

Contractors Exposed To Civil Suits Under New Reporting Rule

By **Daniel Wilson**

Law360 (November 22, 2019, 8:52 PM EST) -- Federal contractors may face increased litigation under a new regulation that expands requirements to report counterfeit items in their supply chains, but fails to offer protection when suppliers dispute those reports.

The final rule, which the Federal Acquisition Regulatory Council issued Thursday, more than five years after it was first proposed, requires all federal contractors and subcontractors to report to a federal database certain parts that they believe are counterfeit or don't conform to specifications.

The reporting requirement, which previously only applied to defense contractors and only for electronic parts, doesn't offer safeguards for civil contractors that abide by the rule's reporting requirements, only to have suppliers challenge their reports as damaging to business.

While defense contractors enjoy protections laid out in an older regulation, the expanded rule leaves other contractors open to liability, according to Foley & Lardner LLP partner Frank Murray Jr., a member of the American Bar Association's Counterfeit Parts Task Force.

"Now if I'm providing an electronic part for the Department of Homeland Security or [General Services Administration] or something else, and I'm supposed to be reporting, I don't have that safe harbor anymore," Murray said.

That existing regulation requiring only U.S. Department of Defense contractors to report counterfeit electronic parts contains a safe harbor from tort suits as long as contractors "make a reasonable effort to determine that the report was factual."

That helps defense contractors avoid defamation and libel suits in situations where suppliers claim to have been hurt as a result of reports identifying suspected counterfeit items, Murray said.

Stinson LLP partner Susan Ebner, also part of the Counterfeit Parts Task Force, said she recognized the council's desire to be tough on contractors and make sure they get their reporting right. But it is also important to provide a carrot to attract contractors to want to comply with the rule — "that if they do this that they will be able to benefit and insulate themselves from future liability," she said.

"You want them to be encouraged to do what they can to try to ferret out problems," she added.

Although both rules stem from a clause in the 2012 National Defense Authorization Act, the FAR Council

rebuffed requests to include an expanded safe harbor in the new rule. The NDAA clause covers only DOD contracts and counterfeit electronics reporting, the council said in its explanation for refusing to expand the safe harbor beyond the statutory language.

The FAR Council "just basically said that's for Congress to deal with, not for us," Murray said.

Murray, Ebner, and Crowell & Moring LLP senior counsel Paul Freeman, who counsels federal contractors on supply-chain risk issues, all also raised other concerns left unaddressed in the new rule.

For example, what counts as a "major" or "critical" nonconformance in a particular part that needs to be reported to the database, and what is a minor issue that does not, is unclear, according to Murray and Freeman.

"The way it's phrased could mean any number of things," Freeman said. "Depending upon what the product is, it could mean a whole host of things, and in our view is really quite fact-dependent, which is going to place a lot of burdens on contractors to sort through what it means for them and their products and their contracts, almost on a case-by-case basis, at least initially."

It's also unclear what contractors need to do to "flow down" requirements through their supply chains, creating more challenges for how they engage with their suppliers, which are already under pressure from other federal supply chain rules, like growing cybersecurity requirements, Freeman said.

And the rule excludes foreign companies from reporting requirements, which could hurt contractors' and the government's ability to stay ahead of potential counterfeits through the database, Ebner noted.

"When I think of counterfeit parts, I don't think of counterfeit parts as being made just in the United States — I think it's widely known there have been problems with counterfeit parts being made in a variety of locations around the world," she said.

On the plus side, the moves the FAR Council made to "significantly descope" the final rule from its 2014 proposal will help to make sure the federal database isn't swamped with "noise," and better ensure compliance with the rule, Murray said.

In its initial proposal, the council said the rule would cover effectively all parts used by federal contractors. The final rule instead covers certain "critical" items, as designated by contracting officers, and also excludes particular broad categories of items, like commercial items — except electronics already covered by the DOD rule — and medical devices regulated by the U.S. Food and Drug Administration.

"The big picture thing I take from this is that the number of people who are going to have this in their contract or subcontract has been dramatically reduced," Murray said. "And that is a benefit compared to the proposed rule, because one of the big concerns was, if you had to apply this to commercial items and to commercial-off-the-shelf items, [those companies] were never going to do this."

For many commercial item companies, federal contracts account for only a small fraction of their business, and they may have been driven away from government work altogether, Murray noted.

But the move to exempt commercial items may also leave a "big gaping hole" that goes against the purpose of the rule, Ebner said.

"When you go through the rule, you see they're talking about counterfeit things like titanium and other parts and components that are not electronic, that could cause major issues [like] fasteners — if they're counterfeit, they're going to be a problem," she said. "And yet, those might very well be considered commercial items."

A part of the rule exempting contracts below the simplified acquisition threshold — currently \$250,000 — may also hurt efforts to counter counterfeit items and ultimately see the FAR Council revise its rule, according to Ebner.

"My question for contractors to be thinking about is — they may have done the rule this way now, but give it another year, and they may come back and remove some of these exemptions, because the problems are going to continue," she said.

--Editing by Breda Lund and Kelly Duncan.