

Government Contracts Alert

Akin Gump
STRAUSS HAUER & FELD LLP

New Prohibition on Federal Purchases of Certain Semiconductor Products and Services

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On December 23, 2022, President Biden signed the James N. Inhofe National Defense Authorization Act for Fiscal Year 2023 (NDAA) into law. The statute prohibits federal agencies from purchasing covered semiconductor products or services designed, produced or provided by:

- Semiconductor Manufacturing International Corporation (SMIC).
- ChangXin Memory Technologies (CXMT).
- Yangtze Memory Technologies (YMTC).
- Any entity that the Secretaries of Defense and Commerce, in consultation with the Director of National Intelligence or the Director of the Federal Bureau of Investigation (FBI), determine to be an entity owned or controlled by, or otherwise connected to, the government of a foreign country of concern. Such determination must be announced via publication in the Federal Register.

Effective Date. The prohibition will take effect in December 2027. The Federal Acquisition Regulatory Council will have until December 2025 to prescribe regulations to implement the prohibition, including a requirement for prime contractors to incorporate the substance of this prohibition into contracts for the supply of electronic parts or products.

Required Certifications. Once effective, federal contractors and subcontractors at all tiers of the supply chain will be required to certify that products for federal government end-use do not contain covered semiconductor products and services.

Reliance on Lower Tier Certifications. The statute allows federal contractors and subcontractors to rely upon certifications from lower tier suppliers that products they procure do not contain covered semiconductor products or services and need not conduct an independent third party audit or formal reviews.

Liability for Rework/Corrective Action. An entity that sells products containing covered semiconductor products or services will bear the financial liability for any rework or corrective action necessary to remedy the use of covered semiconductor products or services in their products.

Contact Information

If you have any questions concerning this alert, please contact:

Angela B. Styles

Partner

astyles@akingump.com

Washington, D.C.

+1 202.887.4050

Scott M. Heimberg

Partner

sheimberg@akingump.com

Washington, D.C.

+1 202.887.4085

Reporting Requirements. Any federal contractor or subcontractor who becomes aware of or suspects the use of covered semiconductor products or services in any end item purchased by the federal government for a critical system must report such information to the appropriate federal authorities within 60 days, with federal agencies required to provide notification to Congress within 120 days. Entities that make such a report, but do not manufacture or assemble the subject electronic parts/products, are protected from any civil liability and suspension or debarment from federal contracting. Entities that make such a report, and do manufacture or assemble the subject electronic parts/products, may be protected from civil liability or suspension/debarment if the entity makes a comprehensive and documentable effort to identify and remove covered semiconductor products or services from the federal supply.

Excluded. The prohibition does not apply to grants or other federal financial assistance awards that are not contracts and will not apply to grants made under the CHIPS Act.

Waivers. The following federal officials are granted the authority to provide a waiver on the effective date of this provision, granted that it is in the critical national security interests of the United States:

- Secretary of Defense
- Director of National Intelligence
- Secretary of Commerce[*]
- Secretary of Homeland Security*
- Secretary of Energy*.

Additionally, all executive agencies are granted waiver authority for a renewable period of two years, if:

- In consultation with the Secretary of Commerce, the agency head determines that no similar product is available to be procured when needed at U.S. market prices or a price not considered prohibitively expensive.
- In consultation with the Secretary of Defense or the Director of National Intelligence, the agency head determines the waiver would not compromise critical national security interests.

The granting of any waiver must be accompanied by a report to Congress notifying of and justifying its use. This report must be submitted within 30 days after the waiver is granted.

Potential Broadening. The NDAA contains a second prohibition that appears to have been an effort to prohibit federal agencies from purchasing electronic parts or products that use electronic parts for a “critical system” from an entity that uses covered semiconductor products or services. However, awkward statutory drafting appears to have failed to require such a prohibition. The second prohibition states that federal agencies cannot enter “into a contract (or extend or renew a contract) with an entity to procure or obtain electronic parts or products that use any electronic parts or products that include covered semiconductor products or services.” As written, the second prohibition appears to be subsumed within the first general prohibition on federal purchases.

Notably, the statutory text for this second prohibition appears to be different than Congress' Joint Explanatory Statement: "We note that the intent of Congress in advancing this proposal is that, in serving federal supply chains, Federal contract recipients and their suppliers (including domestic and foreign subsidiaries, affiliates, distributors, and intermediaries) should not utilize companies connected to foreign countries of concern that threaten national security, such a Semiconductor Manufacturing International Corporation, Yangtze Memory Technologies Corp, and ChangXin Memory Technologies, or any other company identified under this section (including any affiliate, subsidiaries, successor, distributor, or intermediary thereof). . . ."

As the Federal Acquisition Regulatory (FAR) Council moves forward with drafting of implementing regulations, federal contractors and subcontractors will need to watch for a potentially broader interpretation of this second prohibition than may be reflected in the actual language of the statute.

[*] In consultation with the Secretary of Defense or the Director of National Intelligence.

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