Client Alert

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Section 889(a)(1)(B): Five Things to Know About the Interim Rule and a Roadmap for Compliance

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Key Points

- Akin Gump is hosting a Webinar tomorrow, August 6, 2020, at 12:00 p.m. (EST) to discuss Section 889, the implementing regulations, and the grant and loan restrictions also effective August 13, 2020.
- On July 14, 2020, the DOD, GSA, and NASA ("the Federal Acquisition Regulatory Council" or "FAR Council") published an Interim Final Rule ("Rule"), effective August 13, 2020, implementing Section 889(a)(1)(B) of the 2019 NDAA (i.e., "Part B" or the contractor "use" ban) (85 Fed. Reg. 42665).
- The Rule amends Federal Acquisition Regulations (FAR) Clauses 52.204-24 and 52.204-25 to require disclosure of each prime contractor's use of equipment or services produced by five Chinese telecommunications and video surveillance companies, even if the use is completely unrelated to work performed under the prime contract.
- Among other things, the Rule creates **two new compliance obligations** for prime contractors and potentially their subcontractors and suppliers: **First**, the Rule requires each prime contractor to undertake a "reasonable inquiry" prior to submitting an offer regarding the prime contractor's use of covered telecommunications equipment and services. **Second**, the Rule extends the one- and 10-day reporting obligations established under FAR 52.204-25 (the "-25 Clause") to require reporting of prohibited uses identified "during contract performance" by a prime contractor and any subcontractor who accepts the new version of the -25 Clause (at any tier).
- The Rule is effective August 13, 2020, but the FAR Council will accept comments until September 13, 2020.

Background and Summary

Section 889 of the 2019 National Defense Authorization Act (NDAA) broadly prohibits federal executive branch agencies from obtaining, or contracting with entities that use, certain "covered telecommunications equipment or services," specifically those produced by five Chinese companies (and any subsidiary or affiliate thereof)—as a

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"substantial or essential component of any system, or as critical technology as part of any system." As we have described in previous alerts (here, here, and here), Section 889 contains a controversial prohibition on the federal executive branch's ability to "contract[]" with any "entity" that "use[s]" any equipment, system, or service described in the statute. Following more than two years of intense debate and advocacy over the scope and timing of this "use" restriction, the FAR Council released the long-awaited Interim Final Rule on July 14, 2020 (85 Fed. Reg. 42665), implementing the statutory use prohibition in Section 889(a)(1)(B).

The Rule answers many important questions, while creating new interpretive and practical problems for companies directly or indirectly subject to the rule. In this Client Alert, we focus on the five most important developments and implications for federal contractors and their subcontractors and suppliers arising from the Rule, and we provide a "roadmap" of immediate and near- to mid-term actions to guide compliance efforts vis-à-vis the "use" prohibition and Section 889 more broadly.

Five Key Take-Aways from the Interim Rule

1. "Use" means any "use," but only by the "offeror" (i.e., prime contractor)

Under Section 889(a)(1)(B) and the Rule, federal executive agencies 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."

By providing no additional definition of the term "use," the FAR Council confirmed the principal concern of most contractors and subcontractors potentially subject to the rule. That is, the prohibition applies to the "use" of equipment and services described in Section 889 "regardless of whether that use is in performance of work under a Federal contract." While not a limitless concept (for example, "selling" covered telecommunication products or services alone likely does not constitute "use"), the Rule's approach to the concept of "use" is extremely broad and potentially captures any use, in any capacity, and for any reason, anywhere in the world.

Notwithstanding the FAR Council's sweeping approach to the concept of use, it also provided a significant limitation on the scope of relevant "uses" by not broadening the term "entity." The Rule limits the prohibition on use to the "offeror," i.e., "the entity that executes the contract" (the prime contractor). While this is welcome news for companies who contract with the U.S. government through a separate subsidiary or affiliate, the term "offeror" is still quite a broad term for some organizations, as it encompasses any and all branches or divisions of the legal entity acting as the prime contractor, not just those engaged in work under a federal contract. In addition, the FAR Council is "considering" expanding the prohibition and representation requirements (described below) to all of the offeror's affiliates, parents, and subsidiaries that are "domestic concerns" (i.e., companies incorporated or having their principal place of business in the United States).

2. The representation is broader than the prohibition

The FAR Council implemented the "use" ban by requiring a representation that is broader than the corresponding prohibition. Specifically, the Rule requires each offeror (i.e., prime contractor) to represent, after conducting a "reasonable inquiry" (described below), whether:

It [ ] does, [ ] does not use covered telecommunications equipment or services, or use any equipment, system, or service that uses covered telecommunications equipment or services.

Relative to the prohibition as described above, this representation captures uses that may not be prohibited, i.e., because they do not satisfy the "substantial or essential" or "critical technology" standards, or because they qualify for an exemption.

Ultimately, it will be the prerogative of each agency to determine how and when these standards are met, or whether to request a waiver from the head of the agency or the Director of National Intelligence in the event they are not met. As a result, contractors should take care during their reasonable inquiry to broadly collect information on any use (direct or indirect) of covered telecommunications equipment or services and then provide written documentation sufficient to explain why a particular use is permissible.

3. Representations must be based on a "reasonable inquiry"

The Rule included one other unexpected (and favorable) limitation in its requirement that each prime contractor's representation for purposes of the "use" prohibition be based on a "reasonable inquiry." As described in the Rule:

A reasonable inquiry is an inquiry designed to uncover any information in the entity's possession—primarily documentation or other records—about the identity of the producer or provider of covered telecommunications equipment or services used by the entity. A reasonable inquiry need not include an internal or third-party audit.

While the definition and description raise important questions about the amount and types of information prime contractors must collect before submitting a representation, the Rule effectively permits a risk-based approach to internal and external due diligence, and gives prime contractors some discretion (especially relative to the procurement prohibition, which does not include a "reasonableness" element) in designing and executing their compliance activities. This said, what is "reasonable" will likely depend heavily on each contractor's circumstances and the nature of their industry. In addition, what is "reasonable" may depend on the passage of time and issuance of clarifying guidance since publication of the rule—i.e., what is "reasonable" on August 14, 2020, may not be similarly "reasonable" in 2021 when some prime contractors will make their bids or contract renewals subject to the "use" prohibition.

4. Prime and certain subcontractors must report prohibited "uses" within one business day

As we described in our earlier Client Alert on the procurement prohibition (Section 889(a)(1)(A)), FAR Clause 52.204-25 includes a reporting obligation that requires the prime contractor and subcontractors at any tier that accept the -25 Clause to report prohibited "use[s]" within one business day. Specifically, FAR 52.204-25(d) states that:

In the event the Contractor identifies covered telecommunications equipment or services used as a substantial or essential component of any system, or as critical technology as part of any system, during contract performance, or the Contractor is notified of such by a subcontractor at any tier or by any other source, the Contractor shall report [specified information]… to the Contracting Officer…within one business day from the date of such identification or notification….

Critically, this provision was not amended by the Rule, and as a result will apparently require reporting of any prohibited use "identified… during contract performance" (at any tier) within one business day. This is a function of subparagraph 52.204-25(e), which provides that each "[c]ontractor shall insert the substance of this clause, including this paragraph (e), in all subcontracts and other contractual instruments, including subcontracts for the acquisition of commercial items." In other words, given the broad wording of the reporting requirement, it appears that prime contractors and subcontractors that accept the -25 Clause after its amendment on August 13, 2020, will have an obligation to report any prohibited "use[s]" identified after the prime contractor's initial representation, and not just instances of prohibited equipment or services being *provided to* the government.

Notably, the FAR Council expects that each "contractor['s]" ongoing reporting obligations will be part of a multifaceted "compliance plan," which should also include:

- ***Regulatory Familiarization***
- ***Corporate Enterprise Tracking*** — to include "examining relations with any subcontractor and supplier for which the prime contractor has a Federal contract"
- ***Education*** — i.e., of the entity's "purchasing/procurement, and materials management professionals"
- ***Removal Procedures***
- ***Representation*** and ***Reporting Procedures***
- ***Waiver Procedures*** — i.e., procedures for developing a "compelling justification," a "laydown of presences," and a "phase-out plan" in support of a waiver request.

5. Each prime and subcontractor's practical compliance date is unique

Although the Rule will be effective (as currently written) on August 13, 2020, the practical effective date for a prime contractor is the date at which it (1) executes or bids on a new contract, (2) modifies an existing contract (which in many cases is unlikely to happen in the immediate future, if ever), or (3) accepts a new order under an existing contract.

Note, however, that subcontractors and suppliers may be asked to provide commercial representations or other information sooner, in response to inquiries from prime contractors conducting a "reasonable inquiry" into their own "use" of any covered equipment or services provided directly or indirectly by the subcontractor or supplier. As a result, while some contractors may have a relatively longer time to decommission or transition potentially prohibited uses to entities that do not hold prime contracts with the federal government (among other risk mitigation measures), all prime and subcontractors should begin immediately to identify uses that may trigger their own representation or that of a prime contractor with whom they do business as a subcontractor or supplier (whether or not in the context of any federal contract).

Recommendations

The Rule and Section 889 more broadly create significant and complex requirements for the government contracting ecosystem (both within the United States and internationally). To provide some practical clarity to companies caught in the wake of the Rule, listed below are essential actions companies in the U.S. federal supply chain should consider taking in the immediate and near- to mid-term (ideally, before the

submission of a representation). In addition, as a general recommendation, prime contractors and subcontractors should take care to document their actions and decisions to establish their reasonableness and defensibility in the event of an enforcement action, contractual remedy, and/or litigation under the False Claims Act.

Immediate Term

As soon as possible, but no later than before you submit a representation under FAR 52.204-24, your organization should, as part of the "reasonable inquiry" described in the Rule:

- Identify the legal entity named in your company's government contracts (i.e., the prime contractor or offeror), and make an account of the scope of that legal entity (e.g., all branches, divisions, and business units).
- Review information in the entity's possession, such as IT inventories and supplier agreements, indicating whether the entity "uses" (in any capacity, anywhere in the world) any equipment, system, or service described in the interim rule.
  - Note that your organization should be mindful of U.S. export compliance as it conducts its reasonable inquiry, given that affiliates of three of the companies named in Section 889 (i.e., Huawei Technologies Company, Dahua Technology Company, and Hangzhou Hikvision Digital Technology Company) are also designated on the Commerce Department's Entity List (Supp. No. 4 to 15 C.F.R. Part 744).
- Begin organizing documentation to support your (or your prime contractor's) representation and formulate the substance of any descriptions or explanations you intend (or are required) to provide along with your representation submission.

Near- to Mid-term

For prime contractors that identify confirmed or potentially covered uses:

- Identify opportunities to replace or transition and isolate covered uses at entities that do not hold prime contracts with the federal government.
- Engage with subcontractors and suppliers to confirm and resolve any potentially covered "uses" arising from equipment, systems, or services provided by those subcontractors or suppliers.
- Design and develop mechanisms for complying with the representation and reporting requirements in FAR 52.204-24 and 52.204-25.

For subcontractors and suppliers to prime contractors:

- Prepare for questions from prime contractor customers about any equipment, systems, or services you provide and whether it "uses" covered equipment or services as described in the Rule.
- Design and develop risk-based mechanisms for complying with the prohibitions and reporting requirements flowed down via the -25 Clause, which may include identifying and reporting any prohibited "use" identified during contract performance.

Conclusion

The key points and actions are only the beginning of what could be a long road of compliance and legal issues arising from Section 889, among other supply chain

security initiatives that have already or will soon add new layers of complexity to companies' internal and external supply chain obligations (e.g., Section 1656 of the 2018 NDAA (84 Fed. Reg. 72231), the Federal Acquisition Supply Chain Security Act of 2018 (P.L. 115-390), and the Commerce Department's forthcoming regulations implementing the May 15, 2019 Executive Order on Securing the Information and Communications Technology and Services Supply Chain (84 Fed. Reg. 65316)). Several agencies have also already issued their own agency-specific guidance, including the General Services Administration (Guidance Page, July 16, 2020 Update to Class Deviation FAQs, July 30, 2020 Webinar) and the Department of Defense (July 23, 2020 DPC Memo), and the federal contracting community will need to remain alert to clarifications and additional guidance emerging over the coming weeks and months as the practical impact of the Rule takes shape. Contractors should also actively engage in the comment period (until September 13, 2020) and work with the FAR Council and its constituent agencies (as well as with any federal counterparty) to improve and clarify the outstanding issues with the Rule.

To explore these issues in greater depth, please join our Webinar tomorrow at 12:00 p.m. EST.

Akin Gump has extensive experience advising companies on Section 889-related issues and disclosures, among a wide range of other government contract and supply chain regulatory regimes. We also have a long history of assisting in the development and implementation of business-minded compliance solutions to address these issues.

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