

November 20, 2015

VIA ELECTRONIC SUBMISSION

Defense Acquisition Regulations
General Services Administration
ATTN: Ms. Amy G. Williams
OUSD (AT&L) DPAP/DARS
3060 Defense Pentagon
Room 3B941
Washington, DC 20301-3060

Re: Proposed DFARS Regulation to Implement “Detection and Avoidance of Counterfeit Electronic Parts,” 80 Federal Register 56939, September 21 2015 (DFARS Case 2014-D005)

Dear Ms. Williams:

The Office of Advocacy (Advocacy) offers the following comments to the Department of Defense (DOD) in response to the above-referenced rulemaking issued on September 21, 2015. The proposed rule would require contractors, both large and small, who are not the original manufacturer to have a risk-based system to trace electronic parts from the original manufacturer to product acceptance by the Government. If such traceability is not feasible for a particular part, the contractor system must provide for the consideration of an alternative part or utilization of tests and inspections in order to avoid counterfeit electronic parts. The rule also requires the contractor to notify the contracting officer if the part cannot be obtained from a trusted supplier. If such cannot be obtained from a trusted supplier and after notification to the contracting officer, the contractor is responsible for inspection, testing, and authentication, in accordance with existing applicable industry standards. This rule will also apply to commercial contractors. In general, the Government¹ has made a determination that Commercially Off the Shelf Items (COTS) are not bound by the same acquisition regulations as other items unless there is a determination that it is in the best interest of the Government for federal acquisition regulations to apply. DOD has determined that COTS items will be covered by this regulation. Finally the contractor assumes responsibility for the authenticity of parts provided by suppliers.

The Office of Advocacy has been engaged with large and small contractors for several years on the emerging issue of government acquisition regulations of counterfeit

¹ 41 U.S.C. 1906

electronic parts. Most recently, the Office of Advocacy held a telephone conference with small entities in Louisiana and New Mexico on this proposed regulation. Small entities do not want to provide the government counterfeit electronic parts, but they are concerned with the broad application of the proposed rule.

Based on input from small business stakeholders, Advocacy has three chief concerns:

- the cost of compliance will serve to deter small businesses from participating as prime and subcontractors in the Federal Acquisition process.
- the Initial Regulatory Flexibility Analysis (IRFA) lacks clarity as to the actual cost of compliance for small entities as prime and as subcontractors, and
- the rule has not explored workable alternatives that will allow the government to achieve its objectives.

Office of Advocacy

Advocacy was established pursuant to Pub. L. 94-305 to represent the views of small entities before federal agencies and Congress. Advocacy is an independent office within the SBA, so the views expressed by Advocacy do not necessarily reflect the views of the SBA or the Administration. The Regulatory Flexibility Act (RFA),² as amended by the Small Business Regulatory Enforcement Fairness Act (SBREFA),³ gives small entities a voice in the rulemaking process. For all rules that are expected to have a significant economic impact on a substantial number of small entities, federal agencies are required by the RFA to assess the impact of the proposed rule on small entities and to consider less burdensome alternatives.

The Small Business Jobs Act of 2010 requires agencies to give every appropriate consideration to comments provided by Advocacy.⁴ The agency must include, in any explanation or discussion accompanying the final rule's publication in the Federal Register, the agency's response to these written comments submitted by Advocacy on the proposed rule, unless the agency certifies that the public interest is not served by doing so.⁵

Background

DOD is proposing to revise the DFARS to further implement section 818 of the National Defense Authorization Act for Fiscal Year 2012, as modified by section 817 of the National Defense Authorization Act for Fiscal Year 2015. On May 6, 2014, DOD published a final rule under DFARS Case 2012-D005, entitled "Counterfeit Electronic Parts;" that rule constituted the initial partial implementation of section 818 of the Defense Authorization Act for Fiscal Year 2012. This regulation was limited to contractors with Cost Accounting Systems and most small businesses were excluded

² 5 U.S.C. §601 et seq.

³ Pub. L. 104-121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C. §601 et seq.).

⁴ Small Business Jobs Act of 2010 (PL. 111-240) §1601, codified at 5 U.S.C. § 604 (a)(3)

⁵ Id.

from the rule. However, this proposed regulation is not limited to CAS contractors and it will apply to small business prime and subcontractors.

I. The cost of compliance will serve to deter small businesses from participating as prime and subcontractors in the federal acquisition process because the rule raises the cost of doing business with the federal government.

A. Parts that are in production. Small contractors must obtain electronic parts that are in production or currently available in stock from the original manufacturers, their authorized dealers or suppliers that obtain parts exclusively from the original manufacturers or their authorized dealers. It is unclear from the proposed regulation as to who will absorb the higher costs for these restrictive parts, the government or the contractor. This concern was expressed by small business subcontractors during the recent telephone conference. Will the prime contractors accept the higher cost of items or will the subcontractor have to absorb the cost of the higher priced electronic parts? It is also unclear from the proposed regulation whether the contractor is still liable for a part that is counterfeit when the contractor obtains a part according to this method.

B. Parts that are not in production. The proposed regulation will permit the contractor to obtain electronic parts that are not in production, or not currently available in stock, from trusted suppliers, provided that the contractor uses established counterfeit prevention industry standards and processes, including testing, for identifying such trusted suppliers for the authenticity of parts provided by such suppliers. It is unclear as to how the small business owner is to provide documentation to the prime contractor or to the contracting officer that the part is in production or the part is not in production. This uncertainty creates a higher than normal cost for small businesses. Moreover, if the part is not in production the small business must implement counterfeit prevention industry standards and processes, including testing of the supplier and part. The regulation does not provide any guidance on cost or process or acceptable procedures for the small business to follow. Unlike the part of the regulation that requires the obtaining of parts that are in production, if the part is not in production, the regulation is clear that the contractor assumes responsibility

C. COTS. The proposed regulation is extended to commercial products and commercially off the shelf products (COTS). Since most federal acquisition regulations exempt these products, these small businesses will have to establish first time compliance systems and many will have to garner a better understanding of other related Federal acquisition regulations that may impact the acceptance of their electronic products by the contracting officer. This requirement will increase the cost for small companies.

Advocacy recommends that the DFAR provide more clarity in the IRFA as to the actual cost of compliance for small entities as prime and as subcontractors. The DFAR should provide small entities with a clearer statement of the cost of compliance.

II. The Initial Regulatory Flexibility Analysis (IRFA) lacks

clarity as to the actual number of small businesses, prime and subcontractors that will be impacted by the rule, and lacks a meaningful discussion of reasonable alternatives for small businesses to comply

A. Number of small businesses

In determining the number of contractors affected by this proposed rule, the DFAR relies on the number of contractors in the Federal Procurement Data System (FPDS). FPDS does not capture the number of small subcontractors and thus the number of impacted small businesses in the IRFA is inaccurate. The DOD has been under a multi-year Congressional test of the subcontracting program and it should have a more accurate number of such businesses, The DOD Comprehensive Subcontracting Test Program. It is unclear from the number of small businesses that will be impacted by the rule whether COTS small businesses are a part of the estimate that is in the IRFA. The discussion in the IRFA of the impact on small businesses would seem to suggest that COTS small businesses were not included in the estimate or in the discussion of the cost of compliance.

B. Alternatives

The proposed regulation does not provide alternatives for small businesses to evaluate and to make reasonable judgments as to their participation. The DFAR does not give consideration to the impact of the regulation on the cost of insurance. Small businesses expressed a concern that the lack of clarity of the regulation as to what constitutes a counterfeit electronic part and who has ultimate liability for the defective part will result in higher insurance premiums and some may not be eligible for insurance coverage. Until there is more clarity of this overall process and clear uniform acceptable industry standards, the DFAR should give consideration to supporting an Insurance Pool for small businesses.

The DFAR should also give consideration to the use of its vast testing resources to assist small firms in validating the authenticity of the electronic parts. In the alternative, the DFAR could consider providing through, its Mentor-Protégé program a structure that would validate and test electronic parts for small sub-contractors.

The DFAR should examine an alternative that would give consideration to a compliance phase-in of COTS companies and small business subcontractors at certain dollar threshold contracts.

Recommendations

Advocacy recommends that the DFAR provide more clarity in the IRFA as to the actual numbers of small businesses affected by the rule and the cost of compliance for small entities as prime and as subcontractors.

To address the problem that the cost of compliance will serve to deter small businesses from participating as prime and subcontractors in the Federal Acquisition process, Advocacy recommends that the DFAR reconsider the implementation strategy for this proposed rule and provide a phase-in period for small prime contractors and small subcontractors and COT companies.

Advocacy recommends that the comment period for this proposed regulation be extended for 60 days to allow the DFAR to work with the small business community to examine reasonable alternatives for compliance and to publish these alternatives for comment.

Conclusion

Advocacy would like to offer its assistance to create appropriate discussion groups with small businesses on how this proposed regulation can be redesigned to reduce the cost of compliance for small businesses. Advocacy urges the DFAR to give full consideration and to adopt these recommendations. If you have any questions or require additional information please contact me or Assistant Chief Council Major L. Clark at (202) 205-7150 or by email at major.clark@sba.gov.

Sincerely,



Claudia Rodgers
Acting Chief Counsel for Advocacy



Major L. Clark, III
Assistant Chief Counsel for Advocacy

Copy to: The Honorable Howard Shelanski, Administrator
Office of Information and Regulatory Affairs
Office of Management and Budget