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# **SUPPLY CHAIN MANAGEMENT AND COMPLIANCE WEBINAR**

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Michael Mutek’s practice spans government contracts, compliance and ethics, bid protests, claims, internal investigations and disclosures, formation and dissolution of teaming agreements, and dispute resolution.

Prior to joining Steptoe, Mr. Mutek served as vice president and general counsel of Raytheon’s Intelligence, Information and Services, a \$6 billion business of Raytheon Company, where he was responsible for the legal affairs and worked on several successful acquisitions in order to help create a cybersecurity business. During his 26 years at Raytheon, he held several other business unit general counsel and vice president positions, including vice president of contracts. In his early career, he served as senior trial attorney on the Air Force’s Trial Team.

Mr. Mutek is a frequent writer and lecturer on government contracts and corporate law topics, and has testified on government contract issues before Congress. He is a Fellow of the American Bar Association’s Section of Public Contract Law and is a past chair of the Section. Mr. Mutek is also a Life Fellow of the American Bar Foundation. He chaired the ABA’s Services Contracting Best Practices Task Force, which published “Services Contracting Best Practices: A Guide to Successful Services Contracting” and is the author of “Contractor Team Arrangements – Competitive Solution or Legal Liability: The Deskbook for Drafting Teaming Agreements,” published by the ABA.

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# SUPPLY CHAIN MANAGEMENT AND COMPLIANCE

## WEBINAR OUTLINE

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- 1. Supply Chain Management Today**
  - How it Has Evolved
  - A Compliance Function
- 2. Government Interest in Supply Chain Issues**
  - CPSR
  - Responsibility
  - Past Performance
- 3. Subcontractor Source Selection Issues**
  - Risk Management Concerns
  - Competition in Subcontracting
  - Make or Buy



# SUPPLY CHAIN MANAGEMENT AND COMPLIANCE

## OUTLINE

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### 4. Teaming & Collaborative Arrangements

- “To Team or Not to Team?”
- **Benefits**
- **Issues**

### 5. Standard Policies & Standard Forms

- **Why Have Policies?**
- **Developing Standard Forms**
- **Key Terms**

### 6. Addressing Requirements for Supplier Business Ethics & Conduct

- **Flowing Down Ethics into the Supply Chain**
- **Best Practices**

# OUTLINE (continued)

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## 7. Counterfeit Parts

- Why the Attention?
- Rules and Restrictions

## 8. Cybersecurity

- Key Government Concern
- Potential Back Door into Your Company

## 9. Specific Issues with Global Supply Chains

- Country-of-Origin
- Export Controls
- FCPA
- Trafficking in Persons

## 10. Supply Chain Management is a Moving Target

# SUPPLY CHAIN MANAGEMENT AND COMPLIANCE



1. **Supply Chain Management Today**
  - **How it Evolved**
  - **A Compliance Function**

# SUPPLY CHAIN MANAGEMENT

The Council of Supply Chain Management Professionals (CSCMP) defines supply chain management as follows:

*Supply Chain Management encompasses **the planning and management of all activities** involved in sourcing and procurement, conversion, and all logistics management activities.*

*Importantly, it also includes **coordination and collaboration with channel partners**, which can be suppliers, intermediaries, third-party service providers, and customers.*

<http://cscmp.org/>

## ***Broad definition***

## Supply Chain Issues in the News



From National Defense, April 25, 2016

### **Pentagon Fears Foreign Intrusions Into Supplier Networks**

**Both the Pentagon and the intelligence agencies have levied a host of new “supply chain risk management” demands on contractors ... This was the “inevitable consequence” of growing threats and a recognition that much of the defense community’s intellectual propriety resides in the supplier network.**

**Whereas commercial companies focus on the financial impact of threats like cyber espionage and counterfeit manufacturing, for defense suppliers, the risks carry more consequential ramifications ...**

**The defense sector has to worry that leaks could result in loss of lives ...**



# Supply Chain Issues in the News

From National Defense Weekly Insider, Mar. 8, 2016



## Defense Industry Warns Pentagon to Protect Supply Lines

The relationship between the Pentagon and its suppliers is supported by detailed procurement regulations that touch on every aspect of the defense contracting business. Yet **the Defense Department knows little about many of its lower tier suppliers deep down in the value chain.** Industry experts warn that the Pentagon's lax grip on the outer layers of its supply system makes it increasingly vulnerable to intrusions such as malicious hacking.

“The **issue of cybersecurity** in the manufacturing supply chain is just starting to gain more awareness ... “The government has realized how little of a handle they have on the supply chain.”

Procurement experts said **defense contractors and their subcontractors can expect to see new regulations** in response to a recent Government Accountability Office report on the Pentagon's vulnerabilities to counterfeit parts in its global supply chain.

Congress has directed the Defense Department to study the problem and report back next year.

# Supply Chain Management

## How it Evolved from Yesterday's “Purchasing Department”



- Purchasing Departments focused on the placement of purchase orders to achieve
  - ✓ Right part
  - ✓ Right price
  - ✓ Right place
  - ✓ Right time
- Gained **strategic significance** –find suppliers with the best parts and price
  - Wide net cast – global

In the 1980s, the term “supply chain management” was developed to express the need to integrate the key business processes from end user through original suppliers.\*

\*Oliver, R. K.; Webber, M. D. (1992) [1982] "Supply-chain management: logistics catches up with strategy." In Christopher, M. Logistics: The Strategic Issues. London: Chapman Hall. pp. 63–75.



# Government Contractors and Supply Chain Risk



- **The Government expects its prime contractors**
  - **to ensure that the supply chain that supplies its military is effectively policed.**
- **Supply chain problems can jeopardize the award of future contracts**
  - **by creating negative past performance**
  - **and reputational issues.**

# Evolution – Global Supply Chains



- A critical component of evolution from “purchasing department” to a more strategic “supply chain” function has been the addition of important **risk management and compliance responsibilities**,
  - including mandates found in FAR and DFARS clauses.
- A supply chain function today must not only find the right suppliers and ensure that goods and services meet required quality requirements at competitive prices,
  - but must also address **compliance with growing list of laws and regulations**.
  - It must do so with a supply chain that may well have a **global reach**.

# Supply Chain Management is a **Compliance Function**

- Supply chain management has a heightened level of importance.
- Particularly in a regulated industry.
  - **Government contracting is a regulated industry.**
- As a result, a Government contractor's supply chain management must ensure compliance with:
  - a broad range of laws,
  - regulations,
  - and policies that are industry specific.



# Compliance

- Among the **many risks** that supply chains must address are
  - counterfeit parts,
  - human trafficking,
  - supplier business ethics,
  - cyber threats,
  - quality and performance compliance, and
  - restrictions relating to international trade.
- These concerns are some of the **key reasons for the current focus** on Government contractor supply chain risk management.



# SUPPLY CHAIN MANAGEMENT AND COMPLIANCE



## 2. Government Interest in Supply Chain Issues

- **CPSR**
- **Responsibility**
- **Past Performance**



# SUPPLY CHAIN MANAGEMENT AND COMPLIANCE

## Government Interest in Supply Chain Issues

- The Government's interest in and oversight of the contractor's supply chain function includes a framework for review.
- **Contractor Purchasing System Review**
  - Where a contractor's "purchasing" exceeds the regulatory threshold, the Federal Government may decide to evaluate the contractor's purchasing system, **including supply chain risks**,
  - using a Contractor Purchasing System Review (CPSR),
  - conducted by the Defense Contract Management Agency (DCMA).



# SUPPLY CHAIN MANAGEMENT AND COMPLIANCE

## Government Interest in Supply Chain Issues



- The “purchasing system” constitutes a business system.
- The “**business systems rule**” was issued by the DoD in 2011.
  - A business systems may be deemed noncompliant due to a “**significant deficiency.**”
  - In addition to mandatory penalties, a “significant deficiency” can
    - increase the time and cost of contracting with the Government
    - because it will require additional approvals and oversight.

# Responsibility



- The FAR states that “[p]urchases shall be made from, and contracts shall be awarded to, responsible prospective contractors only.”
  - The standards for “responsibility” are found in FAR 9.104.
- The FAR at 9.104-4(a) makes clear that **prime contractors should consider equivalent standards in evaluating and selecting subcontractors:**

*Generally, prospective prime contractors are responsible for determining the responsibility of their prospective subcontractors ... **Determinations of prospective subcontractor responsibility may affect the Government’s determination of the prospective prime contractor’s responsibility. A prospective contractor may be required to provide written evidence of a proposed subcontractor’s responsibility.***

# The Responsibility Standards (FAR 9.104-1)

- (1) Have adequate financial resources to perform the contract (or subcontract) or the ability to obtain them;
- (2) Be able to comply with the required or proposed delivery or performance schedule, taking into consideration all existing commercial and governmental business commitments;
- (3) Have a satisfactory performance record;
- (4) Have a satisfactory record of integrity and business ethics;
- (5) Have the necessary organization, experience, accounting and operational controls, and technical skills, or the ability to obtain them ...;
- (6) Have the necessary production, construction, and technical equipment and facilities, or the ability to obtain them; and
- (7) Be otherwise qualified and eligible to receive an award under applicable laws and regulations.

# Past Performance

- The FAR makes **past performance a factor in almost all source selections**
  - and includes detailed provisions for collecting and maintaining contractor performance information.
- Past performance information related to proposed subcontractors,
  - particularly key subcontractors,
  - can be an important part of an offeror's overall past performance rating, and
  - can be a competitive discriminator.
- Since 2010, the FAR has required the use of the Federal Awardee Performance and Integrity Information System (FAPIIS).



# Past Performance

- The purpose of the database = to **enable COs to monitor the integrity and past performance of companies.**
- FAR at 9.104-6(a) requires that, “[b]efore awarding a contract in excess of the simplified acquisition threshold,”
  - **the CO “shall review” FAPIIS in the responsibility determination**
  - **as well as source selection evaluation of past performance.**
- **The Excluded Parties list is publicly available**
- **Automated subcontractor screening systems are available**



# Summary of Key Points from Part 2 – Government Interest in Supply Chain Issues

- ✓ Government’s interest in and oversight of the contractor’s supply chain function includes a framework for review – the CPSR
- ✓ **CPSR** is “the complete evaluation of a contractor’s purchasing of material and services, subcontracting, and subcontract management from development of the requirement through completion of subcontract performance.”
  - ✓ The “purchasing system” constitutes a **business system**.
- ✓ The FAR states that “[p]urchases shall be made from, and contracts shall be awarded to, **responsible prospective contractors only**.”
  - ✓ **Determinations of prospective subcontractor responsibility may affect the Government’s determination of the prime contractor’s responsibility**
- ✓ **Past performance** related to proposed subcontractors, particularly key subcontractors, can be an important part of an offeror’s overall past performance rating, and can be a competitive discriminator.

# SUPPLY CHAIN MANAGEMENT AND COMPLIANCE



## 3. Subcontractor Source Selection Issues

- Risk Management Concerns
- Competition in Subcontracting
- Make or Buy



# Subcontractor Source Selection Issues

- Exclusion from an opportunity is a risk of ineffective source selection
  - The final DFARS rule on “**Requirements Relating to Supply Chain Risk**”
    - Reflects Government concern over the risk of “back door” cyberattacks through a company’s supply chain.
    - Makes supply chain risk an **evaluation factor** and authorizes officials in the Department of Defense (DOD) to **exclude** sources from providing information technology on the basis of risk.



# Prime Contractor/Higher Tier Sub Source Selection Concerns

## “Competition in Subcontracting” – FAR 52.244-5

- Prime contractors must comply with “Competition in Subcontracting” requirements **if the FAR clause is included in the contract**
  - and select subcontractors on a competitive basis, to the maximum practical extent, consistent with the objectives and requirements of the contract.
- COs may accept justifications for sole-source awards if the prime contractor provides substantive evidence that
  - no other responsible party exists, or there are circumstances of unusual and compelling urgency.

# Prime Contractor/Higher Tier Sub Source Selection Concerns

## “Competition in Subcontracting” – FAR 52.244-5 (continued)

- However, statements by a prime to justify a noncompetitive subcontract
  - ✓ based on the unique position or
  - ✓ characteristics of the subcontractor, such as the geographical location, site specific experience, or
  - ✓ that the supplier is the only available source,
- are unlikely to be an acceptable justification for sole-source subcontracting without strong supporting documentation.



# Prime Contractor/Higher Tier Sub Source Selection Concerns



## “Make or Buy”

- **Significant decision**
- FAR 15.407-2:

***When make-or-buy programs are required, the Government may reserve the right to review and agree on the contractor’s make-or-buy program when necessary to ensure negotiation of reasonable contract prices, satisfactory performance, or implementation of socioeconomic policies.***



# Prime Contractor/Higher Tier Sub Source Selection Concerns

- A basic **supply chain risk management program** should address four key points:
  - (1) How to identify and confirm the qualifications of a potential supplier, including its business reputation and responsibility;
  - (2) How to confirm the business need and justification for working with the potential supplier;
  - (3) How to ensure that the necessary prime contract requirements and provisions are flowed down; and
  - (4) How to conduct ongoing monitoring of the supplier during subcontract performance.

# Summary of Key Points from Part 3. Subcontractor Source Selection Issues

- ✓ **Oversight** of the supply chain is important & and a customer expectation
  - ✓ **Globalization** has increased Government customer concerns.
  - ✓ **Exclusion** from an opportunity is a risk of ineffective source selection
- ✓ A prime must consider risks such as —
  - (1) Counterfeit parts;
  - (2) Human trafficking;
  - (3) Cybersecurity threats;
  - (4) Failure to meet socioeconomic and domestic preference goals;
  - (5) Disputes, claims, and litigation;
  - (6) Potential suspension or debarment of suppliers; and
  - (7) Reputational damage from having a bad actor in the supply chain.
- ✓ Prime contractors must comply with **“Competition in Subcontracting”** requirements if the FAR clause is included in the contract

# SUPPLY CHAIN MANAGEMENT AND COMPLIANCE



## 4. Teaming and Collaborative Agreements

- “To Team or Not to Team?”
- Benefits
- Issues

## Teaming and Other Collaborative Arrangements – “To Team or Not to Team?”

- Major or vital subcontractors often are identified and engaged prior to winning the prime contract.
- Teaming and other collaborative arrangements, such as joint ventures, may be used to work with key partner.
  - **Common in Government contracting.**
  - Such arrangements can offer a working arrangement that extends through both the pursuit and performance of a Government contract.





## Teaming and Other Collaborative Arrangements – “To Team or Not to Team?”

- Some may believe that forming a team — that may include competitors — is without risk.
  - Not the case!
- The **formation of a team presents both opportunities and challenges.**
  - Approach such a “marriage of convenience” with caution.
- Companies in a team arrangement may possess legal rights and expectations which, if unfulfilled, can give rise to
  - ✓ disputes,
  - ✓ claims, and
  - ✓ legal actions.



## Teaming and Other Collaborative Arrangements – The FAR Coverage

- Subpart 9.6 — “Contractor Team Arrangements”
  - Supports contractor team arrangements when the teaming partners complement each other’s capabilities and offer the Government the **best combination of performance, cost and delivery.**
  - The Government can hold the **prime contractor fully responsible** for contract performance.



# Teaming and Other Collaborative Arrangements – The FAR Coverage

## 9.602 General.

**(a) Contractor team arrangements *may be desirable from both a Government and industry standpoint* in order to enable the companies involved to—**

- (1) *Complement* each other's unique capabilities; and**
- (2) *Offer* the Government the best combination of performance, cost, and delivery for the system or product being acquired.**

# Teaming and Other Collaborative Arrangements – The FAR Coverage

## 9.603 Policy.

***The Government will recognize the integrity and validity of contractor team arrangements; provided, the arrangements are identified and company relationships are fully disclosed in an offer or, for arrangements entered into after submission of an offer, before the arrangement becomes effective. The Government will not normally require or encourage the dissolution of contractor team arrangements.***



## Teaming and Other Collaborative Arrangements – The FAR Coverage



### **9.604 Limitations.**

***Nothing in this subpart authorizes contractor team arrangements in violation of antitrust statutes or limits the Government's rights to—***

- (a) Require consent to subcontracts (see Subpart 44.2);***
- (b) Determine, on the basis of the stated contractor team arrangement, the responsibility of the prime contractor (see Subpart 9.1);***
- (c) Provide to the prime contractor data rights owned or controlled by the Government;***
- (d) Pursue its policies on competitive contracting, subcontracting, and component breakout after initial production or at any other time; and***
- (e) Hold the prime contractor fully responsible for contract performance, regardless of any team arrangement between the prime contractor and its subcontractors.***

## Teaming and Other Collaborative Arrangements – Benefits



- The legal obligations may limit certain options.
- For example,
  - the team arrangement may assure a source for certain work, a benefit, but **may inhibit** a later desire to “make” rather than “buy.”
- The first reported teaming dispute involved a company who did not get a subcontract and there was a “make/buy” decision.
  - The court in this 1964 case found that “team membership” on a team meant **more than providing one company the opportunity to bid on a subcontract.**

*Air Tech. Corp. v. General Elec. Co.*, 199 N.E.2d 538, 547 (Mass. 1964).

## Teaming and Other Collaborative Arrangements – Issues: Due Diligence Is A Necessary Step

- **Due diligence** means conducting the type of inquiry that a reasonably prudent company would conduct **before entering into a relationship that imposes legal obligations**.
  - Even if a due diligence inquiry does not reveal “show-stopping” red flags, it should provide important insight into the potential subcontractor as well as into terms and conditions that will be needed.



## Teaming and Other Collaborative Arrangements – Issues: Due Diligence Is A Necessary Step

- An important aspect of due diligence is the **identification of any issues that could reduce the team's chances of being selected for award.**
- For example,
  - ✓ legal problems and
  - ✓ ethical lapses or
  - ✓ other issues that could raise responsibility concerns or potentially lead to suspension or debarment would make a company a risky teaming partner and could prevent the team's selection.





# Teaming and Other Collaborative Arrangements – Issues: Enforceability



- Court decisions create uncertainty
  - **Will an agreement will be deemed enforceable?**
  - Notable examples finding a teaming agreement an unenforceable “agreement to agree” – *W.J. Schafer Assocs.*, *Cyberlock*, *A-T Solutions*, *Navar* decisions, from Virginia, whose law applies to many teaming agreements
  - Suggest difficulty in creating enforceable agreements
- At the same time, there is an incredible sense of urgency in team formation and a push for simpler agreements that may translate to even more enforceability issues.

## Teaming and Other Collaborative Arrangements – Issues: Enforceability

- Although the decisions are mixed,
  - in general a teaming agreement will be enforceable in court if
    - ✓ there is a clear intent to be bound,
    - ✓ adequate consideration, and
    - ✓ sufficient agreement on material terms of the subcontract.



# Summary of Key Points from Part 4. Teaming and Other Collaborative Arrangements

- ✓ Team arrangements are common in Government contracts.
  - ✓ FAR supports team arrangements that complement the teammates' unique capabilities and offer the Government the best combination of performance, cost, and delivery.
  - ✓ However, the arrangement cannot be used to reduce competition.
- ✓ Such an arrangement may be an essential to satisfy the requirements of the customer's RFP.
- ✓ Due diligence is an important aspect of forming a team arrangement.
  - ✓ **Exclusivity** should be considered.
  - ✓ **Enforceability** is often an issue.

# SUPPLY CHAIN MANAGEMENT AND COMPLIANCE



- ## 5. The Role of Standard Policies & Standard Forms
- The Value of Policies
  - Developing Standard Forms

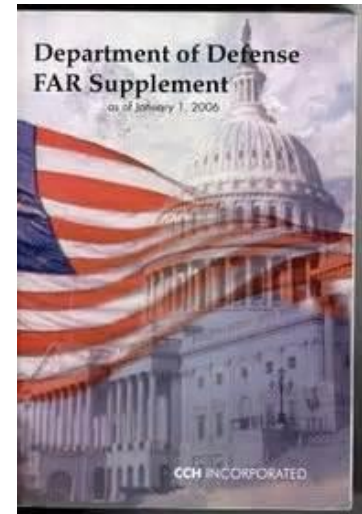
# The Role of Standard Policies & Standard Forms

- Government contractors understand the **benefits of policies and procedures** that address the contractor's
  - ✓ operating principles,
  - ✓ strategy, and
  - ✓ goals.
- Such policies consider
  - ✓ statutory,
  - ✓ regulatory,
  - ✓ customer, and
  - ✓ management requirements.



# The Role of Standard Policies & Standard Forms

- According to a 2015 Government Accountability Office report, between 2010 and 2014 the DOD published 279 final and interim DFARS rules.
  - Each became effective immediately, yet approximately half were issued without prior notice and comment.
- Illustrates the **importance of keeping current.**



# The Role of Standard Policies & Standard Forms



- Many **“mandatory flow down” clauses** are required by the FAR
  - Other clauses are **discretionary flow downs**;
    - they are not required by the contract or regulation but may be necessary as a business matter to protect the prime contractor’s interests.
- When the flow down clauses will be based on the prime contract, they should be tailored as appropriate.
- Due to their volume of solicitations, most large prime contractors will use (and reference in their teaming agreements) certain standard terms and conditions.

# The Role of Standard Policies & Standard Forms

- Standard contract forms **may vary** based upon
  - the nature of the contractor's products and services,
  - whether it typically acts as prime, sub, or both,
  - other factors.





# Summary of Key Points from Part 5. The Role of Standard Policies & Standard Forms

- ✓ There are **benefits** in policies and procedures that address the contractor's operating principles, strategy, and goals.
- ✓ Such policies may be consistent with statutory, regulatory, customer, and management requirements and they should institutionalize best practices.
- ✓ **Many “mandatory flow down” clauses are required by the FAR.**



# SUPPLY CHAIN MANAGEMENT AND COMPLIANCE



## 6. Addressing Requirements for Supplier Business Ethics & Conduct

- Flowing Ethics into the Supply Chain
- Best Practices

# Addressing Requirements for Supplier Business Ethics & Conduct

## ➤ UNIQUE BUSINESS ETHICS & CONDUCT REQUIREMENTS

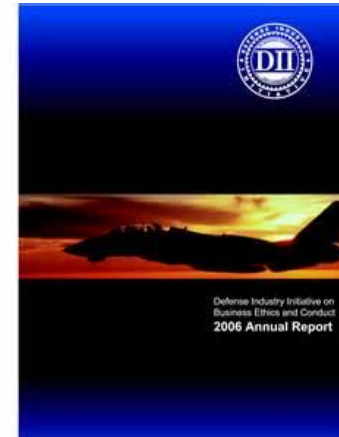
## ➤ FLOW DOWN RESPONSIBILITIES



- Government contractors must comply with **unique business ethics & conduct requirements**.
  - Congress and the Executive Branch expanded considerably the number and types of ethical considerations governing federal contracts after the defense procurement scandals of the 1980s (e.g., " Operation Ill Wind").
- As a result, contractors and prospective contractors must ensure that their employees **and suppliers** comply with these ethics-related statutes and regulations, or face civil, administrative, or criminal sanctions

# Addressing Requirements for Supplier Business Ethics & Conduct

- Contractors today understand the **need for business ethics and conduct**.
  - The defense industry was an early adopter of codes of ethical conduct, starting with the voluntary Defense Industry Initiative (DII).
- The DII was started in 1986, when the defense industry was suffering through a spare parts pricing scandal that provided fodder to late night talk show host monologues and resulted in general mistrust of the industry.



# Addressing Requirements for Supplier Business Ethics & Conduct

- Over time, **the principles of the DII**,
  - along with similar principles found in the United States Sentencing Commission Guidelines Manual,
  - have been **adopted by most defense contractors** and **woven into the fabric of the FAR**.
- What began as a voluntary commitment has evolved into a FAR mandate—
  - **that extends to the supply chain.**



# Addressing Requirements for Supplier Business Ethics & Conduct

- **Flowing Ethics Down Into The Supply Chain**

(1) The **disclosure** commitment encompasses situations where the prime contractor has credible evidence of wrongdoing by a subcontractor (broadly defined as “any supplier, distributor, vendor, or firm that furnished supplies or services to or for a prime contractor or another subcontractor”).

(2) The business ethics awareness and compliance program commitment includes **training** for agents and subcontractors “as appropriate.”

# Addressing Requirements for Supplier Business Ethics & Conduct

- **Flowing Ethics Down Into The Supply Chain**

(3) The **substance of the entire clause** is to be included (i.e., flowed down) in subcontracts that meet the size and duration thresholds that trigger its applicability to prime contracts.

(4) In addition, the preamble to the Federal Register notice finalizing the clause suggested that prime contractors should engage in **“reasonable efforts”** to avoid subcontracting with companies that have engaged in illegal acts, and that “[v]erification of the existence of [a conduct code and compliance program] can be part of the standard oversight that a contractor exercises over its subcontractors.”

# Summary of Key Points from Part 6. Addressing Requirements for Supplier Business Ethics & Conduct

- ✓ Today, contractors understand the attention to business ethics and conduct.
  - ✓ The defense industry was an early adopter of codes of ethical conduct, starting with the voluntary Defense Industry Initiative (DII).
- ✓ **FAR mandates** that contracts with a value expected to exceed \$5.5 million (and with a performance period of 120 days or more) contain the “**Contractor Code of Business Ethics and Conduct**” clause.
  - ✓ The “**Contractor Code of Business Ethics and Conduct**” **reaches the supply chain.**
- ✓ As part of the supplier selection process, prime contractors should consider the business ethics program of potential suppliers.



# SUPPLY CHAIN MANAGEMENT AND COMPLIANCE



## 7. Counterfeit Parts

- **Why is This Issue Getting Attention?**
- **Rules and Restrictions**

# Counterfeit Parts

## Why is This Issue Getting Attention?

- Counterfeit parts in the supply chain represent a **significant threat** to end users and are a **major concern** of Government buyers.
- The last several years have witnessed “**an epidemic of counterfeit items**—electronic components, in particular—in the supply chains of defense contractors.”



# Counterfeit Parts

## Why is This Issue Getting Attention?

- Responding to the concern over counterfeit electronic parts entering the defense supply chain and endangering our troops,
  - **Congress mandated** that the Secretary of Defense assess the DOD's "acquisition policies and systems for the detection and avoidance of counterfeit electronic parts" and
  - disallow certain costs associated with counterfeit electronic parts.

Interesting video: <http://www.c-span.org/video/?302578-1/counterfeit-electronic-parts-defense-systems>



# Counterfeit Parts

## Why is This Issue Getting Attention?

- As mandated by legislation the DOD issued a **final DFARS rule** requiring that
  - contractors establish and maintain a risk-based electronic system
  - **to monitor, detect, and eliminate counterfeit parts.**



# Counterfeit Parts

## Why is This Issue Getting Attention?

- **Concern over counterfeit parts, by its very nature, implicates the supply chain** from which most parts are obtained.
  - In fact, not only does the DFARS rule apply to contractors subject to full or modified coverage under CAS,
  - it also applies to subcontractors under CAS-covered prime contractors, regardless of the subcontractor's CAS or size status.



# Counterfeit Parts

## Why is This Issue Getting Attention?

- It even **reaches commercial items and COTS items**
  - if those items are being supplied to a **CAS-covered contractor.**



# Counterfeit Parts

## Why is This Issue Getting Attention?

- This means that prime contractors and higher tier subcontractors **must pay close attention to the commercial suppliers and vendors** in their supply chains.
- Although the current rule is limited to the DOD,
  - it provides a model for a detection and avoidance system to detect, monitor, and eliminate counterfeit parts, and
  - an expanded rule is anticipated that will address the risk of counterfeit parts for all Government agencies.



# Summary of Key Points from Part 7. Counterfeit Parts

- ✓ **Counterfeit parts threaten our military.**
  - ✓ **The defense industry has responded to Congressional demands and issued a DFARS rule.**
- ✓ **DFARS mandates** that covered contractors must establish and maintain an acceptable counterfeit electronic part detection and avoidance system.
- ✓ **A contractor's counterfeit avoidance system must include risk-based policies and procedures** that address, at a minimum, 12 attributes.
  - ✓ **A broader Government-wide rule is anticipated.**



# SUPPLY CHAIN MANAGEMENT AND COMPLIANCE



## 8. Cybersecurity

- **Key Government Concern**
- **Potential Back Door into Your Company**

# Cybersecurity

## Key Government Concern

- Cybersecurity concerns are among the Government's top issues,
  - and Government contractors are subject to an increasing array of rules and responsibilities.



# Cybersecurity

## Key Government Concern

- Many rules and restrictions address the supply chains because **each level of chain is a potential point of cyber risk** for the Government customer
  - and a **back door** to prime contractor or Government information.
- The regulatory environment regarding cybersecurity is in a state of rapid evolution, and is most advanced in the DOD.



# Cybersecurity

## Key Government Concern

### DFARS Supply Chain Risk Rule

- 2015 Rule allows the DOD to consider the impact of supply chain risk in specified types of procurements related to national security systems.
- Reflects congressional concern over:

***“the risk that an adversary may sabotage, maliciously introduce unwanted function, or otherwise subvert the design, integrity, manufacturing, production, distribution, installation, operation, or maintenance of a covered system so as to surveil, deny, disrupt, or otherwise degrade the function, use, or operation of such system.”***



# Cybersecurity

## Key Government Concern

### DFARS Supply Chain Risk Rule (continued)

- **Competitive evaluation factor** regarding supply chain risk.
  - It mandates the evaluation factor when acquiring information technology, whether as a service or as a supply, that is a covered system, is a part of a covered system, or is in support of a covered system.



# Cybersecurity

## Key Government Concern

### DFARS Supply Chain Risk Rule (continued)

- The final rule notes the **expectation that contractors manage supply chain risk, and provides that sources may be excluded during source selection process (through the evaluation factor) or after award (by withholding consent to a subcontract).**
- **Significantly, there is no exemption for acquisitions below the simplified acquisition threshold or for commercial items or COTS, because that would not be in the “best interest of the United States.”**



# Cybersecurity

## Key Government Concern

### Covered Defense Information & Network Penetration Reporting Rule

- **August 2015: the DOD issued an interim rule amending the DFARS to implement sections of the National Defense Authorization Acts for Fiscal Years 2013 and 2015.**
- **Requires contractor reporting on network penetrations.**
- **The rule expands an earlier DFARS provision:**
  - (a) to implement National Institute of Standards and Technology (NIST) standards for protection of information, and**
  - (b) to report a cyber incident involving unclassified controlled technical information to the DOD within 72 hours of the incident.**

# Cybersecurity

## Key Government Concern

### Covered Defense Information & Network Penetration Reporting Rule (continued)

- **Encompasses “covered defense information,”**
  - ✓ **which includes unclassified controlled technical information**
  - ✓ **as well as export-controlled information,**
  - ✓ **critical information (operations security),**
  - ✓ **and any other information marked or otherwise identified in a defense contract**
  - ✓ **that requires safeguarding or dissemination controls.**
- **It also calls for implementation of a more targeted set of National Institute of Standards and Technology (NIST) standards contained in NIST Special Publication (SP) 800-171.**





# Cybersecurity

## Potential Back Door into Your Company



### Intelligence Community Directive

- **The Intelligence Community (IC) is addressing supply chain cyber risks.**
- **The IC operates under a Directive called “Supply Chain Risk Management,” which outlines the contractor’s duties and responsibilities to protect its supply chain.**
- **This Directive defines the role of supply chain risk management within the IC and is intended to complement other supply chain risk management programs throughout the Government.**

ICD 731 (Dec. 7, 2013), available at <http://fas.org/irp/dni/icd/icd-731.pdf>

# Cybersecurity

## Potential Back Door into Your Company

### Intelligence Community Directive

- The “Supply Chain Risk Management” Directive provides for the **exclusion** of
  - ✓ contractors,
  - ✓ subcontractors,
  - ✓ or vendors from procurements of information technology
- based on supply chain risk factors that are identified during a risk assessment.

# Cybersecurity

## Potential Back Door into Your Company

### Intelligence Community Directive

- In addition, the disclosure of **information relating to that exclusion may be limited** to protect national security.
- This Directive is similar in purpose to the DFARS final rule on supply chain risk.



# Summary of Key Points from Part 8. Cybersecurity

- ✓ **Cybersecurity concerns are among the Government's top issues,**
  - ✓ **and Government contractors are subject to an increasing array of rules and responsibilities**
- ✓ **Rules and restrictions address the supply chains because each level of chain is a potential point of cyber risk for the Government customer**
  - ✓ **and a back door to prime contractor or Government information.**
- ✓ **DFARS Supply Chain Risk Rule and the Intelligence Community Directive**
- ✓ **On "Supply Chain Risk Management" Directive are examples**
  - ✓ **and provide for the exclusion of contractors or subcontractors based on supply chain risk factors.**

# SUPPLY CHAIN MANAGEMENT AND COMPLIANCE



## 9. Specific Issues with Global Supply Chains

- **Country-of-Origin**
- **Export Controls**
- **FCPA**
- **Trafficking in Persons**

# Specific Issues with Global Supply Chains

- **Government contractors are increasingly engaged in opportunities abroad, for both the U.S. and foreign governments,**
  - **and often rely on the **global supply chain** for domestic programs.**
- **The global span of supply chains brings into the compliance mix many laws that apply to global transactions, as well as the laws of other countries.**



# Specific Issues with Global Supply Chains

## Country-Of-Origin Restrictions

- **Several statutes and regulations impose country-of-origin restrictions on products sold to the United States Government.**
- **The most important are the Buy American Act (BAA) and the Trade Agreements Acts (TAA).**
- **These restrictions can have significant supply chain implications.**





# Specific Issues with Global Supply Chains

## Country-Of-Origin Restrictions

### (1) Buy American Act (BAA).

- **The BAA applies to contracts for supplies for use within the United States that are above the “micro-purchase threshold” (currently \$3,000).**
- **However, the BAA does not apply to acquisitions that fall under the Trade Agreements Act (TAA) and most acquisitions of supplies are subject to the TAA rather than the BAA.**
- **The BAA restricts, but does not prohibit, the acquisition of supplies that are not “domestic end products.”**



# Specific Issues with Global Supply Chains

## Country-Of-Origin Restrictions

### (2) Trade Agreements Act (TAA).

- The TAA and related FAR provisions restrict the Government's purchase of products (and services) to **“U.S.-made” or “designated country” end products (and services)**.



# Specific Issues with Global Supply Chains

## Export Controls

- Significant compliance risk is associated with U.S. export control laws.
- The United States has two primary sets of export control laws and regulations
  - **International Traffic in Arms Regulations (ITAR)**, administered by the State Department (defense-related export controls)
  - **Export Administration Regulations (EAR)**, administered by the Commerce Department (dual-use-related controls, some military items)



# Specific Issues with Global Supply Chains

## Export Controls

- **International Traffic in Arms Regulations (ITAR).**
  - **The State Department's Directorate of Defense Trade Controls (DDTC)** regulates the export and temporary import of “defense articles” and “defense services” through the ITAR.
  - **The U.S. Munitions List (USML),** published in the ITAR, sets forth 21 categories of controlled defense articles and defense services.



# Specific Issues with Global Supply Chains

## Export Controls

- **Export Administration Regulations (EAR).**
  - An item not subject to the ITAR is likely subject to the EAR.
  - **The Bureau of Industry and Security (BIS) of the Commerce Department administers the EAR**, which controls the export of dual-use technologies through the Commerce Control List (CCL).
  - Dual-use items are commodities, software, or technology that have both a commercial and military application.



# Specific Issues with Global Supply Chains

## Export Controls

- **Supply chain export situations include**
  - **sharing U.S.-controlled technical data with actual or potential suppliers that employ foreign persons,**
  - **transmitting such data to foreign affiliates or subsidiaries, or**
  - **transmitting such data through entities that support offset requirements imposed by foreign governments.**



# Specific Issues with Global Supply Chains

## Export Controls

- The ITAR and EAR also control “reexports or retransfers.”
- That is where an item subject to U.S. jurisdiction is shipped or transmitted from one foreign country to another foreign country or to an unauthorized user in the same foreign country.



# Specific Issues with Global Supply Chains

## Foreign Corrupt Practices Act (FCPA)

- Government contractors performing work abroad face **substantial risks** under the U.S. FCPA
  - and the **anti-corruption laws** of relevant foreign jurisdictions.
- Even when performing a U.S. Government contract,
  - there are many opportunities for FCPA violations, particularly through the supply chain.

FCPA



# Specific Issues with Global Supply Chains

## Foreign Corrupt Practices Act

- Government contractors operating abroad may need to retain or engage a **variety of third parties** – agents, consultants, subcontractors, joint venture partners, customs brokers, and others.
- **Risk under the FCPA exists** in the use and control (or lack thereof) of third parties in the course of a company's business dealings.
- Although a contractor may not be the one making a particular payment, enforcement agencies might attempt to rely on theories of vicarious liability to impute liability to the contractor.



# Specific Issues with Global Supply Chains

## Combating Trafficking In Persons

- The issue of trafficking in persons has become highly visible and as a result has garnered increased attention.
- Throughout the world, **people are being exploited through trafficking**—some could be in your supply chain.
- In response, the U.S. has adopted a “zero tolerance” policy prohibiting trafficking in persons, and addresses the problem through a variety of laws and regulations, including the Trafficking Victims’ Protection Act of 2000 (TVPA), several later laws, and the FAR.



# Specific Issues with Global Supply Chains

## Combating Trafficking In Persons

- Although some FAR trafficking in persons requirements apply principally to contracts performed outside the U.S.,
  - many of the rules apply to contracts performed in the United States as well. Government **contractors (and subcontractors) must comply with applicable federal legislation and regulations** issued to combat trafficking in persons,
  - including in particular the “Combating Trafficking in Persons” (CTIP) rules found in the FAR.



# Specific Issues with Global Supply Chains

## Combating Trafficking In Persons

- The rules in **three areas are important to managing supply chains:**
  - (1) Prohibit activities related to trafficking in persons that are applicable to all Government contracts and subcontracts, including COTS items;
  - (2) Create expanded reporting and enforcement applicable to all contractors; and
  - (3) They impose compliance plan, due diligence and certification requirements for overseas contracts and subcontracts valued over \$500,000.



# Specific Issues with Global Supply Chains

## Combating Trafficking In Persons

- The CTIP FAR clause is a **mandatory flow down clause for all covered contracts.**
  - Subcontractors must be knowledgeable about these prohibitions and monitor their own supply chains for compliance.
- May not be simple as contractors (and subcontractors) that try to monitor and enforce these requirements may encounter resistance from suppliers.



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# Summary of Key Points from Part 9. Specific Issues with Global Supply Chains

- ✓ **Government contractors are increasingly engaged in opportunities abroad and often rely on a global supply chain.**
  - ✓ **Requires compliance with many laws** including laws of other countries.
  - ✓ **Several statutes and regulations impose country-of-origin restrictions on products sold to the U.S. and the BAA and TAA, can have significant supply chain implications.**
- ✓ **Significant compliance risk is associated with U.S. export control laws.**
- ✓ **Government contractors working abroad face substantial risks under the U.S. FCPA and the anti-corruption laws of relevant foreign jurisdictions.**
- ✓ **Trafficking in persons** has become highly visible and FAR addresses it.

# SUPPLY CHAIN MANAGEMENT AND COMPLIANCE



## 10. Supply Chain Management is a Moving Target

# Supply Chain Management is a Moving Target

## Expect Further Regulation Of The Supply Chain

- We have examined supply chain risk management and compliance issues facing Government contractors and
  - discussed many of the **current concerns** that companies must address in addressing supply chain risk management and compliance.
- Contractors should expect that **new laws and implementing regulations will continue to affect supply chain risk management and compliance.**





# Supply Chain Management is a Moving Target

## Expect Further Regulation Of The Supply Chain

- Anticipated **additional rulemaking** in the areas of
  - organizational conflicts of interest,
  - counterfeit parts,
  - Cybersecurity, and
  - Implementation of Executive Orders,
  - among other issues will affect the supply chain.



# Supply Chain Management is a Moving Target

## Expect Further Regulation Of The Supply Chain

- Highlights the need for Government contractors to keep abreast of new legal and regulatory developments and
  - to consider frequent reviews and, as necessary, revision of
    - ✓ policies,
    - ✓ procedures,
    - ✓ standard terms and conditions of purchase, and
    - ✓ standard agreements.



# SUPPLY CHAIN MANAGEMENT AND COMPLIANCE



**End of Class!**

**Thank You!**