Government Contracts Alert

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Defense Production Act – What Does the March 18th Executive Order Mean?

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The Defense Production Act (DPA) of 1950 (50 U.S.C. §§ 4501 et seq.) grants the President broad authority to prioritize and allocate health resources. This includes two very separate and distinct authorities to (1) "require the acceptance and performance of contracts" for the federal government and (2) "allocate materials, services and facilities in such manner, upon such conditions, and to such extent as he shall deem necessary or appropriate." 50 U.S.C. § 4511(a); 45 C.F.R. § 101.2(a). Defense contractors are intimately familiar with prioritization of products and services for the federal government under the first authority. The second prong, however, allowing "allocation" of materials, services and facilities from any company or person in the United States, has never been invoked or used under the DPA until the issuance of the March 18th Executive Order (EO).

Pursuant to the EO (as yet unnumbered), Alex Azar, the Secretary of Health and Human Services (HHS), now has the "authority under section 101 of the Act [50 U.S.C. § 4511(a)] to determine, in consultation with the Secretary of Commerce and the heads of other executive departments and agencies as appropriate, the proper nationwide priorities and allocation of all health and medical resources, including controlling the distribution of such materials (including applicable services) in the civilian market, for responding to the spread of COVID-19 within the United States." EO at Section 2.b. The EO appears to explicitly override the most recent Obama era Executive Order (EO 13603) which prescribed the following process for invocation of a civilian allocation: "This finding shall be submitted for the President's approval through the Assistant to the President and National Security Advisor and the Assistant to the President for Homeland Security and Counterterrorism. Upon such approval, the Secretary of the resource department that made the finding may use the authority of section 101(a) of the Act, 50 U.S.C. App. 2071(a), to control the general distribution of any material (including applicable services) in the civilian market."

The EO leaves unclear whether HHS will still be required under allocation regulations (45 C.F.R. § 101) to (1) exhaust the priority system (of current and recent federal contractors) under the first prong before an allocation occurs; and (2) make a finding for Presidential approval "that the material or materials at issue are scarce and critical materials essential to the national defense and that the requirements for national

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defense for such material(s) cannot otherwise be met without creating a significant dislocation of the normal distribution of such material(s) in to such a degree as to create appreciable hardship." 45 C.F.R. § 101.51(a). If HHS follows the current allocation regulations, the HHS Secretary will also be required to develop a specific plan for allocation that includes the following items:

(b) A detailed description of the situation to include any unusual events or circumstances that have created the requirement for an allocation action.

(c) A statement of the specific objective(s) of the allocation action.

(d) A list of the materials, services or facilities to be allocated.

(e) A list of the sources of the materials, services or facilities that will be subject to the allocation action.

(f) A detailed description of the provisions that will be included in the allocation orders, including the type(s) of allocation orders, the percentages or quantity of capacity or output to be allocated for each purpose and the duration of the allocation action (i.e., anticipated start and end dates).

(g) An evaluation of the impact of the proposed allocation action on the civilian market.

(h) Proposed actions, if any, to mitigate disruptions to civilian market operations.

45 C.F.R. § 101.51. The EO, does however, direct the Secretary of HHS to "issue such orders and adopt and revise appropriate rules and regulations as may be necessary to implement" the EO. Any needed changes to the priority or allocation regulations could occur quickly in the form of an interim rule with request for comments.

What to Expect?

After issuing the March 18th EO, the President expressed some reluctance about invoking the authority, tweeting: "I only signed the Defense Production Act to combat the Chinese Virus should we need to invoke it in a worst case scenario in the future. Hopefully there will be no need, but we are all in this TOGETHER!" Because the use of the first prong priority authority is fairly common, this is likely a reference to the President's reluctance to invoke the allocation authority. It is unclear if, how or when the HHS Secretary will use the allocation authority.

How to Prepare?

If you manufacture or distribute medical and/or health care products in high demand, make a plan. As defense contractors have learned through many years of experience working with the first prong of the DPA priority system, it is better to plan ahead and determine the best way to best negotiate with the government. Can you increase production? Can you add production lines? Do you have idle facilities that can be used? What are your current commercial contracts or contracts with other public entities that may be breached? Thinking through your answers to the phone call or order from HHS or proactively contacting HHS about what you can do, may mitigate some of the impact. Importantly, the current priority and allocation regulations provide relief from legal liability for damages and penalties, stating, "[a] person shall not be held liable for damages or penalties for any act or failure to act resulting directly or

indirectly from compliance with any provision of this part, or an official action." 45 C.F.R. §101.90. This provision provides an affirmative defense to breach of contract claims by third parties whose source of product was cut off because the government took the supply under the priorities authority of the DPA and should extend to the use of the allocation authority. See e.g., *Eastern Air Lines, Inc. v. McDonnell Douglas Corp.*¸ 532 F.2d 957, 996 (5th Cir. 1976) (finding airplane manufacturer's delay in delivery in breach of commercial contract excusable under DPA's exoneration provision). However, the protection does not extend to every liability. *Hercules Inc. v. United States*, 516 U.S. 417 (1996) (holding that the DPA exoneration provision provides "immunity, not indemnity" and holding plaintiff, a manufacturer of Agent Orange, was not entitled to indemnity by the government for litigation costs incurred due to Agent Orange production).

If you don't manufacture or distribute medical and/or health care, you should be considering whether you have facilities that could be repurposed for production of medical and/or health care products. One benefit of the DPA is the ability of the federal government to provide loans or loan guaranties to build facilities or even invest in new or re-purposed facilities in the U.S.

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