decides to integrate the counterfeit parts compliance program into the purchasing system rules, the Section recommends that DoD clarify that a significant deficiency in either the purchasing system as a whole or in the counterfeit parts compliance system criteria of the purchasing system can only result in a maximum total withholding amount of five percent.

2. The Proposed Rule’s Flowdown Provisions Should be Narrowed

Although the proposed rule states that it only applies to contractors with relevant CAS-covered contracts, the impact will likely extend beyond prime, CAS-covered contractors. Specifically, the proposed amendments to DFARS 252.244-7001 suggest that DoD will require the flowdown of compliance requirements to subcontractors whenever necessary for the covered prime contractor to carry out the heightened requirements of the prime contract “including the requirements of 252.246-7006.” These proposed flowdown provisions broaden the impact of the rule to subcontractors of all sizes throughout the electronic parts supply chain, beyond Section 818’s CAS-coverage requirements.

3. The Rule Would Be Improved By Addressing Grandfathering Provisions To Permit Contractors (and Subcontractors) To Be Eligible for the Safe Harbor’s Protections

The proposed safe harbor rules require that an approved counterfeit detection and avoidance system be in place in order for a contractor (and potentially a subcontractor if that is a flowdown requirement) to be eligible to take advantage of the safe harbor in the event of a counterfeit or suspect counterfeit incident. Absent a “grandfathering” mechanism, the Section is concerned about the availability of a safe

harbor to contractors pending the establishment and formal government review and approval of a system deemed acceptable for counterfeit detection and avoidance. Without a “grandfathering” mechanism, contractors that do not have pre-approved systems – even if they have current purchasing systems that have been approved or they have counterfeit avoidance and detection systems that have never been audited – are at risk of being deprived of a safe harbor because the Government has not conducted a review and formally approved that system. Therefore, the Section recommends that DoD establish some form of grandfathering mechanism or interim approval until an audit of the actual counterfeit detection and avoidance system is conducted and approved. In determining the appropriate grandfathering mechanism, the Section suggests further review and discussion with the public and industry to develop a workable solution to the issue.

4. Government-Approved Subcontractors

FAR 52.244-2, Subcontracts, where included in a contract, typically may contain provisions regarding the Government’s express approval of identified subcontractors. The Section suggests that DoD consider the impact of this rule on these identified subcontractors. For example, such approved subcontractors might be deemed “trusted” suppliers where the Government has approved use of these entities as suppliers on the particular contract/program.

5. Government Role in Detection and Avoidance

Aside from an audit requirement, the proposed rule is silent regarding the role that Government plays in the detection and avoidance of counterfeit parts. In order to understand how all the pieces of the counterfeit part avoidance and detection scheme will work, the Section urges DoD to address the other roles that Government will play in this arena, including the role of Government in establishing quality product lists, supplying GFE, directing subcontractors, as well as reporting.

(a) Directed suppliers GFE

The safe harbor provisions provide for a safe harbor where the Government furnishes equipment or parts. Nonetheless, the proposed rule does not address how this relates to existing provisions regarding Government furnished equipment, information and material (“GFE”). For example, if the Government provides counterfeit or suspect counterfeit GFE, it is not clear if this would be considered a breach of the agreements under which the Government supplies such GFE. The proposed rule also does not address the remedies available to a contractor and its subcontractors where counterfeit GFE enters the supply chain. Furthermore, the rule is unclear on whether a safe harbor will be provided to contractors where the Government directs the contractor to buy from a designated supplier or whether designated suppliers will be treated similarly to GFE. The Section believes that these are important issues implicating bidding, performance,

available remedies, and safe harbors. The Section urges DoD to clarify these points in formulating any final rule.

(b) Directed Suppliers – Qualified Parts Providers

In addition to the foregoing, major weapon systems, equipment and components require the establishment of Bills of Material (“BOMs”). These BOMs not only identify the components that comprise the system, but also identify the qualified suppliers to furnish those components. Changing parts or suppliers from an approved BOM and qualified supplier list is time consuming and costly. Moreover, it is necessary to obtain Government inspection and approval of these changes. Given increased requirements for supply chain provenance, the Section believes that the Government should address how these situations are to be handled, and who will need to absorb the costs associated with accepting these risks, finding alternate suppliers, or qualifying new parts or suppliers.

H. Contract Clause and Exemptions

Proposed DFARS 246.870-3 provides that except for “contracts with educational institutions, Federally Funded Research and Development Centers (‘FFRDCs’), or University Associated Research Centers (‘UARCs’) operated by educational institutions,” the new clause on contractor counterfeit electronic part avoidance and detection system will be used when procuring electronic parts or an end item, component, part, or material containing electronic parts or services where the contractor will supply electronic components, parts, or materials as part of the service and the resulting contract will be subject to the CAS under 41 U.S.C. chapter 15, as implemented in the CAS regulations found at 48 C.F.R. 9903.201-1. The statute does not carve out any of the institutions listed in this provision as exempt from the counterfeit parts strictures. The proposed rule does not sufficiently explain why DoD exempted these institutions and whether these entities are exempt from the rule even if they are subcontractors to CAS-covered contractors who have contracts with these clauses in them. As noted above, the flowdown requirement of the proposed rule does not contain clear explanation of the provisions to be flowed down. With respect to these institutions, clarification is even more necessary.

I. Part 252 – Solicitation Provisions and Contract Clauses

Additionally, proposed clauses 252.244-7001 and Alternate I, and 252.246-70XX, do not include requirements for tracking the provenance of the items purchased in the definition of purchasing system. As noted previously, the Section supports keeping the CPSR separate from a system for detection and avoidance of counterfeit parts. The Section recommends revising these clauses to reflect changes in the other portions of the proposed regulations in light of these and other comments contained herein.

Moreover, the clauses do not make clear that a “significant deficiency” in a counterfeit system should not result in the imposition of a withhold in addition to any withholds due to such significant deficiency findings in the CPSR system audit. At a minimum, the Section urges DoD to clarify this portion of the proposed rule to make clear to contractors and the Government how the business system withhold terms will be used in the counterfeit part detection and avoidance system reviews.

J. Standards

The Section agrees with the statements made by Government representatives at the public meeting regarding the proposed regulations advocating that the rules for implementation of a detection and avoidance system and contract requirements should be tailored during the procurement process to address the specific risks associated with potential of counterfeits for that particular procurement and identify the appropriate industry standard or standards to be applied based on, for example, the standards of the particular industry involved in such procurement. A key component of the implementation of these requirements is how the applicable standard will be identified and what will be required by the Government for a particular procurement/contract. The rule is silent on who will decide which standard(s) to employ. For example, it is not clear if the Government will determine the standard that will apply to a particular procurement/contract or if a contractor may be permitted to propose its own standard. It is also unclear what standards will apply to any lower tier subcontractors. The Section believes that DoD should consider these questions, as well as questions regarding how to select the appropriate standard when there may be multiple standards to choose from, in this rulemaking process. The Section also suggests that, prior to implementing a final rule, DoD engage in a dialogue with industry to address the practical and pragmatic concerns of associated with identifying or adopting a given industry or government standard or the selection of the appropriate standard(s) that contractors may be required to meet in performing DoD for contracts and subcontracts. The Section recommends this course because industry standards on counterfeit parts currently vary, even these standards continue to evolve in response to industry advances, requirements and applicable regulations, and there is risk that procurements involving the same part could specify different standards, which may increase the risks of administrative confusion, noncompliance, and potential liability.

K. Commercial Items

The Senate Armed Services Committee intended that DoD address the treatment of commercial items as part of the Section 818 rulemaking.⁵³ Nevertheless, the

⁵³ S. Rep. 112-173, 112 Cong. 2d Sess. (June 4, 2012) (Senate Report providing in pertinent part:

The committee expects the DOD to implement these requirements quickly and aggressively. At the same time, however, the committee is aware of a number of complex issues that must be addressed. For example, which requirements of section 818 apply only to “covered contractors”—contractors who are subject to the cost accounting standards—and which

proposed rule does not mention commercial items nor does it make reference to Title VIII, Federal Acquisition Streamlining Act of 1994 (FASA) (Pub. L. 103-355, Oct 13, 1994, codified at 41 U.S.C. § 1906). Title 41 U.S.C. §1906(b)(2) requires that laws enacted after October 13, 1994, to apply to commercial items, must reference 41 U.S.C. §1906 or a determination must be made by the Federal Acquisition Regulatory Council that “it would not be in the best interest of the Federal Government to exempt contracts for the procurement of commercial items from the applicability of the provision.” The proposed rule does not contain a determination by the DAR Council that it would not be the best interests of the Government to exempt the procurement of commercial items from the applicability of Section 818. Accordingly, as a matter of statutory and regulatory construction, Section 818 and the proposed rule do not apply to commercial items. While appropriate application of the law and rules of construction make it clear that the proposed rule does not apply to commercial items, the Section believes the rule should so state to avoid confusion. Additionally, the DAR Council should ensure that other provisions of the proposed rule do not contradict this specifically intended exclusion of commercial items.

In the event that the DAR Council were to consider asking the FAR Council to make a determination that Section 818 ought to apply to commercial items, the public should be given the opportunity to review and comment on the proposed determination.

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,



Mark D. Colley
Chair, Section of Public Contract
Law

requirements apply more broadly? To what extent should suppliers of commercial, off-the-shelf end items be excluded from coverage pursuant to the authority of section 1907 of title 41, United States Code? Should the provision disallowing costs of rework or corrective action that may be required to remedy the use or inclusion of counterfeit parts apply to parts that are supplied to contractors as government-furnished equipment? The committee encourages DOD to solicit the views of both independent experts and interested parties—including representatives of original equipment manufacturers, DOD prime contractors, and lower-tier contractors in affected industries—as it works to address these and other implementation issues.

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