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Legal Update

The US National Defense Authorization Act for Fiscal Year 2021: Procurement Policy and Requirements

The William (Mac) Thornberry National Defense Authorization Act for Fiscal Year 2021 ("NDAA," the "Act"), which was enacted into law on New Year's Day when the US Congress overrode President Trump's veto of the legislation, contains a broad range of policy reforms and new requirements that will impact companies that do business with the US government, directly or as a subcontractor or supplier. We address a number of these provisions below.

As with NDAAs from prior recent fiscal years, this year's NDAA introduces a significant number of new measures that will have an enduring effect on government contracting and contractors. Many of these measures will be further refined through the rulemaking process.

The Act also contains numerous changes that will impact the financial services industry and approaches to cybersecurity, which will be addressed in our separate Legal Updates, *The National Defense Authorization Act for Fiscal Year 2021: What Financial Services Companies Need to Know* and *The National Defense Authorization Act for Fiscal Year 2021: Cybersecurity Provisions*.

Defense Industrial Base and Domestic Source Restrictions

Section 817 modifies the threshold for application of the Berry Amendment in 10 U.S.C. § 2533a(h). It lowers the threshold from the Simplified Acquisition Threshold (currently $250,000) to $150,000, subject to inflation adjustments. As a result, a greater number of Department of Defense ("DoD") acquisitions will be restricted to domestic sources for covered items.

Section 837 imposes a number of safeguards to prevent defense-sensitive intellectual property, technology, and data (including hardware and software) from being acquired by China. It requires DoD to ensure policies are put in place to avoid that prospect. Section 837 further requires that in developing such policies, DoD shall "[e]stablish and maintain a list of critical national security technology that may require certain restrictions on current or former employees, contractors, or subcontractors (at any tier)" of DoD that contribute to such technology. DoD also must (i) review existing authorities under which DoD employees "may be subject to post-employment restrictions with foreign governments and with organizations subject to foreign ownership, control, or influence ['FOCI']" and (ii) identify "additional measures that may be necessary to enhance" these authorities. Finally, DoD must consider "mechanisms to restrict current or former employees of contractors or

subcontractors (at any tier)" of DoD "that contribute significantly and materially to a technology referred to" in Section 837 "from working directly for companies wholly owned by the government of China, or for companies that have been determined by a cognizant Federal agency to be under the ownership, control, or influence of the government of China." Section 837 does not refer to regulations, although it directs DoD to assess "measures" and "mechanisms." Depending on DoD's review, restrictions may be implemented by further statute and require detailed regulations. The provision is far-reaching into the operations of contractors and their employees. It clearly intends to restrict the post-employment of government employees (in addition to current restrictions), as well as employees of contractors. The restriction to organizations subject to FOCI is broad—as is the definition of FOCI.

Section 841 calls for application of new rules restricting the acquisition of printed circuit boards ("PCBs") from China, Russia, Iran, and North Korea above the micro-purchase threshold that perform "a mission critical function in any product or service that is not a commercial product or commercial service." The provision can be waived by the Secretary with a determination that there are no significant national security concerns and the contractor is otherwise in compliance with relevant cybersecurity provisions. The conferees noted they expect DoD to take steps to reduce and mitigate national and economic security risks related to sources of the supply and manufacture of printed circuit boards. The regulations must be promulgated by May 1, 2022, and take effect on January 1, 2023.

Section 844 modifies 10 U.S.C. § 2533c to expand the prohibition on acquisitions of certain metal materials from Russia, North Korea, China, and Iran. The statute currently prohibits acquisition of materials "melted or produced" in those countries. Section 844 extends the prohibition to include materials "mined, refined, [or] separated" in those countries. The expanded prohibition takes effect five years from the effective date of the NDAA.

Section 849 directs DoD to undertake a comprehensive assessment of supply chain risks for a list of high-priority items, including microelectronics, medical devices, pharmaceuticals, and aluminum. This provision requires DoD to identify specific actions the United States should take through sourcing or investment to increase domestic industrial capacity to manufacture these products and explore ways to entice critical technology industries to move production to the United States for national security.

TAKEAWAYS

- DoD will be subject to ever tighter controls regarding materials from China, Iran, North Korea, and Russia.
- Tighter controls will impact supply chains, which are increasingly global.
- Some tighter controls are being phased in over time, which should enable DoD and the defense industrial base ("DIB") to find alternative sources.
- With regard to Chinese companies, DoD employees and contractors (current and former) may face post-employment restrictions that are broader in scope and effect than any restrictions currently in effect.

The NDAA does not focus only on source restrictions and domestic preferences. The Act highlights an emphasis on building domestic capacity. In particular, Section 848 is directed at prioritizing, "to the maximum extent practicable," the order of sources for "strategic and critical materials," which are not defined in the statute. The prescribed order of preference is domestic sources, National Technology and Industrial Base ("NTIB") sources, and other sources. The NTIB countries are the United States, the

United Kingdom, Australia, and Canada (10 U.S.C. § 2500(1)). Among other things, Section 848 calls for incentives for the DIB to "develop robust processing and manufacturing capabilities" in the United States to refine "strategic and critical materials" for DoD purposes. Section 851 calls for DoD to submit an annual report that identifies the "strategic and critical materials" used by DoD.

Section 848 recognizes that building capacity will take time, setting a goal of January 1, 2035, for eliminating the US dependence on "potentially vulnerable sources of supply for strategic and critical materials" and having sufficient capacity to meet the full demands of the domestic DIB. Among the methods identified in the statute is the expanded use of existing programs such as the National Defense Stockpile and reliance on Title III of the Defense Production Act of 1950.

In adopting this provision, the conferees referred to a 2018 study that identified several risks to the industrial base, including foreign dependency and, in some cases, dependency on sole foreign suppliers for critical technologies used by the US military. The conferees noted that such dependency represents a critical vulnerability, especially when suppliers come under the direct control or influence of foreign governments such as China. The conferees directed DoD to increase resiliency by expanding the domestic industrial base as well as fostering industrial cooperation with trusted allies and partners that offer additional capacity in important areas. In considering alternative sources of supply, the Department must enhance defense industrial base resiliency, minimize espionage vulnerabilities, support domestic economic growth, and limit the potential for foreign sabotage or disruption of US access to critical sources of supply.

TAKEAWAYS

- Section 848 continues an emphasis, also reflected in executive orders issued by President Trump, on enhancing the domestic sources of supply for materials that are deemed critical or strategic to the country. It remains to be seen which materials will be designated as "strategic and critical materials."

Sustainment and Cost Control

Section 802, labeled as an understated "sustainment" requirement, is aimed at the persistent problem of cost control involving sustainment and life-cycle costs for both major defense acquisition programs and programs or projects carried out under the rapid fielding or rapid prototyping acquisition authorities of Section 804 of the FY 2016 NDAA (defined as "covered systems").

Among other things, this section requires amending 10 U.S.C. § 2337 to require an approved life-cycle sustainment plan for each "covered system" before granting Milestone B approval (system development and demonstration phase). The plan must include key performance parameters, system attributes and other metrics, an approved life-cycle cost estimate, identification of sustainment risks and mitigation plans, relevant engineering and design considerations, and an IP management plan for product support.

This provision also amends 10 U.S.C. § 2441 to increase oversight by requiring recurring sustainment reviews of a "covered system" every five years. It specifically requires an annual submission of sustainment reviews by each military service to Congress to increase visibility of cost growth. For covered systems experiencing cost growth, the submission must include a remediation plan to address cost growth or a certification by the applicable Secretary that the cost growth is necessary to meet national security requirements.

Section 805 mandates a notification to Congress when Middle Tier procedures fail to deliver the system being developed. Under Middle Tier Acquisition, DoD was empowered to develop rapid acquisition approaches to focus on the delivery of capabilities urgently needed by the warfighter, i.e., within two to five years. Section 804 of the FY2016 NDAA granted an interim approach that was excepted from the DoD Directive (No. 5000.01) related to acquisition of defense systems; in other words, Middle Tier Acquisitions are not subject to the Joint Capabilities Integration Development System. Section 804 describes two permissible acquisition approaches: (1) Rapid Prototyping, in which innovative technologies are used to rapidly develop fieldable prototypes to demonstrate capabilities and satisfy emerging needs of the military; and (2) Rapid Fielding, or using existing technologies that have been shown to be effective to produce to field production quantities of new or upgraded systems.

The Conference Committee is concerned about DoD's "lack of sustainment planning during the acquisition process and its ongoing challenges managing sustainment cost growth on fielded systems." Accordingly, the FY2021 NDAA takes several steps to address these concerns, which the "conferees intend to monitor" to be certain DoD is "improving sustainment outcomes, including the extent to which sustainment planning is carried out under each of the pathways in the Department's new Adaptive Acquisition Framework." To facilitate that monitoring, DoD must report to Congress any termination of a program under the Middle Tier Acquisition program, with the notice including at least the following: (1) the initial amount of a contract awarded under the acquisition program, (2) the aggregate amount of funds awarded under the contract, and (3) documentation of the reason for termination of the program.

TAKEAWAYS

- Section 803 reflects continuing concern with cost growth on defense programs. The expansion to include the "Middle Tier" programs demonstrates that those programs also will now receive additional scrutiny. In some cases, programs that may have previously been considered "major defense acquisition programs" have been restructured in recent years to fit the middle tier criteria or programs are initiated as "Middle Tier." Those will now be subject to scrutiny.
- The new reporting to Congress provision also suggests that the Nunn-McCurdy requirements are not viewed as sufficient for these "covered systems."
- The requirement for consideration of an IP management plan, a long standing issue with sustainment, portends more pressure on industry to give up IP rights.
- Section 805 reflects that Congress is concerned about programs that are initiated as streamlined Middle Tier acquisitions and then are terminated before completion.

Focus on Ownership, Control, and Disclosure

Section 885 amends 41 U.S.C. § 2313(d) to require identification of the "beneficial owner" of a corporation. The requirements of 41 U.S.C. § 2313 are focused on maintaining a government database (by GSA) regarding the "integrity and performance" of federal contractors and grantees for use by agency officials. The database includes, among other things, information regarding criminal convictions; judicial findings in civil cases of fault or liability resulting in fines, penalties or damages in excess of $5,000; or administrative proceedings resulting in findings of or fault or liability resulting in fines or penalties of $5,000 or more, or payment of restitution, reimbursement, or damages in excess

of $100,000, or a resolution of the matter by consent or compromise, if the proceeding could have led to a conviction, or a civil or administrative fine or penalty.

The database also includes information regarding contracts or grants terminated for default, any suspension or debarment of the contractor or grantee, and final negative responsibility determinations. The database is required to include similar information regarding such actions by state governments. In addition, it includes persons sanctioned by the Office of Foreign Assets Control and other sanctions on foreign persons and financial institutions. Federal officials awarding contracts and grants are required to review the database and document the manner in which the information was considered.

The term "beneficial owner" is defined (pursuant to Securities and Exchange Commission regulations) in the manner used for determinations of FOCI as provided in section 847 of the FY 2020 NDAA (a provision enacted to mitigate FOCI risk in the assessment of DoD contractors and subcontractors).

Section 819 further modifies the FY 2020 section 847 provision to mitigate risks related to foreign beneficial ownership by mandating that DoD obtain reports and conduct periodic examinations of "covered contractors or subcontractors" to assess their compliance with FOCI restrictions and requirements and create procedures for responding to changes. DoD is required to provide a plan by March 2021 for implementation of section 847 as amended. A "covered contractor or subcontractor" is a company that is an existing or prospective contractor or subcontractor with respect to a contract or subcontract valued at $5 million or more, with the exception of commercial products or services absent a special determination of risk by a senior DoD official.

Section 883 requires a company receiving a contract to represent that it does not require confidentiality or non-disclosure agreements from its employees that would restrict or prohibit an employee from lawfully reporting fraud, waste or abuse related to any DoD contract to a DoD investigative or law enforcement agency. Companies are required to inform their employees of these limitations.

TAKEAWAYS

- In addition to other provisions of the NDAA that address risks related to foreign access, these provisions further emphasize attention to the ownership or control of, or influence over, companies doing business with the government.
- The provisions increase the scrutiny of ownership of companies doing business with the government and suggest that questionable ownership or behavior may preclude participation in government business.
- The restriction on terms in confidentiality agreements and the inclusion of information in the government-wide database is an effort to assure that bad actors exercising FOCI also are identified and avoided.

Procurement Provisions Affected by Cybersecurity Concerns

Section 1704 responds to a provision in the Senate bill (S. 4049) regarding cybersecurity protection of operationally critical contractors. The Senate bill included a provision (§ 1635) that would have provided for a member of the military to obtain access to the equipment or information of an operationally critical contractor at the request of DoD to conduct a forensic analysis to detect or mitigate an intrusion. The provision was replaced in conference with a different approach by

amending 10 U.S.C. § 391(d) to provide liability protection to a contractor for compliance with the contract requirements established by the Defense Federal Acquisition Regulation Supplement ("DFARS") 252.204-7012 (Safeguarding Covered Defense Information and Cyber Incident Reporting).

Section 1712 addresses evaluation of cyber vulnerabilities of major weapons systems and modifies requirements for the Strategic Cybersecurity Program. With respect to weapons systems, the provision amends section 1647 of the FY 2016 NDAA and section 1633 of the FY 2020 NDAA to establish policies and requirements for each major weapon system and associated infrastructure to be reassessed for cyber vulnerabilities with respect to upgrades, system modifications, or changes in the threat landscape.

The provision also amends section 1640 of the 2018 NDAA to establish a Strategic Cybersecurity Program to identify and include all of the systems, critical infrastructure, kill chains, and processes, including those still in development, that comprise the following DoD missions: (A) nuclear deterrence and strike, (B) select long-range conventional strike missions relating to the warfighting plans of the US European Command and the US Indo-Pacific Command, (C) offensive cyber operations, and (D) homeland missile defense.

TAKEAWAYS

- The provision regarding major weapons systems recognizes that such systems and their infrastructure evolve, as does the threat landscape, and that vulnerability assessments need to be ongoing. Consequently, the contracting process needs to address this process proactively in a timely, ongoing, and effective manner.
- The provision establishing the Strategic Cybersecurity Program links the identification of the systems, infrastructure, kill chains, and processes and their missions with the need to coordinate analysis, assessments, resources, and infrastructure to timely provide support for the missions.

Mandating Improvements to Cybersecurity for the Defense Industrial Base

With the recent implementation of the Cybersecurity Maturity Model Certification ("CMMC") regulations and many other requirements, remaining abreast of changes in this important area is crucial for government contractors. The 2021 NDAA includes two requirements that DoD perform assessments that are likely to result in additional requirements on industry. Those assessments, which are supposed to be created as a result of collaborative work with members of the DIB, must be developed and submitted to Congress 270 days after enactment of the NDAA.

Section 1737 requires an assessment of DIB "participation in a threat information sharing program." DoD must analyze "the feasibility, suitability, and definition of, and resourcing required to establish, a [DIB] threat information sharing program to collaborate and share threat information with, and obtain threat information from" the DIB. The assessment must also consider a series of practical concerns regarding how the sharing program would work between government and industry, e.g., a mechanism for developing a shared real-time picture of the threat environment, options for joint, collaborative, and co-located analytics, and how industry could be incentivized to participate. If the Defense Secretary determines that an information sharing program is feasible and suitable, DoD shall establish such a program "[n]ot later than 180 days after a positive determination."

Section 1739 requires DoD to assess the suitability, feasibility, definitional issues, and resources required to develop a DIB Threat Hunting Program. The focus of such a program would be "to actively

identify cybersecurity threats and vulnerabilities within the defense industrial base." Such a program would include (among other things, and as appropriate) DIB threat hunting elements at each level of the new CMMC program, and the potential to have a continuous cybersecurity threat hunting program supplements the cyber hygiene requirements of the CMMC.

TAKEAWAYS

- Depending on the outcome of the assessments mandated by Sections 1737 and 1739, contractors' compliance burdens could continue to increase with respect to cybersecurity. In the interim, contractors must be attentive to the CMMC requirements.

Procurement Flexibility

The NDAA also includes provisions to add flexibility in procurement. For example:

- Section 814 modifies the Truthful Cost or Pricing Data statute (still commonly referred to by its former name, the "Truth in Negotiations Act" or "TINA") to increase the thresholds for DoD contracts and subcontracts from $750,000 to $2 million, including for contracts entered into prior to July 1, 2018. The change makes the threshold change statutory; DoD has applied a $2 million threshold under a Federal Acquisition Regulation ("FAR") class deviation effective on July 1, 2018. Section 814 also requires DoD to conduct a study and report to Congress regarding the benefits of the change and any associated costs to the federal government resulting from a higher threshold.
- Section 888 repeals Section 830 of the 2017 NDAA, which required use of firm fixed-price contracts for Foreign Military Sales ("FMS"). Section 830 and the implementing regulations required use of firm fixed-price contracts unless the foreign country customer had established in writing a preference for a different contract type or requested in writing that a different contract type be used for a specific FMS. Section 888 thus will facilitate greater flexibility for DoD agencies (and contractors, to some degree) in FMS contracting.
- Section 891 alleviates the current restriction on extending progress payments beyond 80 percent of the value of an undefinitized contract action ("UCA") during the COVID-19 national emergency. UCAs frequently take longer than the prescribed 180 days (from the date the contractor submits a qualifying proposal) to definitize. The COVID-19 emergency has exacerbated delays in the definitization of UCAs. The Conference Report directs the Government Accountability Office ("GAO") to conduct a study regarding the change, including the number and types of contracts and contractors that received the advanced funding and DoD's oversight of the payments.

Other Procurement Provisions of Note

In addition to the foregoing, the NDAA also contains a variety of provisions that will affect the award and administration of contracts. We address a few below.

Section 816 addresses long-running concerns with commercial item determination for products sold to DoD. These determinations affect whether contractors are required to disclose certified cost or pricing data (and have other implications) with respect to the procurement of certain products and services. In the past, the level of expertise of government personnel making commercial item determinations has not been consistent across DoD—and has resulted in an expectation of contractor pricing data that contractors should not, under applicable regulations, be required to provide. DoD previously directed that commercial item determinations be centrally conducted to ensure

consistency in the application of professional judgment. Section 816 amends the applicable statute to provide contracting officers authority to "request support from" the Defense Contract Management Agency ("DCMA") or other appropriate experts to make these determinations. The statute also requires that contracting officers "consider the views of appropriate public and private sector entities." And Congress adds a requirement that within 30 days of a contract award, the contracting officer must "submit a written memorandum summarizing the determination" that includes "a detailed justification for [the] determination."

Section 833 addresses Other Transaction ("OT") Authority. OT Authority provides DoD a process to acquire certain goods and services outside the traditional regulations (FAR, DFARS) applicable to federal procurement. Although OTs were originally intended to facilitate entrance of non-traditional defense contractors into the market, the use of OT agreements by DoD has expanded during the past several years, and many within government and industry have sought increased transparency as the amount spent using OT procedures has increased. Section 833 requires that DoD make public ("maintain on a single Government-wide" portal) "a list of consortia used by the Secretary to announce or otherwise make available opportunities to enter into a transaction" under OT authority. OT consortia generally involve a relationship between a government sponsor and traditional and non-traditional companies that do (or intend to) operate in part of the government market that are managed by a single entity and focus on solutions to government technology challenges. Consortia also may include non-profit organizations and academic organizations focused in the same technology areas. Because OT awards are made outside traditional channels in which government contracting opportunities are publicized, additional transparency concerning possibilities for companies to become party to an OT is needed. In addition to requiring a public list of consortia operating with DoD, the Conference Report directs GAO to report to Congress on "the nature and extent of [DoD's] use of consortia for other transactions," including "the number and dollar value of other transaction awards through consortia." That information will assist companies understand the growing size of the OT market and facilitate congressional oversight.

An important part of the oversight of federal procurement involves bid protests, which allow interested offerors to challenge (and have outside counsel and subject matter experts examine) whether certain agency procurement decisions were consistent with applicable law and regulations. Most bid protests are considered by GAO, and, during the last several years, there have been numerous proposals to change GAO's rules and reduce oversight of the procurement decisions. Section 886 repeals a pilot program imposed by the FY2018 NDAA (Section 827), which required that DoD attempt to determine the effectiveness of requiring contractors to reimburse DoD for costs incurred in processing covered protests. The pilot program would have affected protests denied by GAO when such actions were brought by parties "with revenues in excess of $250,000,000." Many DIB participants and members of the bid protest bar pointed out problems with the proposals and pilot program when the FY2018 NDAA was being considered and was enacted. After two years, the Senate Armed Services Committee explained that the repeal was necessary because "the pilot program is unlikely to result in improvements to the bid protest process given the small number of bid protests captured by the pilot criteria and lack of cost data."

TAKEAWAYS

- Section 816's allowance for agency officials making commercial item determinations to obtain assistance from DCMA experts will hopefully improve and make these determinations consistent across DoD.
- Government contractors and companies that have technologies that may be helpful to government buyers will soon have access to more information regarding OT consortia.
- The pilot program to study fee shifting in bid protest actions has been eliminated.

For more information about the topics raised in this Legal Update, please contact any of the following lawyers.

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