

## E-ALERT | Government Contracts

January 11, 2013

### THE GOVERNMENT CONTRACTS UPDATE

On a semi-monthly basis, Covington & Burling LLP's Government Contracts practice delivers an update on major news, notes, and trends relevant to government contractors. This particular update focuses on noteworthy provisions in the recently-passed [National Defense Authorization Act](#) ("NDAA").

#### PRESIDENT SIGNS THE NDAA INTO LAW

On January 2, 2013, President Obama signed the \$633 billion NDAA for Fiscal Year 2013. The omnibus bill contains the following noteworthy provisions:

- [Trafficking In Persons \(Sections 1701-1708\)](#). As reported in our October 12, 2012 [E-Alert](#), President Obama previously issued an Executive Order strengthening protections against human trafficking in federal government contracts. Sections 1701-08 of the NDAA largely codify that Executive Order. Similar to the Executive Order, the NDAA expands the list of prohibited activities for contractors and their employees to include labor-related conduct, such as (1) denying employees access to their identity or immigration documents; (2) refusing to pay return transportation costs to employees "from a country outside the United States"<sup>1</sup>; (3) offering employment under false pretenses; (4) charging employees unreasonable placement or recruitment fees; and (5) arranging housing that fails to meet the host country's standards. Further, to be eligible to obtain government contracts valued at greater than \$500,000, contractors entering into a grant, contract or cooperative agreement with an agency must certify that (1) they have implemented compliance plans that comport with the new human trafficking provisions; (2) they have implemented procedures to monitor subcontractors and employees; and (3) to the best of their knowledge, neither they, nor their subcontractors, have engaged in proscribed activities. An agency that discovers credible information suggesting a violation has occurred must report the violation to the Inspector General. Violators are subject to severe sanctions, including termination, suspension and debarment, and potential criminal penalties. The NDAA also expands criminal penalties for fraud in foreign labor contracting.
- [Cybersecurity \(Section 941\)](#). Section 941 of the NDAA requires the Secretary of Defense to establish procedures for "cleared defense contractors" to report to the Department of Defense ("DoD") in the event the contractor's information system is successfully penetrated by a cyberattack. (A "cleared defense contractor" is defined in the NDAA as a "private entity granted clearance by [DoD] to access, receive, or store classified information for the purpose of bidding for a contract or conducting activities in support of any program of [DoD].") Those procedures must include mechanisms for granting DoD access to contractor data and equipment necessary to determine whether government data was compromised.

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<sup>1</sup> It is unclear whether this provision would apply to citizens of another country, residents of another country or anyone traveling from another country.

Section 941 contains language addressing contractor concerns about the scope of the access and reporting requirements that were included in a prior version of this provision in the Senate's draft NDAA. For example, the procedures allowing for DoD access to contractor data must include "reasonable protection of trade secrets, commercial or financial information, and information that can be used to identify a specific person." Furthermore, the information obtained by DoD may not be disseminated outside DoD absent the contractor's approval. And the requirements are triggered only by penetrations of a "covered network," defined as a "network or information system of a cleared defense contractor that contains or processes information created by or for [DoD] with respect to which such contractor is required to apply enhanced protection." Notwithstanding Congress' enactment of this cybersecurity provision, the FAR Council appears to be moving ahead with a proposed rule for safeguarding contractor information systems, as reported in our August 29, 2012 [Covington E-Alert](#).<sup>2</sup>

- Whistleblower Protections (Sections 827 and 828). As reported in the December 10, 2012 edition of [The Government Contracts Update](#), the Senate previously approved a provision to its version of the NDAA that would extend whistleblower protections. Section 827 of the final version of the NDAA amends 10 U.S.C. § 2409 (which applied only to employees of DoD contractors) by extending whistleblower protections to all employees of DoD subcontractors. Section 828 also temporarily extends essentially the same protections beyond DoD contractors to employees of all non-intelligence, civilian contractors, subcontractors, and grantees in a four-year pilot program, pending a GAO study and recommendations on making these rights permanent. The [Government Accountability Project estimates](#) that this bill will protect an additional twelve million federal contractors. Notably, the NDAA prohibits "reprisals" even if undertaken at the request of an executive branch official. President Obama has expressed concern that these provisions "threaten to interfere with [his] constitutional duty to supervise the executive branch" and made clear that he "will interpret [the expanded whistleblower protections] consistent with [his] authority to direct the heads of executive departments to supervise, control, and correct employees' communications with the Congress in cases where such communications would be unlawful or would reveal information that is properly privileged or otherwise confidential." The basis for this concern is unclear, given that the NDAA expands whistleblower protections for employees of contractors, subcontractors, and grantees, but not employees of executive agencies.
- New Guidance on DCAA Access to Internal Audit Reports (Section 832). Section 832 of the NDAA specifies that the Defense Contract Audit Agency ("DCAA") may request contractors' internal audit reports, but only for the purpose of evaluating and testing the efficacy of contractor internal controls and the reliability of associated contractor business. A DCAA determination based upon those internal reports that a contractor has a sound system of internal controls may provide a basis for increased reliance on contractor business systems, or, as appropriate, a reduced level of testing. However, internal audit reports requested by DCAA cannot serve as the sole basis for a determination that a contractor has a sound system of internal controls. Revised guidance from the DCAA, incorporating Section 832, is due within 180 days of the NDAA's enactment. Section 832 is restricted in application to DCAA, and does not appear to apply to the Inspector General.

Full access to these internal audit reports can potentially lead to a DCAA fishing expedition related to what the agency sees or believes it sees in these reports. Many internal audit reports are targeted at financial controls and not the internal controls for government contracting and

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<sup>2</sup> See Department of Defense (DoD), General Services Administration (GSA), and National Aeronautics and Space Administration (NASA), Semiannual Regulatory Agenda, 78 Fed. Reg. 1,646 (Jan. 8, 2013) (targeting an April 2013 date for issuance of a final rule).

the potential for miscommunication needs to be considered by companies as they move forward with their internal audit planning.

- DoD Review of Contractor Profits (Section 804). With its continued focus on contractor profits and government spending and against the background of “fiscal cliff” negotiations, Congress has required DoD to examine defense contractor profit levels. Section 804 requires DoD to review the DFARS, and within 180 days, to identify necessary modifications to “ensure an appropriate link between contractor profit and contractor performance.” DoD must solicit comments from experts and interested parties and consider, at minimum (1) profit levels necessary to sustain competition; (2) appropriate adjustments to address performance risk, taking into account the extent to which the risk is passed to subcontractors; and (3) incentives for superior contractor performance.
- Prohibition on Cost-Type Contracts Relating to Major Defense Acquisitions (Section 811). Not later than 120 days after enactment, DoD must modify the DFARS to prohibit the use of cost-type contracts for “major defense acquisitions” (i.e., those over \$300 million for R&D, testing, and evaluation, or \$1.8 billion for total procurement). Exceptions to this prohibition will require a written certification by the Under Secretary of Defense for Acquisition, Technology, and Logistics.
- Increased Sanctions Against Iran (Section 1244). As reported in our January 4, 2013 [Covington E-Alert](#), the NDAA imposes significant new economic sanctions on (1) persons who knowingly engage in transactions with entities in Iran’s energy, shipping, and shipbuilding sectors; (2) persons who provide precious metals or other materials to Iran; (3) persons that provide underwriting or insurance relating to sanctionable activities; and (4) foreign financial institutions that facilitate transactions on behalf of specially designated nations.
- Requirements and Limitations for Suspension and Debarment (Section 861). As reported in the December 10, 2012 edition of [The Government Contracts Update](#), the Senate version of the NDAA would have required an amendment to the FAR creating a process for the “automatic referral” to suspension and debarment officials of contractors facing (1) charges of contracting-related crimes; (2) civil allegations of contracting-related fraud; or (3) found by the head of a contracting agency to have failed to pay or refund amounts due to the Government. In its final form, the NDAA no longer requires an “automatic referral” to suspension and debarment officials, but does require that there be at least one independent suspension and debarment official in each agency, and that each official establish written policies for handling matters formally referred for potential suspension and debarment, as well as for matters that are not formally referred.
- Misrepresentation of Size Status as Basis for Suspension and Debarment (Section 1683). Section 1863 of the NDAA directs that misrepresenting the status of an entity as a “small business concern,” a “qualified HUBZone small business concern,” a “small business concern owned and controlled by socially and economically disadvantaged individuals,” or a “small business concern owned and controlled by women” to obtain a government contract is an independent basis for suspension or debarment.
- Annual Report on Suspension and Debarments Proposed by the Small Business Administration (Section 1683). Section 1683 of the final bill incorporates a House provision requiring the Small Business Administration to submit an annual report on suspension and debarment actions taken by the administration, including the number of contractors proposed for suspension or

debarment, the reason for proposal, the result of the proposal, and the number of suspensions or debarments that have been referred to the Inspector General.

- Review and Justification of Pass-Through Contracts (Section 802). As reported in the December 10, 2012 edition of [The Government Contracts Update](#), the Senate version of the NDAA would have required the FAR to be amended to prohibit certain pass-through charges. Section 802 of the final NDAA instead directs DoD, the Department of State, and USAID to issue guidance and regulations to ensure that, on certain pass-through contracts, procuring agencies consider alternative contracting vehicles as well as contracting directly with a subcontractor that will perform the bulk of the work. Section 802 also requires a written determination that the contracting approach selected is in the best interest of the Government.
- Database on Price Trends of Items and Services Under Federal Contracts (Section 851). Section 851 establishes a database of price trends for products and services to be used in the evaluation of offers for contracts with the Government.
- Inclusion of Data on Contractor Performance in Past Performance Databases for Executive Agency Source Selection Decisions (Section 853). Section 853 requires the inclusion of contractor performance information in past performance databases to be used for source selection decisions.
- Status of Other Previously Reported Measures. As previously reported in the December 10, 2012 edition of [The Government Contracts Update](#), the Senate had approved amendments relating to an annual report on federal contracting waste (S.Amdt.3182) and a public database listing DoD officials seeking employment with Defense Contractors (S.Amdt.3183). However, neither of these provisions made it into the final version of the NDAA.

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