

## Defense Policy Banning Chinese Telecom Will Likely Expand

By **Robert Huffman, Angela Styles, Scott Heimberg and Chris Chamberlain**  
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On Jan. 22, the U.S. Office of Management and Budget proposed changes to its grants and agreements regulations at Title 2, Part 200 of the Code of Federal Regulations, to implement Section 889 of the National Defense Authorization Act for 2019.

The regulations prohibit the procurement and use of certain covered telecommunications equipment and services produced by Chinese companies — Huawei Technologies Company, ZTE Corporation, Dahua Technology Company, Hikvision Digital Technology Company and Hytera Communications Corporation, and any affiliate or subsidiary thereof.

The OMB's proposed regulations would create 2 CFR 200.216, providing that "[g]rant, cooperative agreement, and loan recipients are prohibited from using government funds to enter into contracts (or extend or renew contracts) with entities that use covered technology."

According to the OMB, the prohibition "applies even if the contract is not intended to procure or obtain, any equipment, system, or service that uses covered telecommunications equipment or services."

The guidance reflects a broad interpretation of Section 889's grant- and loan-related statutory prohibitions, and it may signal the Trump administration's intention to pursue a similarly broad approach in its forthcoming rulemaking implementing procurement regulations under Section 889(a)(1)(B), which will also become effective Aug 13.

If implemented as written, the prohibition could have significant ramifications for recipients of federal grants, cooperative agreements and loans, as well as their sub-recipients and suppliers. Companies and institutions with potential exposure to Section 889 should consider filing comments with the OMB by March 23.

### Background on Procurement, Use and Loan/Grant Restrictions

Section 889 of the National Defense Authorization Act of 2019 generally prohibits federal agencies, federal contractors, and grant or loan recipients from procuring or using — without a waiver or exemption — any equipment, system or service that uses certain covered telecommunications



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equipment or services as a “substantial or essential component of any system, or as critical technology as part of any system.”[1]

“Covered telecommunications equipment and services” generally include those produced by (or provided using equipment or services produced by) Huawei and ZTE and, with respect to certain public safety or surveillance applications, Dahua, Hangzhou and Hytera, or any subsidiary or affiliate thereof.

It may also include equipment or services produced by any entity that the U.S. Secretary of Defense, in consultation with the U.S. Director of the National Intelligence or the Federal Bureau of Investigation, “reasonably believes to be an entity owned or controlled by, or otherwise connected to, the government of ... [a] covered foreign country” (currently defined as the People’s Republic of China).

Section 889 contains two sets of prohibitions: Subparagraphs to 889(a)(1), Section 889 (a)(1)(A) and (a)(1)(B), set forth Section 889’s “Prohibition on Use or Procurement,” while Section 889(b) describes Section 889’s “Prohibition on Loan and Grant Funds,” i.e., the loan/grant restriction.

Subsection 889(a)(1)(A), which addresses procurements under the Federal Acquisition Regulations, became effective Aug. 13, 2019. It states that the head of an executive agency may not:

procure or obtain or extend or renew a contract to procure or obtain any equipment, system, or service that uses covered telecommunications equipment or services as a substantial or essential component of any system, or as critical technology as part of any system.

This provision was implemented through two interim rules issued by the Federal Acquisition Regulatory Council in August and December of 2019 that amended the FAR.[2]

The second of the prohibitions addressing procurements under subsection, Section 889(a)(1)(B), becomes effective Aug. 13. This provision states that the head of an executive agency may not:

enter into a contract (or extend or renew a contract) with an entity that uses any equipment, system, or service that uses covered telecommunications equipment or services as a substantial or essential component of any system, or as critical technology as part of any system.

This provision will be implemented in a forthcoming rulemaking.[3]

In addition to the prohibitions under Section 889(a), Section 889(b)(1) (effective Aug. 13), i.e., the loan/grant restriction, states:

The head of an executive agency may not obligate or expend loan or grant funds to procure or obtain, extend or renew a contract to procure or obtain, or enter into a contract (or extend or renew a contract) to procure or obtain the equipment, services, or systems described in subsection [Section889](a).

By contrast to Section 889(a), Section889(b) — the loan/grant restriction — does not expressly include a corollary prohibition on the obligation or expenditure of loan or grant funds to those who themselves use, or contract with entities that use, any equipment, system or service that “uses covered telecommunications equipment or services.”

However, the Trump administration has in the past indicated that it interprets Section 889(b)(1) to

include such a prohibition, and it has now formally proposed regulations reflecting that position.[4]

### **Proposed OMB Guidance Implementing Section 889(b)'s Loan/Grant Restriction and Expansion to Cooperative Agreements**

In 2014, the OMB consolidated various sources of grant-related guidance into 2 CFR Part 200, Subtitle A, also known as the Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards, or uniform guidance.

The OMB's uniform guidance is broadly followed by executive branch agencies and largely adopted as written through binding, agency-specific regulations in Subtitle B of 2 CFR Part 200.

Indeed, the OMB requires that federal agencies adopt the OMB guidance in their own agency-specific regulations, "unless different provisions are required by Federal statute or are approved by [the] OMB." [5]

Against this backdrop, on Jan. 22, the OMB proposed new guidance to align federal grant administration regulations with Section 889 of the 2019 NDAA.[6] Specifically, the OMB proposes to create 2 CFR Section 200.216, "Prohibition on certain telecommunication and video surveillance services or equipment," which would provide that:

Grant, cooperative agreement, and loan recipients are prohibited from using government funds to enter into contracts (or extend or renew contracts) with entities that use covered technology. [7]

The OMB does not define covered technology, but based on the context, it appears to use the term to refer to "covered telecommunications equipment and services" as described in Section 889.

The OMB also does not define the term use, and the term is not defined in Section 889 or other implementing regulations issued to date. However, the OMB states that the prohibition "applies even if the contract is not intended to procure or obtain, any equipment, system, or service that uses covered telecommunications equipment or services."

Further, the OMB's proposal appears to prohibit the mere use of covered technology, whereas the statutory prohibitions describe "covered telecommunications equipment or services [used] as a substantial or essential component of any system, or as critical technology as part of any system."

### **Discussion**

Many in the federal contracting community are anxiously awaiting the arrival of regulations implementing Section 889(a)(1)(B)'s prohibition on contracting with an entity that uses items and services described in Section 889.

The OMB's proposed implementation of the loan/grant restriction is not specifically related to those anticipated regulations, but its prohibition on federal awardees' contractual relationships with other entities that use covered technology suggests the Trump administration intends to broadly interpret the term uses in Section 889(a)(1)(B).

Also, evidence of the administration's willingness to broadly interpret Section 889, the OMB's proposal extends the loan/grant restriction to "cooperative agreements," a category of agreements not

addressed in the statute.

More importantly for federal grant, cooperative agreement and loan recipients, the OMB's proposed regulation could, if adopted as written, create serious and onerous due diligence obligations for recipients, sub-recipients and suppliers. It could also require significant investments in alternatives to the equipment and services described in Section 889.

### **Conclusions and Recommendations**

Entities that receive federal grants, cooperative agreements or loans, and those who contract with such entities, should undertake an assessment of their exposure to Section 889 and the potential consequences of the OMB's proposed rule on their existing and future federal awards.

Affected entities should consider filing comments with the OMB, as this feedback will be of critical importance not only in generating guidance on as-yet undefined terms and requirements in the final regulation(s), but also potentially with respect to any forthcoming amendments to the FAR implementing Section 889(a)(1)(B).

Indeed, the OMB states in the preamble to the proposed restriction that:

[The] OMB has limited data on the impact of this prohibition on Federal award recipients and contractors who use covered technology and seeks feedback on the feasibility, burden, programmatic impact, and cost associated with implementing this requirement. Commenters are encouraged to provide relevant data on the impacts of this proposed change and suggestions on how to support implementation of this prohibition.

Comments must be filed by March 23.

Looking ahead to Aug. 13, all entities with potential exposure to Section 889's prohibitions — whether through contracts, grants, cooperative agreements or loans — should prepare to identify and potentially describe in submissions to the U.S. government any equipment, system or service that uses covered telecommunications equipment, as described in Section 889.

Specifically, these preparations may include the following:

- Conduct or review IT inventories to identify potentially covered equipment.
  - Review supplier agreements and vendor contracts to identify potentially covered services.
  - Analyze, identify and prepare to defend any uses of covered equipment or services that may fall outside the scope of the forthcoming prohibitions, such as uses excluded by Section 889's two exceptions, or uses that do not involve covered equipment or services used as a "substantial or essential component" or as "critical technology."
  - Understand and develop procedures for satisfying ongoing supply chain-related obligations, such as reporting and risk management activities.
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[1] See Akin Gump Strauss Hauer & Feld LLP, Agencies Call for Comments on NDAA 2019 Section 889 and Agencies Release Interim Final Rule Implementing First Phase of 2019 NDAA Section 889.

[2] See 84 FR 40216 and 84 FR 68314.

[3] See FAR Case 2019-009.

[4] See letter from Russell T. Vought, Acting Director of the Office of Management and Budget, <https://www.whitehouse.gov/wp-content/uploads/2019/06/Pence-Proposal.pdf>.

[5] See 2 CFR Section 200.106 Agency implementation.

[6] See 85 FR 3766.

[7] See Section 889 of Public Law 115-232 (National Defense Authorization Act 2019).