

Contractors Prepare For Expanding Anti-Counterfeit Crusade

By **Dietrich Knauth**

Law360, New York (June 10, 2014, 1:39 PM ET) -- While defense contractors get acquainted with recent regulations on counterfeit electronic parts, a proposal unveiled Tuesday would significantly expand anti-counterfeiting responsibilities for all government contractors and greatly expand the government's database of suspected counterfeit or nonconforming goods.

The Federal Acquisition Regulatory Council, made up of the Department of Defense, NASA and the General Services Administration, issued a proposed rule Tuesday that would require contractors to report suspected counterfeit or defective parts to a central government clearinghouse known as the Government-Industry Data Exchange Program. Contractors then would have to check GIDEP's database before purchasing parts.

Attorneys say the rule, if implemented without major revisions, would represent a major change in the way most companies handle suspected counterfeit or defective parts. They say contractors would have to spend money to link up their purchasing systems with GIDEP to screen for problematic parts and to incorporate quality assurance and reporting requirements into their subcontracts and supply agreements.

"It is a significant change," said Robert Huffman of Akin Gump. "You have to report to keep industry and government apprised when there's a problems with a part or a class of parts. There are a lot of twists and turns in this rule, and it's going to take a lot of work to figure it all out, particularly when flowing it down to subcontracts."

The rule builds on a Pentagon rule finalized May 6 that requires defense contractors to scour their supply lines for counterfeit electronics and puts contractors on the hook for the costs of replacing any counterfeits that make their way into DOD weapons systems.

While the previous rule applies only to the DOD, only to electronic products and only to intentional counterfeits, the FAR proposal would cover all contracts and extend to nonelectronic counterfeits and noncounterfeit but defective parts.

"The changes proposed by this rule will help mitigate the growing threat that counterfeit items pose when used in systems vital to an agency's mission," the proposed rule said. "The rule is intended to reduce the risk of counterfeit items entering the supply chain by ensuring that contractors report suspect items to a widely available database."

Contractors are likely to seek more clarity on the proposed rule's expansive take on what constitutes a problematic part, attorneys say. The new proposed rule goes beyond counterfeits to include any part that contains a "critical nonconformance" likely to result in unsafe conditions or "to prevent performance of a vital agency mission," as well as any part that contains a "major nonconformance" likely to "result in failure of the supplies or services, or to materially reduce the usability of the supplies or services for their intended purpose."

"That last sentence is very broad," Huffman said. "You're really into warranty territory there."

The proposed rule emphasizes that counterfeit electronic parts are "a severe and growing problem across the supply chain," citing data from the Senate Armed Services Committee, the Department of Commerce and GIDEP. The Senate Armed Services Committee identified 1,800 cases of counterfeiting, involving roughly 1 million parts, in 2011, and the Commerce Department reported in 2010 that counterfeiting in the defense industry nearly tripled between 2005 and 2008.

Those counterfeits pose severe reliability and safety risks and can cause catastrophic mission failure and potential loss of life, the proposed rule said.

But according to Peter Eyre of Crowell & Moring LLP, contractors may question whether GIDEP, which is managed by the Pentagon, is the most appropriate vehicle for the new reporting framework. Currently, federal agencies report into GIDEP, but the proposed rule would require contractors to be much more linked in to its system, reporting directly into the database and using it as a screen to vet supplies before making purchases under a government contract or subcontract.

"I think you'll see comments about GIDEP itself and whether GIDEP is equipped for this type of activity," Eyre said. "This could be a significant expansion because contractors would be reporting directly into GIDEP and using GIDEP to screen, prior to purchasing supplies. Incorporating that screen into your procurement process is potentially quite onerous and might necessitate enhancements to the GIDEP system itself."

Contractors may also seek clarity on overlapping reporting requirements. The proposed rule would require reporting to GIDEP and a contracting officer, but the DOD's inspector general has language on its website requiring contractors to report to its office, which could cause confusion, Huffman says.

The proposed rule also makes no exemptions for commercial item contractors or subcontractors or for foreign companies, essentially hitting everyone in the government contracts supply chain, Huffman says. The proposed rule's flow-down clause would require prime contractors and large subcontractors to check up on their suppliers to ensure they have quality control and reporting systems that can comply with the rule.

"It's hard to see how you comply with this proposed reporting requirement without imposing fairly detailed quality assurance requirements and reporting requirements on your subcontractors," he said. "Companies will probably be raising those issues in hearings and written comments."

--Editing by Kat Laskowski and Richard McVay.