

## Congress Expands Department of Defense Authority to Exclude Companies that Pose a Risk to Supply Chain Security

On January 7, 2011, the President signed the Ike Skelton National Defense Authorization Act for Fiscal Year 2011 (Act) into law. The Act contains new provisions enhancing the authority of the Secretary of Defense (Secretary) to address the risk that a company in the supply chain for a national security system could sabotage the operation of the system. Section 806 of the Act, entitled Requirements for Information Relating to Supply Chain Risk, authorizes the Secretary to take certain adverse procurement actions if the Secretary determines that a company poses a risk to supply chain security. These adverse actions include the potential exclusion of a company from a procurement.<sup>1</sup> The Act also requires the Department of Defense (DOD) to inform other federal agencies that may be affected by the same or similar supply chain risk of exclusions. Companies that do business with DOD should understand the agency's enhanced authority under the Act and the potential impact of this authority on existing and future DOD contracts. A summary of the new provisions is set forth below.

### Section 806 of the Defense Authorization Act for Fiscal Year 2011

Section 806 applies to certain procurements for national security systems and items for use in such systems.<sup>2</sup> A national security system is an information system, including a telecommunications system, that is used for intelligence activities or cryptologic activities related to national security; for command and control of military forces; or as an integral part of a weapon or weapons system.<sup>3</sup>

The statute aims to minimize risks to the supply chain for national security systems—that is, the network of organizations, people, technology, activities, information, and resources a contractor relies on to deliver to DOD a national security system or a component of such a system. Section 806 defines a “supply chain risk” as “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

<sup>1</sup> Ike Skelton National Defense Authorization Act for Fiscal Year 2011, H.R. 6523, 111th Cong. § 806 (2010).

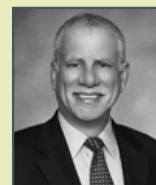
<sup>2</sup> *Id.* § 806(e)(5).

<sup>3</sup> 44 U.S.C. § 3542(b)

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a covered system so as to surveil, deny, disrupt, or otherwise degrade the function, use, or operation of such system.”<sup>4</sup>

The statute authorizes the Secretary of Defense, and the Secretaries of the military departments<sup>5</sup> (collectively referred to as “the Secretary”) to take adverse action against a contractor to protect national security by reducing supply chain risk.<sup>6</sup> These adverse actions—characterized in the statute as a “covered procurement action”—include the exclusion from a procurement of a contractor that poses an unacceptable risk to supply chain security.<sup>7</sup> In addition, the Secretary also may direct a prime contractor not to use a particular subcontractor that poses an unacceptable risk.<sup>8</sup> Moreover, in carrying out an exclusion, the Secretary may limit the disclosure of information relating to the basis for the covered procurement action to protect sensitive information.<sup>9</sup>

Section 806 authorizes the Secretary to take the above adverse actions during procurements for national security systems when the terms of the solicitation or contract require the procuring agency to consider potential risk to the supply chain when making an award; or when taking other action during a procurement. Specifically, the statute applies to:

- a source selection where the solicitation contains a performance specification or an evaluation factor relating to supply chain risk;
- the consideration of proposals for and issuance of a task or delivery order where the task or delivery order contract has a requirement relating to supply chain risk; or
- *any contract action* involving a contract for a national security system that includes requirements relating to supply chain risk.<sup>10</sup>

To exercise the authority under the statute to exclude a source, the Secretary must:

- Obtain a joint recommendation by the Under Secretary of Defense for Acquisition, Technology, and Logistics

and the Chief Information Officer of the Department of Defense, concluding on the basis of a risk assessment by the Under Secretary of Defense for Intelligence that there is a significant supply chain risk;

- Determine, with the concurrence of the Under Secretary of Defense for Acquisition, Technology, and Logistics, that (a) the exclusion is necessary to protect national security and (b) less intrusive measures are not reasonably available to reduce the supply chain risk; and
- Provide notice of the determination to the appropriate congressional committees.<sup>11</sup>

The Secretary may limit disclosure of information relating to the basis for the exclusion, but in order to do so, the Secretary must determine that the risk to national security from disclosure of the information outweighs the risk due to nondisclosure.<sup>12</sup>

## Effects of Limiting Disclosure on Contractors

Once the Secretary exercises its authority to limit disclosure of information relating to an exclusion, the exercise of such authority triggers additional important provisions.

### Limits on Bid Protests

If the Secretary has exercised its authority to limit disclosure, the Act limits review of the Secretary’s actions. Section 806 provides that if the Secretary “has exercised the authority...to limit disclosure of information...no action undertaken by [the Secretary] under such authority shall be subject to review in a bid protest before the Government Accountability Office [GAO] or in any Federal court.”<sup>13</sup> It is unclear whether this provision precludes only review of the Secretary’s action to withhold information relating to an exclusion, or precludes bid protests challenging the exclusion action. An earlier Senate version of the Section 806 provisions provided that a “*determination...that the exclusion of a particular source is necessary* to avoid an unacceptable supply chain risk...*shall not be subject to review in a bid protest* before the Government Accountability Office or in

4 H.R. 6523, § 806(e)(4).

5 *Id.* § 806(e)(1).

6 *Id.* § 806(a)(1).

7 *Id.* § 806(e)(2).

8 *Id.*

9 *Id.* § 806(a)(2).

10 *Id.* § 806(e)(3).

11 *Id.* § 806(b).

12 *Id.*

13 *Id.* § 806(d)(1).

any Federal court.”<sup>14</sup> The conference report accompanying the final version of the bill contains no explanation as to why Congress ultimately adopted the final language and whether the failure to adopt the Senate version represents an intentional narrowing of the Secretary’s review authority.

Ultimately, even if the review limitation precludes review only of the Secretary’s withholding of information, this limitation still significantly inhibits a contractor’s ability to protest an exclusion because the adjudicator likely cannot compel disclosure of withheld information needed to evaluate the propriety of an exclusion.

#### ***DOD’s Disclosure of Exclusion to Other Federal Agencies***

The Act also provides that the Secretary “shall notify other Department of Defense components or other Federal agencies responsible for procurements that may be subject to the same or similar supply chain risk.”<sup>15</sup> Accordingly, although Section 806 is a DOD-only provision, DOD must inform other relevant agencies of an adverse action taken against a DOD contractor.

#### **Effect on Contracting Activity**

Section 806 takes effect 180 days after the enactment date of the Act and expires three years from the enactment date.<sup>16</sup> The statute applies prospectively to contracts that are awarded on or after the effective date.<sup>17</sup> It also applies to any task and delivery orders issued on or after the effective date, including those under contracts in existence prior to the effective date.<sup>18</sup>

#### **Conclusion**

The above discussion is intended to assist companies that do business with DOD in understanding how the new provisions of Section 806 may affect future contracting activity with DOD, and the potential impacts of those activities on contracts involving other agencies. Companies should assess how

the DOD’s expanded authority to manage supply chain risk might affect their supply chain selection and oversight, and their bidding strategy in future solicitations.

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*We hope that you have found this advisory useful. If you have additional questions, please contact your Arnold & Porter attorney or:*

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<sup>14</sup> National Defense Authorization Act for Fiscal Year 2011, S. 3454, 111th Cong., § 815 (2010).

<sup>15</sup> H.R. 6523, § 806(d)(2).

<sup>16</sup> *Id.* § 806(f)-(g).

<sup>17</sup> *Id.* § 806(f)

<sup>18</sup> *Id.*

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