

MAY 17, 2013

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GOVERNMENT CONTRACTS CLIENT ALERT

DEPARTMENT OF DEFENSE PUBLISHES PROPOSED RULE ON COUNTERFEIT ELECTRONICS

The Department of Defense (“DOD”) is proposing to amend the Defense Federal Acquisition Regulation Supplement (“DFARS”) to implement sections of the 2012 and 2013 National Defense Authorization Acts (“NDAA”).

The 2012 NDAA required the DOD to eliminate counterfeit electronics from its supply chain through regulations that would shift liability for replacing counterfeits to contractors. After the DOD missed its October 2012 deadline for publishing the regulations, the 2013 NDAA made further changes to the law, including the provision of a safe harbor for contractors who provided early warning about potential counterfeits and had DOD-approved testing systems.

The intent of the amendments is to hold contractors responsible for detecting and avoiding the use or inclusion of counterfeit electronic parts or suspect counterfeit electronic parts. Key changes to the DFARS, as reflected in the proposed rule published in the Federal Register on Thursday, May 16, include:

- new or expanded definitions of “electronic part”, “counterfeit electronic part”, “suspect counterfeit electronic part”, “covered contractor” and “legally authorized source”;
- the addition of a requirement for compliance with the rules for identifying, avoiding, and reporting counterfeit parts to the existing requirements for a contractor’s purchasing system; and
- the determination that the costs of counterfeit electronic parts or suspect counterfeit electronic parts, or the cost of rework or corrective action that may be required to remedy the use or inclusion of such parts, are unallowable (taking into account the safe harbor provision in the 2013 NDAA noted above).

According to the DOD, the additional requirements for purchasing systems will only affect large contractors subject to the Cost Accounting Standards. But the proposed rule will clearly have a significant impact on many DOD suppliers, who will face increased compliance costs and increased risk of liability for any counterfeit parts they place, inadvertently or not, into the supply chain.

The proposed rule requires contractors to flow down the anti-counterfeiting requirements to their subcontractors and suppliers.

The Proposed Rule is “Defense Federal Acquisition Regulation Supplement: Detection and Avoidance of Counterfeit Electronic Parts” (DFARS Case 2012-D055). The 60-day comment period ends July 15, 2013.