

NDAA Bills Would Tighten Sourcing Rules For Defense Cos.

By **Joseph Berger** (November 22, 2022)

The U.S. House of Representatives and U.S. Senate versions of the National Defense Authorization Act for fiscal year 2023 continue to prioritize and reform technology acquisition policies amid the current global technology race with strategic competitors, and related tensions from ongoing global conflict.

The Senate bill would authorize topline funding of about \$847 billion for military and national security programs at the U.S. Department of Defense and U.S. Department of Energy.



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This bill increased the topline authorization level by about \$45 billion beyond that proposed by the administration, to address the effects of inflation by \$13 billion and further support implementation of the DOD's National Defense Strategy, as well as additional security assistance to Ukraine. The full Senate has not yet voted on its final bill.

The House debated, voted on and passed its version of the NDAA for fiscal year 2023 in July.[1] The House bill authorizes \$839.3 billion in topline spending for national defense. Like the Senate bill, it includes a variety of acquisition policy measures supporting emerging technologies and national security priorities.

The bill, which totals more than 3,800 pages, passed the House by a wide margin of 329-101, following extensive amendments to the version filed by the House Armed Services Committee.

The Senate Armed Services Committee leaders commenced the full Senate's deliberations on its bill on Oct. 11. Their substitute bill[2] included the original Armed Services Committee-passed NDAA,[3] and 75 amendments from other senators and committees. The Senate bill has not gone through the full debate process for hundreds of still-pending amendments proposed by individual senators.

The differences between the final House and Senate bills would usually be reconciled by a conference committee, and congressional staff have been engaged in preconfereencing dialogue. Following the election, it has been reported that the Senate may forgo a vote on its own bill, while House and Senate Armed Services Committee leaders in negotiate a compromise bill, which could be passed by both chambers before the end of the year.

This article discusses acquisition policy provisions relating to technology, foreign sourcing and the related competition between nations, located in Title VIII of Division A of the House and Senate NDAA bills.

In Title VIII, both the House and Senate have expressed support for the DOD's flexibility and speed in acquisition, the need for superiority in strategic competition and emerging technologies, the security of the DOD's supply chains, and mitigation of threats from foreign nations, as well as the key role of small business and socioeconomic priorities.

As stated in the House Armed Services Committee's summary of the bill, the NDAA more broadly seeks to address the growing strategic challenge posed by the People's Republic of China, and by Russia's unlawful invasion of Ukraine.

Notably for contracting policy, the House bill includes the Federal Contracting for Peace and Security Act,[4] which implements the policy of the federal government not to conduct business with companies that continue to operate in the Russian Federation during its ongoing war of aggression against Ukraine.

The FCPSA, which would be implemented by regulations, prohibits agencies from entering, extending or renewing contracts with companies that continue to conduct business operations in Russia, with exceptions for contractors making good faith efforts to comply and for certain permissible operations. The FCPSA was a priority for the House — and given Russian President Vladimir Putin's continuing escalation of his war, these provisions have a reasonable chance of adoption by Congress in the final version of the bill.

The most recent Senate bill also contains new provisions supporting an enhanced defense partnership between the U.S. and Taiwan, which likewise may be addressed in the final bill.

Below is a review of a select few policy provisions in Title VIII of the House and Senate bills relating primarily to technology and foreign sourcing, based on the bill released by the Senate Armed Services Committee, its recent amendments and the earlier committee report,[5] and the final House bill and earlier House Armed Services Committee report.[6]

These provisions reflect the ongoing technology race between competitor nations. While any one of these provisions might not become law in its current form, the issues they collectively address will drive what does become the law — as determined ultimately by the compromise between the House and Senate on their final version of the bill.

Technology, Foreign Sourcing and Domestic Production

The Senate bill would prohibit the procurement of covered items used in major defense acquisition programs, made in China or by companies controlled by China.[7] The Senate Armed Services Committee stated that the DOD's continued reliance on certain items poses unacceptable risks to U.S. national security.

The relevant provision requires the DOD to transition the sourcing of such items to sources not controlled by China, and to implement regulations to accomplish these goals. This approach builds on similar measures enacted with prior NDAA's, including the statutory provision that banned certain foreign telecommunications equipment from use in government contracting — Section 889 of the NDAA for fiscal year 2019.

Like that provision, this one and others like it can be expected to impose significant compliance and implementation costs on industry, which should be taken into account in any DOD rulemaking process.

The House bill, by contrast, provides an alternative approach to the same objective, but focuses on an enhanced domestic content requirement. Under the House version, manufactured articles, materials or supplies procured in connection with a major defense acquisition program must be manufactured substantially in the U.S. if the cost of components exceeds a certain threshold.[8]

Exceptions would be provided for nations in the national technology and industrial base. This continues the Biden administration's broad emphasis on "Buy American" policies — or in this case, "Buy Allied."

The House version focuses on the role of domestic manufacturing as well as the national technology and industrial base, which under statute is intended to foster industrial and technology collaboration, and includes Canada, the U.K. and Australia. Both the House and Senate versions also expand the national technology and industrial base by adding New Zealand, a member of the intelligence alliance between the same nations.

The Senate NDAA manager's package filed on Oct. 11[9] included a series of amendments, several of which focus on foreign sourcing. The policy provisions include a new prohibition on certain semiconductor products and services.[10] This provision would modify Section 889 of the fiscal year 2019 NDAA, which adopted the wide-ranging prohibition against certain Chinese telecommunications equipment and was one of the most burdensome requirements added in recent NDAA's.

This provision would add covered semiconductor products and services from designated foreign companies to Section 889 — effectively banning them from the government's supply chain, and creating complicated new burdens for all contractors in the supply chain's stream of commerce. Given the possible implications of this recently included amendment, it may face higher hurdles to adoption by Congress in the compromise bill.

The Senate would also require the DOD to restrict certain specific types of procurements to suppliers in the U.S., the national technology and industrial base and other allied nations; to expand production capacity and diversity of sources of supply; and to prohibit procurements from certain sources or nations.[11]

This provision specifically addresses satellites and ground stations, but this framework could be expanded to include other items, and reflects continued congressional concern for national security issues in certain critical supply chains.

Other House and Senate provisions likewise could prohibit use of specific foreign products or technologies in government supply chains. The Senate NDAA manager's package also included the American Security Drone Act, which places extensive restrictions on the procurement of unmanned drone technology from covered foreign entities.

Another Senate provision would require certain disclosures concerning rare earth elements and strategic and critical materials, specifically relating to magnets used in DOD systems.[12] After the bill was released, a product made with magnetic materials of Chinese origin led the Air Force to suspend deliveries of its F-35 aircraft, demonstrating the critical importance of this supply chain.

This Senate provision would also expand restrictions on procurement of military and dual-use technologies by Chinese military companies. This reflects continuing congressional efforts to prevent transfer of military and dual-use technologies to competitor nations, and the need for contractors' careful attention to U.S. export control requirements. For example, since the bills were released, the administration has imposed new export control requirements on semiconductor chips in particular.

Rapid Acquisition and Flexible Authorities

The Senate would also require new procedures for rapid acquisition and deployment of capabilities needed in response to urgent operational demands in high-priority circumstances.[13]

This would codify rapid acquisition authorities from prior NDAA's — including the Middle Tier

of Acquisition pathway, which focuses on delivering capability in a period of two to five years with rapid prototypes and fielding. Congress continues to focus on speed in DOD acquisition, needed to keep pace with rival nations' technology development.

The House bill, pursuing the same objective, would clarify that an "other transaction," or OT, award for a prototype project may provide for the award of a follow-on production contract or transaction, without further competitive procedures.[14] The House bill further clarifies and expands the definition of "prototype project," including novel applications of commercial technologies.[15]

These provisions continue congressional and DOD support for nontraditional and non-Federal Acquisition Regulation-based innovative procurement methods — and expanding OT authorities in particular.

A House floor amendment likewise provides for "increased competitive opportunities and strategy for certain critical technology contractors." [16] Under this provision, the DOD would seek to further increase opportunities for U.S. commercial products or dual-use capabilities relating to certain critical technologies, including through OT awards.

This amendment further builds upon OT and similar authorities, which intend to increase the speed of procurement of critical technologies that are subject to the greatest competition between the U.S. and its near-peer technology rivals.

Protecting U.S. Technology

The Senate would make amendments to the Defense Research and Development Rapid Innovation Program, to focus and improve DOD technology development and transition.[17]

This includes amendments to the Small Business Innovation Research and Small Business Technology Transfer programs, which would increase the potential lifespan of projects. The SBIR and STTR programs were reauthorized by Congress in September, when it imposed new due diligence requirements to manage risks of foreign affiliations.

This Senate NDAA provision would also establish a new public-private partnership for technology investment.[18] The purpose of this pilot program is to accelerate the development of advanced technology for national security priorities by creating incentives for trusted private capital, free from foreign influence, to invest in domestic small or nontraditional businesses.

Congress continues to support the role of small businesses in the industrial base, while seeking to reduce the risks of foreign influence and to speed the deployment of advanced technologies.

Additionally, the Senate bill focuses on protecting U.S. technology through guidance on controlled unclassified information, or CUI.[19] This provision would require the DOD to ensure that all program classification guides (for classified programs) and program protection plans (for unclassified programs) include guidance for the proper marking for CUI, at their next regularly scheduled update.

This attention to guidance on CUI should be welcomed by industry, which has struggled with the DOD's practices relating to CUI — including the DOD's markings and how best to comply with the DOD cybersecurity requirements that depend in part on these CUI designations. The CUI designations and related cybersecurity requirements are ultimately intended to

prevent improper transfer of U.S. technology to foreign nations.

The Senate Armed Services Committee, in its report, further expressed concern about the "uneven application" of CUI document markings within the DOD. The committee directed the DOD inspector general to conduct a review of CUI marking guidance, training and oversight, and to provide a report to the congressional defense committees.

This provision should be welcomed by industry, because such a report could provide some of the guidance that Congress recognizes is lacking, and should encourage the DOD to improve its own guidance to industry.

Balancing Burdens Under Executive Orders

The Senate bill includes a provision that could help balance the burdens imposed by restrictions on foreign sourcing and technology, by addressing the way these and other mandates are implemented by executive orders.[20] This provision would clarify that the insertion of a clause into a DOD contract implementing a new requirement mandated by an executive order would be considered a government-directed change.

Such a change would be subject to the changes clause of the Federal Acquisition Regulation — FAR 52.243-4 — and the DOD would adopt regulations to implement this provision.

The House Armed Services Committee report also identified DOD implementation of executive order requirements as an item of special interest, so there is potential for Congress to adopt this reform.

This provision could assist contractors seeking equitable adjustments to help cover the costs of extensive changes imposed by executive order, and reflects the reality that such requirements have proliferated in recent years, including under both the Biden and Trump administrations. Many of these executive order requirements have related to limitations on foreign sourcing and technology, and these mandates often impose significant costs on contractors.

This year's bills continue the trend of recent NDAA limitations on the uses of various foreign products by DOD contractors — requirements that may eventually be implemented by executive order, regulation and contract clauses.

Items of Special Interest

The Senate and House committee reports included extensive lists of items of special interest, which usually instruct the DOD to submit detailed reports to the congressional committees, and which are treated as requirements by the DOD. These included many items relating to Title VIII and to technology, foreign sourcing and related security risks.

The House committee report, for example, included items on the DOD semiconductor supply chain, critical and rare earth minerals, microelectronics infrastructure, foreign investment review, countering rapidly evolving technological threats and dual-use technology. These items reflect the current concerns on both sides of Capitol Hill relating to global technology competition.

The Senate committee report noted that DOD contracting processes remain vulnerable to malicious actors, despite prohibitions on certain entities and enhanced supply chain management. The committee stated that more needs to be done to actively manage the

DOD's supply chain vulnerabilities, and pointed to additional lists of entities of concern that are maintained by agencies outside the DOD, such as the U.S. Department of State.

Contractors should expect that in the future, additional prohibitions on the use of designated products of foreign companies, as well as contracting measures similar to export control requirements, will become more widespread — and an increasingly significant but costly aspect of DOD contracting.

Conclusion

According to the Senate Armed Services Committee's executive summary released with its bill, the national security challenges facing the U.S. are "momentous." The committee reported that the DOD's 2022 National Defense Strategy, which has only recently been released publicly, identifies China as the "most consequential strategic competitor and the pacing challenge for the Department" and identifies Russia as an "acute threat."

The committee stated that "our long-term strategic competition with China and Russia is likely to intensify," while the DOD must also manage other persistent threats, including from terrorist organizations.

In this context, the House and Senate NDAA bills each reflect the current era of technology competition between nations. While this article focuses on Title VIII, there are extensive procurement-related provisions throughout the NDAA — including those focused on specific procurements and technologies, research and development, operation and maintenance, space, cyberspace, military construction and matters relating to foreign nations.

The Title VIII provisions collectively play a significant role in providing the DOD with the necessary flexibility and authorities in acquisition to pursue U.S. leadership in advanced technologies. These provisions also take into account a variety of national security and domestic priorities — from the need for superiority in emerging technologies to the security of DOD supply chains to the vital role of small businesses.

The NDAA bills and their Title VIII provisions also reflect the key role of government contracting in fulfilling the DOD's many critical missions, while supporting a diverse and broader array of U.S. national interests, including U.S. leadership in the global technology race.

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[1] H.R. 7900, 117th Cong. (2022).

[2] Senate amendment (S.A.) 5499 is the substitute bill released on Oct. 11, 2022 by the SASC leaders.

[3] S. 4543, the James M. Inhofe NDAA for fiscal year 2023, was filed by the SASC in July.

- [4] H.R. 7900 Section 5866 added the FCPSA through amendment to the House bill.
- [5] S. Rept. No. 117-130 (2022).
- [6] H. Rept. No. 117-397 (2022).
- [7] S. 4543 Section 803.
- [8] H.R. 7900 Section 807.
- [9] S.A. 5499.
- [10] S.A. 5499 Section 5871.
- [11] S. 4543 Section 841.
- [12] S. 4543 Section 844.
- [13] S. 4543 Section 804.
- [14] H.R. 7900 Section 817.
- [15] H.R. 7900 Section 845.
- [16] H.R. 7900 Section 873.
- [17] S. 4543 Section 861.
- [18] Id.
- [19] S. 4543 Section 874.
- [20] S. 4543 Section 821.