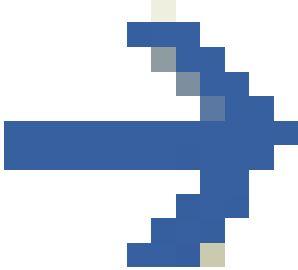


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DOD Issues Proposed Regulations on the Detection and Avoidance of Counterfeit Electronic Parts

If implemented, the proposed regulations will significantly impact contractors who supply products with electronic parts to the Government

The Department of Defense (DOD) recently issued proposed regulations which would partially implement Section 818 of the National Defense Authorization Act for Fiscal Year 2012 (NDAA 2012) related to the detection and avoidance of counterfeit electronic parts. The proposed regulations make several changes to the Defense Federal Acquisition Regulations Supplement (DFARS) and, if implemented, will significantly impact contractors who supply products with electronic parts to the Government.

New Requirements for Contractor Purchasing System Administration

The proposed regulations incorporate a new requirement to avoid and detect counterfeit electronic parts within the framework of the Government's approval of contractors' purchasing systems. To obtain an approved purchasing system, contractors will be required to establish and maintain a counterfeit electronic parts avoidance and detection system, which must address nine specific areas, including: training personnel; inspecting and testing electronic parts; creating mechanisms to trace parts to suppliers; reporting and quarantining of counterfeit electronic parts; and flowing down avoidance and detection requirements to subcontractors. The adequacy of the avoidance and detection system will be a factor in reviewing a contractor's purchasing system. Consequently, the failure to maintain an acceptable avoidance and detection system may result in the disapproval of the contractor's purchasing system as well as the withholding of contract payments.

New Contract Clause

The proposed DFARS creates a new contract clause to be included in solicitations and contracts that will: (i) be subject to the Cost Accounting Standards (CAS), and (ii) procure electronic parts or items containing electronic parts, when the contractor will be supplying the electronic parts. This new clause requires contractors to establish and maintain a counterfeit electronic parts avoidance and detection system, and states that failure to maintain an acceptable system may result in the disapproval of the contractor's purchasing system.

Flow-downs

The proposed DFARS further mandates that the requirements for an avoidance and detection system be flowed down to subcontractors. Because of this flow-down provision, small businesses which are currently exempt from CAS requirements may still have to establish the avoidance and detection system described in the new regulations.

Unallowable Costs

In addition, the proposed DFARS makes contractors responsible for any rework or corrective action that may be required to remedy the inclusion of counterfeit electronic parts into products supplied to the Government. The costs associated with this rework or corrective action are expressly unallowable.

Safe Harbor

The proposed DFARS contains a very limited safe harbor that covers the unallowable costs for rework or corrective action and makes these costs allowable if three factors are met:

- The contractor must have a system to avoid and detect counterfeit electronic parts that has been reviewed and approved by DOD as part of the contractor's purchasing system;

- . The counterfeit electronic parts are Government-furnished property; and
- . The contractor provides timely notice to the Government.

Because all three of the factors must be met in practice, few if any contractors will be able to avail themselves of this safe harbor protection.

The burden these new regulations will place on government contractors cannot be overstated. Not only must contractors create elaborate and costly avoidance and detection systems, they will now also face unrecoverable costs associated with replacing counterfeit parts, along with the disapproval of their purchasing systems and the associated contract withholds. In short, government contractors must begin planning how they will implement the onerous inspection regime created by the proposed DFARS.

The DOD will hold a meeting open to the public to discuss the proposed DFARS on June 28, 2013, in Washington, DC. ***Comments on the proposed DFARS are due by July 15, 2013.***

For more information on how the proposed regulations might impact your business, or to better understand the requirements regarding counterfeit electronic parts, please contact **Paul Debolt** at , **George Wyatt** at , or any of the other attorneys in **Venable's Government Contracts Practice Group**.