E-ALERT | Government Contracts

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THE GOVERNMENT CONTRACTS UPDATE

DOD PROPOSES RULE TO CLARIFY FLOWDOWN REQUIREMENTS RELATING TO SPECIALTY METALS RESTRICTIONS (79 FED. REG. 35507)

On June 23, 2014, the Department of Defense ("DoD") issued a proposed rule to clarify the flowdown requirements pertaining to Defense Federal Acquisition Regulation Supplement ("DFARS") clause 252.225-7009 ("Restriction on Acquisition of Certain Articles Containing Specialty Metals"). The clause provides, with certain exceptions, that any so-called "specialty metals" (*e.g.*, certain types of cobalt, nickel, steel, titanium and titanium alloys, zirconium, and zirconium base alloys) incorporated in items delivered under the contract shall be melted or produced in the U.S., its outlying areas, or a qualifying country. Currently, the "substance" of the clause must be flowed down to subcontracts for items containing specialty metals. DoD's proposed rule rewrites this requirement to specify that the only modifications allowed when flowing down the clause are (1) to exclude and reserve paragraph (d) of the clause, which sets forth an alternate compliance mechanism applicable to commercial derivative military articles; (2) to modify paragraph (c)(6) to facilitate management of the allowance for up to 2 percent otherwise noncompliant specialty metal content in the end product; and (3) to identify the appropriate parties.

Comments on the proposed rule must be submitted by August 22, 2014. If finalized, the proposed rule may require contractors, especially those involved in the manufacture of aircraft, missile or space systems, ships, tank or automotive items, weapon systems, or ammunition, to update their subcontract and purchase order forms.

DOD PROPOSES RULE ESTABLISHING REQUIREMENTS FOR DEFENSE CONTRACTORS PERFORMING PRIVATE SECURITY FUNCTIONS OUTSIDE THE UNITED STATES (79 FED. REG. 35713)

On June 24, 2014, DoD issued a proposed rule that would amend the DFARS to prescribe a clause addressing DoD-unique requirements for defense contractors performing private security functions outside the United States. The new proposed clause goes beyond current requirements set forth in FAR 52.225-26 ("Contractors Performing Private Security Functions Outside the United States") by requiring contractors to (1) register in DoD's Synchronized Predeployment and Operation Tracker ("SPOT") database all weapons, armored vehicles, helicopters, and other vehicles used or operated by personnel performing private security functions; and (2) comply with ANSI/ASIS PSC.1-2012, American National Standard, Management System for Quality of Private Security Operations -- Requirements with Guidance.

The new proposed clause further requires that contractors flow down the substance of the clause in all subcontracts when private security functions will be performed outside the United States (1) in areas of contingency operations; (2) combat operations, as designated by the Secretary of Defense; (3) other significant military operations as designated by the Secretary of Defense, and (4) only upon agreement of the Secretary of Defense and the Secretary of State; in humanitarian or peace operations; or (5) other military operations or military exercises, when designated by the Combatant Commander. Comments on the proposed rule must be submitted by August 25, 2014.

DoD Proposes Rule to Notify Contractors of Requirements Relating to Afghan Taxes (79 Fed. Reg. 35715)

On June 24, 2014, DoD issued a proposed rule to amend DFARS to add two new clauses regarding taxes paid to the Government of Afghanistan:

- DFARS 252.229-70XX ("Taxes -- Foreign Contracts in Afghanistan): This clause states that the solicitation or contract is covered by an agreement between the U.S. and Afghanistan governments that exempts U.S. contractors, subcontractors, and contractor personnel from paying any Afghan taxes. It directs contractors to exclude any Afghan taxes or similar charges from the contract price, and requires that the substance of the clause be flowed down to all subcontracts. This clause would be mandatory in all solicitations and contracts for work to be performed in Afghanistan, unless the clause below applies.
- DFARS 252.229-70YY ("Taxes -- Foreign Contracts in Afghanistan (Military Technical Agreement)"): This clause would be mandatory in all solicitations and contracts with performance in Afghanistan awarded on behalf of NATO, subject to approval by the Director, Defense Procurement and Acquisition Policy, Office of the Under Secretary of Defense For Acquisition, Technology, and Logistics. Such contracts are covered by the Military Technical Agreement ("MTA") between the International Security Assistance Forces ("ISAF") and the Afghan government, which establishes the terms of NATO's security activities in Afghanistan. The proposed clause states that the MTA exempts contractors from paying any Afghan taxes, except that local contractors are subject to tax for profits earned from NATO/ISAF contracts or subcontracts. The clause directs contractors to exclude any Afghan taxes or similar charges from the contract price, with the exception that the tax on profits can be included in the contract price. Contractors must also flow down the substance of the clause.

Both clauses make clear that Afghan employees of DoD contractors and subcontractors are subject to Afghan tax laws and that contractors must withhold tax from the wages of those employees to the extent required by Afghan law. This proposed rule ignores the significant problem faced by contractors caught between the two governments. Since 2008, the Afghan government has assessed nearly $1 billion dollars in taxes on U.S. contractors working in Afghanistan, according to a 2013 report issued by the Special Inspector General for Afghanistan Reconstruction. As noted in the report, the U.S. government does not have a comprehensive agreement with the Afghan government that addresses the tax status of contractors working on behalf of the U.S. government. Instead, various individual U.S. government agencies have executed bilateral agreements with the Afghan government that exempt contractors supporting agency-funded contracts from paying various Afghan taxes. At issue is the Afghan Finance Ministry's view that the various individual agreements provide tax-exempt status only to prime contractors, and not subcontractors. In contrast, the U.S. government contends that the agreements provide tax exemption for all non-Afghan companies (both prime and subcontractors) supporting U.S. government efforts.

The U.S. government's failure to resolve this issue has created an opening for the Afghan tax authorities to use heavy-handed tactics in their attempts to extract tax payments from contractors, such as arresting contractor personnel and denying licenses to operate in country. It also has led to increased costs to the U.S. government and has interrupted American military operations. Although the new rule, which is formalizing a substantively identical existing DFARS class deviation (2013-O0016), does not resolve the underlying disagreement regarding subcontractors, it does clarify which of the two bilateral agreements relevant to DoD contracting apply in particular circumstances. It also highlights that the taxes are unallowable costs with the exception of tax on profits incurred by an Afghan contractor on a contract covered by the Military Technical Agreement; those taxes may be included in the contract price.

Comments on the proposed rule must be submitted by August 25, 2014.

SENATE COMMITTEE MARKS UP FEDERAL INFORMATION TECHNOLOGY ACQUISITION REFORM ACT

On June 25, 2014, the Senate Committee on Homeland Security and Governmental Affairs marked up and passed a substantially modified version of the Federal Information Technology and Acquisition Reform Act ("FITARA," H.R. 1232). The original bill passed the House of Representatives on February 25, 2014 (see our discussion here). In the Senate, Committee Chairman Tom Carper (D-DE) and Ranking Member Tom Coburn (R-OK) introduced a substitute amendment that replaced most of the language of the House bill. Like the House bill, the Senate version grants Chief Information Officers ("CIO") at government agencies increased authority over IT spending and operations, and establishes a government-wide strategic sourcing initiative for the acquisition of software. But the bill departs from the House approach in several important respects, including by:

- Omitting provisions that would create a new Common Application Collaboration Center to assist with practices related to the acquisition of undefined "IT infrastructure and common applications."
- Omitting a provision seeking to consolidate government websites and increase user transparency.
- Omitting a provision encouraging agencies to transition to cloud computing.
- Omitting provisions seeking to strengthen the IT acquisition workforce.
- Omitting provisions to clarify the current law with respect to technology neutrality in software acquisition.
- Omitting provisions that would allow for spending analysis or study of acquisition methods to inform decisions about the new strategic sourcing initiative.
- Replacing the data center provisions of the House bill with provisions drawn from the Federal Data Center Consolidation Act of 2013 (S. 1611).

340B DRUG DISCOUNT PROGRAM UPDATE

The Health Resources and Services Administration ("HRSA") recently announced that it plans to publish a new 340B program rule in the Federal Register that would require drug manufacturers to provide discounts to certain 340B entities on orphan drugs[1] when used for non-orphan indications. As we previously reported, the U.S. District Court for the District of Columbia permanently enjoined HRSA from implementing regulations that required pharmaceutical manufacturers to offer orphan drugs to covered hospitals at reduced prices if the drugs were used to treat non-orphan conditions. The Court did not, however, invalidate HRSA's interpretation of the statute; it vacated the regulation on the grounds that HRSA lacked the authority to engage in such rulemaking. HRSA decided to stand by its interpretation of the statute in an interpretive rule posted on the website, and its

[1] Orphan drugs are drugs that treat rare diseases or conditions. They are so-named because efforts to research, invest in, and produce them might be abandoned if not for the incentives Congress provides pharmaceutical manufacturers. While orphan drugs can only be designated as such to treat rare diseases or conditions, they also are often used to treat non-rare diseases or conditions.

announcement to publish this interpretation in the Federal Register is a continuation of this approach.

HRSA also recently announced changes to the process for 340B entities to contest adverse audit findings. HRSA's July, 2014 program update states: "While notification to the covered entity and audit processes remain relatively unchanged, the steps that take place after the audit has been conducted have undergone several enhancements. The most notable change is that HRSA no longer issues preliminary reports to the audited covered entities. HRSA notifies audited covered entities of the audit findings in the HRSA Final Report." Some industry stakeholders have expressed the concern that this removed "one of two opportunities health care providers had to challenge adverse findings."

CASE DIGEST

Supreme Court Agrees to Review FCA Statute of Limitations Case, and District Court Becomes First to Hold That WSLA Does Not Apply to the FCA (*United States ex rel. Carter v. KBR*, 710 F.3d 171 (4th Cir. 2013) and *United States ex. rel. Landis v. Tailwind Sports Corporation*, No. 10-cv-00976 (RLW) (D.D.C. June 19, 2014))

On July 1, 2014, the Supreme Court granted certiorari in *Kellogg Brown & Root Services Inc. ("KBR") et al. v. U.S. ex rel. Carter*, despite the U.S. Department of Justice's recommendation that it refrain from doing so (covered here and here). The Court will review a ruling by the U.S. Court of Appeals for the Fourth Circuit on the application of the Wartime Suspension of Limitations Act ("WSLA"), 18 U.S.C. § 3287, to the False Claims Act's ("FCA") statute of limitations, and on the application of the FCA's "first-to-file" provision, 31 U.S.C. §3730(b)(5). The WSLA suspends the statute of limitations for any "offense" involving fraud or attempted fraud until five (5) years after the termination of hostilities. The Fourth Circuit held that the WSLA operates to toll the statute of limitations for all FCA claims, including those brought by relators in which the Government does not intervene, from the passage of the October 11, 2011 Authorization for the Use of Military Force against Iraq, until a formal termination of the conflict is "proclaimed by a Presidential proclamation, with notice to Congress, or by a Concurrent resolution of Congress." The Fourth Circuit's ruling significantly expands contractor exposure to potential liability for old FCA claims that would otherwise be barred by the statute of limitations. The Court's decision to grant cert suggests that it may not endorse this broad interpretation of the WSLA.

On June 19, 2014, shortly before the Supreme Court granted cert in the *KBR* case, the U.S. District Court for the District of Columbia rejected the Fourth Circuit's interpretation of the WSLA. Relying on a 1953 Supreme Court case, the court concluded that the WSLA applies only to offenses in which a specific intent to defraud the government is an "essential element" of the claim. Finding that proof of fraud has not been an "essential element" of a civil FCA claim since the 1986 amendments to the statute, the court concluded that WSLA does not apply to such claims.

The Supreme Court will also review the Fourth Circuit's holding that the FCA's "first-to-file provision" applies only when a related suit is "pending" at the time the relator files an action. The first-to-file provision bars private relators from filing an FCA suit based on the same facts underlying a "pending action." The Fourth Circuit's narrow interpretation of "pending" would allow relators to avoid that bar and file claims similar or identical to those raised in previous cases that have been dismissed.

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