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Government Contracts Update

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NDAA for FY 2023 Passes Congress with Annual Changes to Federal Contracting Policies

The James M. Inhofe National Defense Authorization Act for Fiscal Year 2023 (NDAA) has been passed by the U.S. House of Representatives and U.S. Senate after the text was finalized by the House and Senate Armed Services Committees (HASC and SASC). The NDAA legislative text ("agreement") was passed by the House on December 8 (350-80) and by the Senate on December 15 (83-11). The NDAA will become law when signed by President Biden.

According to the Senate's summary of the agreement, this year's NDAA focuses on the most vital U.S. national security priorities, including strategic competition with China and Russia; disruptive technologies like artificial intelligence, 5G, quantum computing and hypersonic weapons; modernization of ships, aircraft and vehicles; and improving the lives of service members and their families. The legislation authorizes funding to support a 4.6% pay raise for both military service members and the Department of Defense (DoD) civilian workforce.

The NDAA supports a total of $857.9 billion in FY 2023 funding for national defense, and within this topline, the legislation authorizes $816.7 billion for the DoD and $30.3 billion for national security programs within the Department of Energy (DoE). The NDAA increases the topline authorization level to address the effects of inflation and accelerate implementation of the National Defense Strategy. Within this topline, the bill authorizes $12.6 billion for inflation impacts on purchases, $3.8 billion for inflation impacts on military construction projects and $2.5 billion for inflation impacts on fuel purchases.

This year's NDAA addresses new developments arising within the past year, including the invasion of Ukraine, and authorizes increased funding to support Ukraine's defenses. The NDAA expresses the sense of Congress that the United States must continue to assist Ukraine in its fight against the unjust and unprovoked attack by Russia, and that oversight and transparency for such assistance is essential to ensure effective and sustained support.

The NDAA also includes other matters outside its usual scope, beyond the scope of the DoD alone and relevant to other agencies, and of significant importance to government contractors.

For example, in Division E (Non-DoD Matters), this year's NDAA includes the FedRamp Authorization Act (in Title LIX, Other Matters). This act codifies the Federal Risk and Authorization Management Program (FedRamp) within the General Services Administration, which establishes the government-wide program that provides a standardized, reusable approach to security assessment and authorization for cloud computing products and services.

Division E also includes Section 5949, a new prohibition on certain foreign semiconductor products and services. While semiconductor products from the designated companies will be effectively banned from the government's supply chain, the prohibition does not take effect for five years and regulations are due in three years.

This year's NDAA also includes an extensive Division G on homeland security matters. This includes the Homeland Procurement Reform Act (in Title LXXI), which includes various domestic sourcing requirements. This title also includes a Department of Homeland Security mentor-protégé small business program modeled after the DoD program.

In addition, the homeland security division also includes the Advancing American AI Act (in Title LXXII, Governmental Affairs), with the purposes to encourage agency artificial intelligence-related programs that enhance the competitiveness of the United States; to assist agency leaders in fulfilling their missions; and to ensure the protection of privacy, civil rights and civil liberties.

The NDAA agreement's legislative text is based on H.R. 7900 ("House bill"), which passed the House on July 14, 2022, by a vote of 329-101; and S. 4543 ("Senate bill"), which was approved by the SASC on June 16, 2022. The two bills were combined through negotiations led by the leadership of the HASC and SASC ("committees").

We summarize below select provisions in the NDAA's Title VIII of Division A, which each year addresses government contracting and acquisition policies, as well as Section 5949, which adds the new prohibition on certain foreign semiconductor products and services. The summary is based on the NDAA text as well as the Joint Explanatory Statement (JES) released by the committees.

Sec. 805 – Treatment of certain clauses implementing Executive Orders

The Senate bill contained a provision that would amend 10 U.S.C. 3862 to clarify that the insertion of a clause implementing a new requirement mandated by an Executive Order into a DoD contract vehicle would be considered a government-directed change. The NDAA agreement includes this Senate provision with a clarifying amendment.

Accordingly, NDAA Section 805 adds a new paragraph to 10 U.S.C. 3862, which states that "the unilateral insertion of a covered clause into an existing [DoD] contract, order, or other transaction by a contracting officer shall be treated as a change directed by the contracting officer pursuant to, and subject to, the Changes clause of the underlying contract, order, or other transaction."

The "Changes clause" is defined as the clause in part 52.243-4 of the Federal Acquisition Regulation and "covered clause" is defined as any clause implementing the requirements of an Executive Order issued by the president. The DoD must revise the Defense Federal Acquisition Supplement (DFARS) to implement these requirements and must also revise policy guidance on other transactions (OTs) within 120 days after enactment of the NDAA.

This provision should assist contractors seeking equitable adjustments to help cover the costs of such unilateral changes and reflects the reality that such requirements have proliferated in recent years, including under both the Biden and Trump administrations. This will in turn promote greater fairness in the contracting process by recognizing that these unilateral mandates often impose significant costs on contractors.

Sec. 822 – Modification of contracts to provide extraordinary relief due to inflation impacts

The Senate bill contained a provision that would allow funds to be used to modify the terms and conditions of a contract or option to provide an economic price adjustment. The NDAA agreement includes this Senate provision with an amendment. The committees stated that they recognize that higher than anticipated economic inflation continues to challenge the budgeting and execution processes of the DoD and defense industrial base (DIB) and that the ability to adapt to economic conditions is a critical factor in maintaining the health of the DIB.

Section 822 of the NDAA amends Public Law 85-804 (codified at 50 U.S.C. 1431) to accomplish this objective. Under this provision, DoD may amend or modify an eligible contract when, due solely to economic inflation, the cost to a prime contractor of performing is greater than the price of the contract, with similar provisions applicable to subcontractors. Section 822 raises certain thresholds for DoD's authority to act; DoD authority under the new inflation provisions lasts until the end of 2023; and guidance is due from DoD within 90 days after enactment of an act providing appropriations to carry out the new amendment.

The committees recognized that while it is important for the DoD to uphold and enforce contractual terms and conditions, in certain fixed-price contracts industry bears the predominant financial risk and DoD should have tailored authority to address extraordinary economic impacts. They stated that to support a robust DIB, DoD needs additional temporary authorities to respond to the effects of recent and current inflation levels and provide a measure of relief to the DIB where appropriate.

Sec. 842 – Modification of authority of the Department of Defense to carry out certain prototype projects

The House bill contained a provision that would amend 10 U.S.C. § 4022 to clarify that the authority for noncompetitive follow-on awards includes transactions for prototypes, even where notification was not explicitly provided within the original request for proposals, if other requirements are met. The Senate bill contained a similar provision, and the NDAA agreement includes the Senate provision with a modifying amendment. Under Section 842, authority is provided to DoD for a follow-on production contract or transaction expected to cost the DoD in excess of $100 million, if a designated official makes a required determination in writing and notifies the congressional defense committees.

Sec. 843 – Other transaction authority clarification

Based on the House bill, the NDAA agreement's Section 842 clarifies the definition of "prototype project" and creates a three-year pilot authority to use other transactions for installation or facility prototyping. "Prototype project" includes, among other items listed, "a pilot or novel application of commercial technologies for defense purposes." According to the committees, the list of prototype project types added by Section 843 is "not meant to be restrictive and should not be read to change the intent or purpose of the glossary entry in the [DoD] Other Transaction Guide."

The committees stated that to make the best use of the authority in this section, "we strongly encourage the Department to invest in continuous and experiential education for management, technical, and contracting personnel, as well as attorneys, to understand how to effectively and innovatively use other transaction authority and explore flexible means to achieve mission results more quickly and with more value added."

Sections 842 and 843 can be expected to continue the trend of increased use of OT authorities by DoD.

Sec. 861 – Strategy for increasing competitive opportunities for certain critical technologies

Based on the House bill, this provision requires the Secretary of Defense to seek to increase competitive opportunities for appropriate U.S. companies to be awarded prime contracts, grants, cooperative agreements or other transactions for commercial products or dual-use capabilities, of which any component primarily relates to critical technology.

Within one year after enactment, the DoD must submit to the congressional defense committees a strategy to increase competitive opportunities for U.S. companies and enhance the integrity and diversity of the DIB. This strategy can be expected to increase opportunities for U.S. commercial companies in the defense sector, including nontraditional defense contractors.

Sec. 807 – Amendments to contractor employee protections from reprisal for disclosure of certain information

The House bill contained a provision that would amend 10 U.S.C. 4701 and 41 U.S.C. 4712 by expanding the applicability to include qualified grantees, subgrantees and personal services contractors. The agreement includes this House provision with an amendment.

NDAA Section 807 adds these whistleblower protections for employees of grantees, subgrantees and personal services contractors. The changes clarify that employees of grantees, subgrantees and personal services contractors are protected from reprisal for making protected disclosures (related to fraud, waste or abuse) directly to the organizations that employ them. This continues to expand the extensive protections for whistleblowers relating to DoD programs under current law.

Sec. 803 – Data requirements for commercial products for major weapon systems

The House bill contained a provision that would amend 10 U.S.C. 3455 to grant the DoD authority to obtain data to support a commercial product determination in certain circumstances. The Senate bill contained a similar provision, and the NDAA agreement includes the Senate provision with an amendment.

NDAA Section 803 requires offerors to provide certain information to support an assertion of commercial product status in connection with major subsystems of a major weapon system and with components and spare parts. This provision reflects the understanding of the congressional defense committees that the "of a type" category of commercial products is very broad and flexible, and Congress here is seeking to impose some limitations on the use of this category in the contracting process.

The JES text states that contracting officers need access to sufficient information to assess commercial item assertions and price reasonableness determinations. The Senate report accompanying the NDAA for FY 2020 required the Under Secretary of Defense for Acquisition and Sustainment to submit an annual report detailing instances where potential contractors have denied contracting officer requests for uncertified cost or pricing data. The committees stated that "[w]e have found these 'data denials' reports to be illuminating, and believe the contents of these reports should be provided to the associated companies[.]"

The committees directed the Under Secretary of Defense for Acquisition and Sustainment to continue to submit this annual report to the congressional defense committees and to make the appropriate portions of these reports available to the leadership of companies named in the reports. Contractors should be mindful of this provision, which should have the effect of improving contractor responses to requests for uncertified cost or pricing data.

Sec. 817 – Modification to prohibition on operation or procurement of foreign-made unmanned aircraft systems

The House bill contained a provision that would amend Section 848 of the NDAA for FY 2020 and the Senate bill contained a similar provision. Based on the House bill, NDAA Section 817 clarifies the prohibition on contracting with entities that use covered unmanned systems in the execution of DoD contracts, provides for a two-year implementation period, adds other countries to the definition of covered foreign country, and requires the Secretary of Defense to issue policy implementing a due diligence review and an appeal process for contractors.

Sec. 841 – Guidelines and resources on the acquisition or licensing of intellectual property

Based on the House bill, the NDAA agreement contains a provision that requires the DoD to develop guidelines and resources on the acquisition or licensing of intellectual property. Under Section 841, the guidelines must include IP strategies supporting the use of modular open system approaches, evaluation and negotiation of IP licenses in competitive and noncompetitive awards, and best practices for specially negotiated licenses. While the DoD's guidelines can be expected to favor DoD in the negotiation process, they should also provide improved clarity to contractors.

Sec. 851 – Modification to the national technology and industrial base

Section 851 adds New Zealand to the participants of the national technology and industrial base (NTIB), which under statute promotes industrial cooperation between its members, including Canada, the United Kingdom and Australia.

Sec. 856 – Codification of the Department of Defense Mentor-Protégé Program

The NDAA agreement contains a provision that codifies, makes permanent and makes certain revisions to the DoD Mentor-Protégé Program, which was formerly a pilot program. The agreement also establishes a new five-year pilot program under which a protégé firm may receive up to 25% of the reimbursement for which the mentor firm is eligible under the Mentor-Protégé Program for engineering, software development or manufacturing customization that the protégé firm must perform.

Sec. 884 – Incorporation of controlled unclassified information guidance into program classification guides and program protection plans

Based on the Senate bill, NDAA Section 884 requires the Secretary of Defense to ensure that all program classification guides (for classified programs) and all program protection plans (for unclassified programs) include guidance for the proper marking for controlled unclassified information (CUI) at their next regularly scheduled update.

The committees stated that they understand that the DoD's "uneven application of CUI markings is particularly problematic for industry, which often receives little CUI training or guidance from the Government and is unsure of its responsibilities regarding this marking convention. We are also concerned with the extent and efficacy of the training, guidance, and oversight provided to [DoD's] Government personnel on the CUI marking convention, which has resulted in the over-classification of entire documents and a lack of clear portion markings within documents."

This provision should benefit and assist industry by requiring the DoD to provide better guidance on the application of its CUI markings.

Sec. 5949 – Prohibition on certain semiconductor products and services

The Senate bill contained a provision that would have updated Section 889 of the NDAA for FY 2019 to include semiconductor products and services from specified Chinese companies within the prohibition. The NDAA agreement includes the Senate provision with modifying amendments that establish the new prohibition outside Section 889, with narrower requirements.

Accordingly, Section 5949, paragraph (a) establishes the prohibition that generally prevents any executive agency from procuring any electronic parts, products or services that include covered semiconductor products or services. Extensive waiver authority is established for the DoD and other agencies in paragraph (b). Covered semiconductor products or services include semiconductors or related products that are designed, produced or provided by designated foreign companies.

This provision can be expected to impose significant costs on industry; however, the provision also gives industry several years to prepare for the regulations and eventual prohibitions. While semiconductor products from the designated companies will be effectively banned from the entire government's supply chain, the prohibition does not take effect for five years, and DoD regulations are due no later than three years from enactment of the NDAA.

The committees stated that "the intent of Congress in advancing this proposal is that, in serving federal supply chains, Federal contract recipients and their suppliers (including domestic and foreign subsidiaries, affiliates, distributors, and intermediaries) should not utilize companies connected to foreign countries of concern that threaten national security, such as Semiconductor Manufacturing International Corporation, Yangtze Memory Technologies Corp, and ChangXin Memory Technologies, or any other company identified under this section (including any affiliate, subsidiary, successor, distributor, or intermediary thereof)."

The committees further stated that for the purposes of waivers that may be issued, "critical national security interests of the United States may include protecting the Nation's economic security and its technological competitiveness relative to strategic competitors."

The new Section 5949 thus provides maximum waiver authority to federal agencies, but contractors should begin to prepare now for the new prohibitions and assume they will apply extensively throughout the government's contracting agencies and their supply chains.

FOR MORE INFORMATION

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