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Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

6 Takeaways From Executive Order On Defense Industrial Base

By **Susan Cassidy, Justin Ganderson and John Sorrenti**

Susan Cassidy

Justin Ganderson

John Sorrenti

Law360, New York (August 1, 2017, 10:07 AM EDT) -- On July 21, 2017 — and during "Made in America Week"[1] — President Donald Trump issued Executive Order 13806 on "Assessing and Strengthening the Manufacturing and Defense Industrial Base and Supply Chain Resiliency of the United States."[2] The EO sets forth a policy stressing the importance of having a "healthy" domestic "manufacturing and defense industrial base and resilient supply chains" to meet "national security" needs. This policy comes on the heels of President Trump's April 2017 Executive Order 13788 on "Buy American and Hire American," which announced a policy and action plan to increase U.S. manufacturing capabilities by "maximiz[ing]" the Federal Government's procurement of "goods, products, and materials produced in the United States."

The manufacturing EO calls for a sweeping review and assessment of the strengths and weaknesses of the defense industrial base ("DIB") and supply chains, and cites the need for the United States "to surge in response to an emergency." This review stems from the administration's stated conclusion that the "manufacturing capacity and defense industrial base of the United States have been weakened by the loss of factories and manufacturing jobs." Although a report on this review is not due until April 2018, the manufacturing EO's underlying policies and reporting requirements offer contractors an important glimpse into the Trump administration "America First" vision and potential impacts on federal procurement.

Forthcoming Report to the President

By April 17, 2018, the secretary of defense, coordinating with myriad government agencies and offices, must deliver a report to the president that assesses the strengths and weaknesses of the DIB and supply chains. Among other things, the DIB report will:

- identify goods (including military and civilian materiel) essential to national security, and the manufacturing capabilities (including emerging capabilities) essential to producing these goods;

- identify any contingencies that could compromise the supply chain (whether natural or man-made), and the causes of any deficiencies in the supply chain; and

- assess the "resiliency and capacity" of the U.S. manufacturing and DIB and supply chains to support national security needs in the event a contingency arises.

The assessment of "resiliency and capacity" requires the evaluation of various topics, such as

- U.S. manufacturing capacity, DIB physical plant capacity, and the ability to "modernize to meet future needs" and the adequacy of the work force personnel;

- "gaps in national-security-related domestic manufacturing capabilities" including nonexistent or "single-point of failure" capabilities"; and

- exclusive or dominant supply of goods (and components) "by or through nations that are or are likely to become unfriendly or unstable" and whether substitutes or alternative sources are available for goods essential to national security.

Finally, the DIB report must include recommendations for any legislative, regulatory, or policy changes that the president or agency heads deem appropriate "based upon a reasoned assessment that the benefits outweigh the costs (broadly defined to include any economic, strategic, and national security benefits or costs) over the short, medium, and long run." Such changes should focus on addressing contingencies identified in the report, fixing any deficiencies in the DIB or supply chain, and strengthening U.S. manufacturing capacity and the DIB while also increasing the resiliency of supply chains.

Key Questions and Answers Raised by the Manufacturing EO

1. What is the relationship between the manufacturing EO and the "Buy American" EO?

Given the manufacturing EO's emphasis on "strengthening" U.S. manufacturing and DIB capabilities and supply chains, we expect there to be some overlap between the manufacturing EO and President Trump's April 2017 Buy American EO,[3] which we previously analyzed. Similar to the manufacturing EO, the Buy American EO requires the secretary of commerce to submit a report to President Trump by November 2017 providing specific recommendations for strengthening the implementation of existing "Buy American Laws, including domestic procurement preference policies and programs." It appears that the Trump administration could be equating strict compliance with the so-called "Buy American Laws" with increased domestic manufacturing capabilities.

However, mandating strict compliance with Buy American laws, alone, likely will not strengthen U.S.

manufacturing in a significant manner. For example, the Buy American Act (41 U.S.C. §§ 8301–8305) ("BAA")[4] does not prohibit the procurement of "foreign end products." Under the BAA, domestic end products may include foreign components, so long as the cost of the U.S. components exceeds 50% of the cost of all components — there is no cost of components test for commercially available off-the-shelf ("COTS") end products. With regard to U.S. Department of Defense acquisitions, "qualifying country end products" and components — i.e., end products and components manufactured in countries that have a reciprocal defense procurement memorandum of understanding with the U.S. which removes certain purchasing barriers — are treated as domestic. In other words, unless narrowed, the qualifying country public interest exception can serve as a bypass to U.S. manufacturing.

If, however, the DIB report indicates that the U.S. is disproportionately reliant on foreign suppliers, mechanisms beyond the existing Buy American laws (such as new procurement evaluation preferences, stricter sourcing requirements or tax incentives) likely would be needed to convince contractors to open new domestic factories or decrease their reliance on global supply chains. The bottom line: Contractors should closely follow the reports and recommendations arising from each executive order.

2. What is the relationship between the manufacturing EO and proposed legislation regarding the DOD's procurement of commercial products?

The House version of the National Defense Authorization Act of 2018 includes a provision that would establish a program to procure commercial products through online marketplaces, such as Amazon. Because companies selling on these marketplaces typically rely on global supply chains, it will be interesting to see how the DIB report addresses this type of proposed legislation, as well as the general intersection between commercial and DOD products/components and manufacturing.

3. Should contractors expect legislative and regulatory changes to the acquisition process?

The DIB report may determine that the U.S. supply chain and the DIB simply does not have the capacity to produce certain goods critical to national security. The DIB report may also find that certain goods are unavailable in the U.S. or are viewed as being too costly to produce domestically. What steps could the government take to ameliorate these potential concerns?

To the extent the DIB report finds that manufacturing and DIB capabilities have suffered because agencies and contractors have not routinely complied with existing domestic sourcing requirements, contractors can expect increased enforcement of the existing rules. The government likely would address such a finding by increasing its scrutiny over contractor compliance — potentially resulting in increased False Claims Act investigations and suspension or debarment actions. To that end, the press release[5] accompanying the Buy American EO notes that executive agencies need to "conduct comprehensive assessment aimed at cracking down on weak monitoring, enforcement, and compliance efforts to strengthen Buy American policies."

If the DIB report determines that increased enforcement of and scrutiny over existing regulations and policies would be insufficient to increase domestic manufacturing, the government could implement further changes — through legislation, regulation or executive order — to strengthen domestic manufacturing. For example, contractors could see increases in the percentage of domestic content required by the BAA or changes to existing exceptions and waivers. Such changes, however, would not be without significant costs to contractors (and to the government when buying their products). Similarly, because a global supply chain is the norm for most commercial manufacturers, these types of changes could discourage such companies from competing in the federal sector. Thus, the administration will need

to weigh the increase in U.S. manufacturing capabilities against increased costs to buy products and the potential loss of access to the technological innovation that comes with participation by commercial contractors in federal procurement.

Whatever the outcome of the DIB report, contractors must pay particular attention to these potential changes, and should consider engaging Congress and the administration where necessary.

4. Will the DIB report forecast future requirements and needs?

In addition to assessing existing capabilities and deficiencies, the DIB report must identify "emerging capabilities" and assess the capacity of the DIB to "modernize to meet future needs." Thus, there is a significant aspect of this report that will be forward-looking. The DIB report could provide insight into government spending priorities going forward. Contractors should pay close attention to how the report identifies or estimates future needs, and any related analyses, and prepare accordingly.

5. How will the DIB report differ from the annual DIB reports prepared pursuant to 10 USC § 2504 and Senate Report 112-26?

Congress already requires the DOD to issue an "Annual Industrial Capabilities Report" that assesses the capability of the U.S. technology and industrial base to attain national security objectives. The most recent Industrial Capabilities Report, submitted in September 2016 and covering fiscal year 2015, found that the "defense industry remains viable and competitive," while acknowledging that "DoD contractors must constantly examine and realign their business activities while competing for capital in competitive markets." (The report also noted that the U.S. "no longer has the luxury of assuming that it will remain the sole origin of new technology breakthroughs.") This conclusion appears to be somewhat at odds with the manufacturing EO, which seems to suggest that significant efforts are required to revive domestic manufacturing and the DIB. The Industrial Capabilities Report also recognized that more regulation could deter participation by commercial contractors, citing perceptions about contracting practices and intellectual property protection. It further cited the significant efforts by the DOD to encourage participation by these companies. The push for more domestic manufacturing could run counter to those efforts.

Additionally, although the DIB report will require coordination with a larger number of agencies than the Annual Industrial Capabilities Report, it is not clear whether the DIB report will build off of these annual reports or chart its own course. In any event, it will be insightful to compare the assessment in the DIB report with the fiscal year 2016 Industrial Capabilities Report, which should be issued in the next few months. (It also will be insightful to compare the DIB report to assessments from other reviews such as the Section 809 Panel and potentially the National Defense Strategy Advisory Panel, whose proceedings involve a review and analysis of the industrial base.)

6. How will the Trump administration address manufacturing capacity concerns?

In introducing the manufacturing EO, the administration cited problems with manufacturing capacity and, in a press briefing, provided the example of there being just one company in the U.S. that can repair propellers for Navy submarines and that certain military-grade semiconductors and printed circuit boards have become "endangered species." The fiscal year 2016 Industrial Capabilities Report identified similar concerns about capacity, noting that recent mergers and acquisitions involving large prime defense contractors have led to problems with the DIB, including barriers to entry in critical sectors that limit the "variety, breadth, and diversity of innovation."

Contractors should pay close attention to how the DIB report addresses this matter. Will the government seek to have multiple companies produce the same good or component? Will the government shape procurements to award to more than one company in an effort to boost capacity? Contractors should be aware of these potential solutions as they could open the door for new opportunities to break into the market or, conversely, limit the influence of incumbent contractors.

Susan B. Cassidy is a partner, Justin M. Ganderson is special counsel and John W. Sorrenti is an associate in the Washington, D.C., office of Covington & Burling LLP.

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[1] https://www.whitehouse.gov/the-press-office/2017/07/17/president-donald-j-trump-proclaims-july-17-2017-made-america-day-and

[2] https://www.whitehouse.gov/the-press-office/2017/07/21/presidential-executive-order-assessing-and-strengthening-manufacturing

[3] https://www.whitehouse.gov/the-press-office/2017/04/18/presidential-executive-order-buy-american-and-hire-american

[4] http://uscode.house.gov/view.xhtml?path=/prelim@title41/subtitle4/chapter83&edition=prelim

[5] https://www.whitehouse.gov/the-press-office/2017/04/18/president-trump-promotes-buy-american-and-hire-american

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