

INTRODUCTION

I appreciate the opportunity to speak before this hearing. My name is Robert Metzger. I am an attorney in private practice with the law firm of Rogers Joseph O'Donnell. My firm specializes in public contracts law. I manage our Washington, D.C. office.

I have written and spoken extensively on counterfeit parts prevention. I am the Vice-Chair of the Supply Chain Subcommittee of TechAmerica, and a member of the Counterfeit Parts Task Force of the ABA Section of Public Contract Law. However, the views I express here are my personal views, only, and do not reflect those of TechAmerica, or the ABA, or any client.

WHY WE ARE HERE

As was exposed in 2011 and 2012 by the work of the Senate Armed Services Committee, the threat of counterfeit electronics was not taken seriously enough by some in industry, or by DoD itself. The result was Section 818 of the National Defense Authorization Act of 2012. The law acts upon many “junctures” of the supply chain. For our purposes the most important are *purchasing practices, inspection and testing, reporting, corrective measures, contractor systems and sanctions*.

In Section 818, Congress directed DoD to issue new regulations governing contractors before the end of September 2012. The proposed DFAR emerged on May 16, 2013, 17 months after enactment and nearly eight months later than Congress intended.

WHY THIS HAS TAKEN SO LONG

While the objectives of Section 818 are fairly plain, and its purposes widely supported, implementation is very complex. There are risks of unintended and harmful consequences, and costs that might overwhelm the value of Section 818 rules.

By definition, the supply chain is both very broad and very deep. The supply chain is global, in that necessary electronic parts come from international sources. Also, DoD has only limited influence over the supply chain and must be careful not to isolate defense needs from commercial sources of technologies and innovation.

The “supply chain” extends to a vast array of hardware and systems, products and services. It encompasses not only microelectronic devices but the software and firmware that drive those devices. The threat ranges from crude fakes to very sophisticated “cloned” parts that might harbor malicious code. In this sense, the implementation of Section 818 must be context-sensitive. DoD is to be commended for its apparent recognition that it should neither go “to far” or insist upon “too much” in these regulations. But DoD has not yet gone far enough to inform industry of how it is to comply with Section 818’s many requirements.

Industry wants guidance and cooperation, to implement a risk-based method of counterfeit parts avoidance – not a prescriptive, rule-based regime. DoD may be well-counseled to implement 818 through *accommodation* of reasonable and different business practices, relying upon established industry standards, rather than by attempting to impose a technical orthodoxy upon such a dynamic and diverse industrial base.

THE PROPOSED RULE IS A DISAPPOINTMENT

Taking all this into account, the proposed rule is a disappointment.

Congress, in enacting Section 818, required DoD to issue regulations to cover key areas of contractor responsibility to detect and avoid counterfeit electronic parts. In **several** key areas, the Proposed Rule falls short of answering the statute’s assignments..

- 1) A *definition of “counterfeit” and “suspect counterfeit” part*. Section 818 (b)(1) requires DoD to establish “Department-wide definitions of the terms ‘counterfeit electronic part’ and ‘suspect counterfeit electronic part.’”

There are several problems with the proposed definition.

One is that it includes an unnecessary second part – an “item misrepresented to be an authorized item *of the legally authorized source*” – that raises many questions of interpretation and could exclude supply from bona fide distributors who acquire excess and out of production authentic parts. It is unclear whether the definitions accommodate any distributors other than those who have some license or contractual relationship with the original authorized source.

The third part of the proposed definition treats as a counterfeit part a “new, used, outdated, or expired item procured from a *legally authorized source* that is misrepresented by any source to the end user as meeting the performance requirements for the intended use.” This would characterize as “counterfeit” even

items newly made by original manufacturers that happen to fail an acceptance test. Ordinary quality problems should not be treated as “counterfeit” parts.

- 2) **Strengthening contractor purchasing practices**. This is addressed by Section 818(c)(3). The requirement is that contractors –“*whenever possible*” – “obtain electronic parts that are in production or currently available in stock from the original manufacturers of the parts or their authorized dealers, or from trusted suppliers who obtain such parts exclusively from the original manufacturers of the parts or their authorized dealers.”

Industry *knows* that electronic parts should be purchased from OCMs and their authorized distributors. But this is not always possible. There are thousands of systems in the inventory for which parts necessary for sustainment are *not* available from such “trusted suppliers.”

Section 818 says that where electronic parts are *not* in production or currently available in stock from original sources, they are to be obtained “from **trusted suppliers**” The law directs DoD to “establish requirements for **notification**” and for “**additional inspection, testing and authentication**” and to establish standards and processing for identifying those “**trusted suppliers**” from whom parts are purchased when not bought from original sources.”

The Proposed Rule does little more than repeat the words of the statute. The Proposed Rule does not tell industry **how it is to qualify** either a supplier or a part when it requires an *obsolete* or *out-of-production part* to support a system and the needed parts are not available from preferred sources. Nothing is said as to **notification** to DoD, DoD’s responsibility when it receives such notification, or what **additional test and inspection** is required. .

- 3) **Improvement of contractor systems**. Section 818(c)(2)(A) makes contractors “**responsible** for detecting and avoiding the use or inclusion of counterfeit electronic parts.” For this purpose, Section 818(e) requires DoD is to **implement a program** to “enhance contractor detection and avoidance of counterfeit electronic parts.” There are **nine (9) specified elements** to such a program, identified by Congress as -

Training – inspection and testing – processes to abolish counterfeit electronic parts proliferation – improved traceability of parts – use of trusted suppliers – reporting and quarantining of counterfeit parts – methodologies to identify suspect parts and rapidly determine if a part is counterfeit – enhanced systems to detect and avoid counterfeit

electronic parts – flow down to subcontractors – and review and approval of contractor systems.

Here again, the Proposed Rule does nothing more than recite – word for word – the relevant provisions of the statute. No additional dimension or detail is provided. Nowhere does the Proposed Rule indicate how to determine whether a system is “acceptable.” Nor does the Proposed Rule inform industry as to how to evaluate the adequacy of such a system, or what role industry standards may play.

- 4) Congress was insistent on ***improved reporting*** by DoD and industry. At 818(c)(2), the law requires DoD to revise regulations to require DoD contractors to report in writing within 60 days to “appropriate Government authorities” and GIDEP whenever a contractor “becomes aware, or has reason to suspect” a counterfeit.

It is through reporting that industry and government inform each other of known risks and identified threats. But reporting is essentially ignored by the Proposed Rule. A FAR Case, 2013-002, will address reporting – but it remains pending.

KEY RECOMMENDATIONS

First, resolution of issues with the proposed definitions is very important. DoD should take care to be consistent with industry standards, such as SAE AS5553, as these evolve. DoD also should conform the DFARS with its own documentation, such as the Counterfeit Prevention Policy), so that the same definitions apply internally and externally. The final Rule should eliminate that language of the **proposed definition** that could cause an ordinary quality problem to be treated as a “suspect” or “counterfeit part.” The definition also should assure that qualified distributors remain potential sources of non-counterfeit parts.

Second, the Rule should provide **more guidance on purchasing decisions** that contractors and their DoD customers should make where required parts are obsolete, out of production or otherwise cannot be obtained from “trusted suppliers.” A mechanism should be considered for contractors to identify requirements that call for such parts. Contractors should be encouraged to identify risks and recommend alternatives to their customer. DoD also should integrate recognition of its existing “trusted foundry” and “trusted supplier” programs.

Third, the Rule should give formal recognition to the accomplishments of government and industry experts in the development of **industry standards** and best practices. Section 818(c)(3)(D)(ii) provides that the “standards and processes” for identifying additional trusted suppliers, i.e., those used where parts are not available from original sources, are to “comply with established industry

standards”. Similarly, where DoD adopts a standard for its internal use, the Rule should extend a presumption of validity to use by the private sector.

Fourth, the Rule should treat prevention of counterfeit parts as a **separate contractor system** rather than attempt to graft elements of counterfeit parts prevention onto the existing DFARS treatment of purchasing systems. The approach of the Proposed Rule, while expedient, is not ideal. Purchasing is a component of supply chain risk management, but there are many other relevant functions – such as design, engineering, quality assurance, materiel management and accounting, and compliance – that are outside purchasing.

Fifth, DoD needs to reconsider how it will treat **commercial items**. The risk of a commercial off-the-shelf (COTS) part being counterfeit, where purchased directly from an original source, is comparatively very small. In contrast, there is potentially severe industrial base and supply chain impact should DoD attempt to force this Rule upon commercial device makers. The final Rule should specifically exempt COTS items purchased directly from OCMs, OEMs and their authorized distributors and should accept commercial warranties and other standard commercial assurances of authenticity or provenance.

Sixth, the Rule must confront the problem of how to apply counterfeit-prevention objectives to **small business**. It is not correct that this Rule will have only a “negligible” impact on small entities in the supply chain. The CAS-covered contractors, to whom the Proposed Rule *does* apply, must flow down “counterfeit avoidance and detection requirements” to all subcontractors. While some small businesses have made the investments necessary to comply, other small businesses refuse to accept flow-down of 818 requirements. DoD cannot “exempt” small business because the impact of a counterfeit from a small business is just as bad as from a large contractor. Hence, for certain procurements, DoD may need to adjust or even waive small business participation requirements.

Seventh, the Rule should do more to implement a “**risk-based approach**” to deal with counterfeits. DoD employs a risk-based approach in its internal counterfeit prevention policy. This proposition of a “risk-based approach” recognizes that it is impossible to eliminate all risk of counterfeit in every system that the DoD buys or supports. A risk-based approach would give priority to prevention efforts where the presence of a counterfeit would do the greatest harm, either to operations or personnel safety, so that those systems can be given special attention. The final Rule should address how DoD will work with its suppliers to design, implement and operate a responsible, risk-based approach to counterfeit part prevention.

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