

Meeting the Requirements for the DOD's Counterfeit Electronic Parts Safe Harbor

August 31, 2016

WHAT: The Department of Defense (DOD) issued a final rule amending the Defense Federal Acquisition Regulation Supplement to specify that the costs associated with counterfeit electronic parts and suspect counterfeit electronic parts will be allowable, but only if the contractor can meet a three-part test for safe harbor:

1. The contractor has a DOD-reviewed-and-approved system in place to detect and avoid counterfeit electronic parts and suspect counterfeit electronic parts;
2. The counterfeit electronic parts or suspect counterfeit electronic parts were provided to the contractor as Government property or obtained in accordance with separately published regulations that restrict sources for electronic parts to specially defined "trusted suppliers"; and
3. The contractor provides written notice to the Contracting Officer and the Government-Industry Data Exchange Program within 60 days after it becomes aware of the counterfeit electronic parts or suspect counterfeit electronic parts.

WHEN: Effective immediately (August 30, 2016).

WHAT DOES IT MEAN FOR INDUSTRY: This final rule represents a true safe harbor in a storm of new regulations prompted by the 2012 National Defense Authorization Act. These new regulations, designed to reduce the risk of counterfeit electronic parts and to shift that risk to the contractor community, have been published at a steady pace, and continue to require contractors to take significant action to ensure compliance.

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Practice Areas

Cost Accounting and Cost Allowability
Government Contracts

This final rule, Costs Related to Counterfeit Electronic Parts (DFARS Case 2016-D010), allows contractors to classify as allowable the costs associated with counterfeit electronic parts and suspect counterfeit electronic parts, and the costs of any rework or corrective action that may be required to remedy their use. But meeting the three-part test to take advantage of this provision requires careful planning, wise investment, and constant vigilance. Covered contractors should establish or revisit their supply chain management program and policies to ensure that they do not miss opportunities to treat the potentially significant remedial costs of counterfeit or suspect counterfeit electronic parts as allowable charges. These should include:

1. Validating that their detection and avoidance systems have been reviewed or approved, or initiating the process for DOD review and approval;
2. Reviewing the latest regulations regarding sourcing electronic parts, including a separate final rule published on August 2 requiring contractors and subcontractors to acquire electronic parts only from "trusted suppliers"; and
3. Establishing or enhancing procedures for discovering and reporting counterfeit electronic parts and suspect counterfeit electronic parts.