

COVID-19 and the Defense Production Act: What Does it Mean for Government Contractors and Suppliers?

March 19, 2020

On Wednesday March 18, 2020, the President invoked the Defense Production Act (“DPA”) in response to the Coronavirus (“COVID-19”) pandemic. The DPA is a Korean War-era statute that grants the President the power to ensure the availability of the nation’s industrial resources to meet national security needs. Significantly, it authorizes the President to prioritize contracts by requiring that contractors provide critical materials or supplies before they fulfill the terms of other federal or commercial contracts or orders. This authority has significant repercussions for contractors and their supply chains, most immediately in the health and medical services industries.

The President’s March 18th Executive Order on Prioritizing and Allocating Health and Medical Resources to Respond to the Spread of COVID-19 invokes the DPA to combat the COVID-19 outbreak by prioritizing the production of health and medical resources needed to respond to the spread of COVID-19. The Department of Defense routinely uses DPA authority in its contracts. Recently, the U.S. Army Corps of Engineers used the DPA to prioritize contracts in the aftermath of Hurricane Katrina, and the Federal Emergency Management Agency invoked the DPA to prioritize contracts for food and bottled water in Puerto Rico following Hurricane Maria.

The DPA contains three titles that are relevant for government contractors and suppliers:

Title I, Priorities and Allocations, which permits prioritizing and allocating government contracts for goods and services over competing customers;

Title III, Expansion of Productive Capacity and Supply, which offers incentives to enhance domestic production of critical materials and technologies; and

Title VII, General Provisions, which encompasses antitrust protection for voluntary industry agreements serving defense interests and establishes a voluntary reserve of trained private sector executives available for emergency federal employment.

DPA Titles I and Title III are the most significant for government contractors in light of the March 18th Executive Order. However, one aspect of Title VII is critical in the context of COVID-19 as it immunizes companies from liability for damages or penalties for any act or failure to act resulting directly or indirectly from compliance with the DPA.

The authority to prioritize contracts is limited to programs necessary to promote the national defense, as determined in writing by the Secretary of Defense, the Secretary of Homeland Security, and the Secretary of Energy. Once such a determination has been made, agencies with specific expertise in different resource and material sectors are also delegated authorities under the DPA,

including the Departments of Agriculture, Commerce, Health and Human Services, and Transportation. Given the extent of COVID-19's impact, all of these agencies will likely play a role in the current effort to stop the virus's spread.

DPA Title I Authorities - Priorities and Allocations

Priority Authority

The Priority Authority under Title I of the DPA allows the President to require that performance under contracts or orders (other than contracts of employment) which he deems necessary or appropriate to promote the national defense take priority over performance under any other contract or order. Implementing regulations include the U.S. Department of Commerce's regulations establishing the Defense Priorities and Allocation System ("DPAS") which has typically been used to prioritize contracts and orders pursuant to the DPA. *See* 15 C.F.R. §§ 700.1-700.93. Contracts and orders are categorized in order of national priority using a rating system. DOD employs two ratings; a DX rating designates orders of the highest national priority, while a DO rating is of lesser priority (but still takes priority over unrated orders). National defense is defined broadly under the DPA as programs for military and energy production or construction, military or critical infrastructure assistance to any foreign nation, homeland security, stockpiling, space, and any directly related activity. The term also includes emergency preparedness activities conducted pursuant to the Robert T. Stafford Disaster Relief and Emergency Assistance Act ("the Stafford Act"). 42 U.S.C. §§ 5121-5207.

On March 13, 2020, the President declared a nationwide emergency pursuant to the Stafford Act due to COVID-19. The Stafford Act defines emergency preparedness to include all "activities and measures designed or undertaken to prepare for or minimize the effects of a hazard upon the civilian population, to deal with the immediate emergency conditions which would be created by the hazard, and to effectuate emergency repairs to, or the emergency restoration of, vital utilities and facilities destroyed or damaged by the hazard." 42 U.S.C. § 5195a(a)(3).

With respect to COVID-19, the federal government may use the priority authority under the DPA to ensure the timely availability of critical materials (such as those used in COVID-19 test kits), equipment (such as surgical masks, ventilators, and respirators), and services (such as health related or laboratory testing services) produced in the private market. Thus far in the COVID-19 crisis, the federal government has not exercised this priority authority; however, should states encounter further supply chain issues, it may do so. As noted above, contractors will not be held liable for actions taken to comply with governing rules, regulations, and orders (e.g., prioritization requirements) under the DPA. With very limited exceptions, private companies and corporations are not permitted to reject a prioritized contract and severe consequences can follow for non-compliance, including criminal liability.

Allocation Authority

The second DPA Title I authority, the Allocation Authority, authorizes the president to allocate materials, services, and facilities to the extent necessary to promote the national defense. 50 U.S.C. § 4511. To invoke these powers, the President must find that the applicable material is "critical material essential to the national defense," and "that the requirements of the national defense for such material cannot otherwise be met without creating a significant dislocation of the normal distribution of such material in the civilian market to such a degree as to create appreciable hardship." ***No Hoarding Provision***

The DPA also includes an "anti-hoarding" provision, which provides that no person shall accumulate (1) in excess of the reasonable demands of business, personal, or home consumption, or (2) for the purpose of resale at prices in excess of prevailing market prices, materials which have been designated by the President as scarce materials or materials the supply of which would be

threatened by such accumulation. Hoarding and price gouging are risks in the current environment. Willful violations of this and other provisions of DPA Title I constitute criminal acts that carry serious penalties, including fines and imprisonment.

DPA Title III Authorities - Expansion of Productive Capacity and Supply

While DPA Title I authorities were intended to ensure that the government has priority access to goods that are already being produced by domestic industries, Title III authorities are designed to create a sufficient supply of essential goods in the interest of national defense where the commercial market is not satisfying that supply. Under DPA Title III, the President may provide financial incentives “to develop, maintain, modernize, restore, and expand the production capacity of domestic sources for critical components, critical technology items, materials, and industrial resources essential for the execution of the national security strategy of the United States.” In addition to loan authorities, Title III authorities include restricting contract solicitations to reliable sources or domestic sources and stockpiling.

Loan Guarantee and Direct Loan Authority

Sections 301 and 302 of Title III of the DPA authorize the President to issue loan guarantees (to non-federal borrowers) and direct loans (from the federal government that require repayment with/without interest) to reduce current or projected shortfalls of industrial resources, critical technology items, or essential materials needed for national defense purposes. Loan guarantees and direct loans can be issued to private businesses to help them create, maintain, expedite, expand, protect, or restore production and deliveries or services essential to the national defense. However, funding for guarantees and loans must be appropriated by Congress.

Purchase, Purchase Commitments, and Installation of Equipment

Section 303 of Title III grants the President an array of authorities to create, maintain, protect, expand, or restore domestic industrial base capabilities essential to the national defense. These authorities include, but are not limited to, purchasing or making purchase commitments of industrial resources or critical technology items; making subsidy payments for domestically produced materials; and installing and purchasing equipment for government and privately owned industrial facilities to expand their productive capacity. Section 303 authorities can be structured in a number of ways, including direct purchases or subsidies of such goods.

Conclusion

The exercise of DPA authority by the President is a significant development in the battle against COVID-19. If a company receives a DPAS rated contract or order, it must prioritize the order and defer work or services for other customers, commercial or Government.

As noted, the DPA protects contractors from claims arising under other non-rated Government or commercial contracts. However, this does not mean that private companies will be compensated for lost business opportunities.

Government contractors in the medical and health industries, including suppliers to those industries, should consider implementing the following measures:

1. Review federal contracts for rated orders.
2. Monitor purchasing system for orders containing DPAS ratings.
3. Be prepared to flow-down DPA requirements to subcontractors.
4. Survey supply chain to identify gaps or delays, including coordinating with subcontractors to identify supply chain gaps at lower tiers.
5. Be prepared to identify supply chain gaps to prime contractors (if applicable).

6. Assess the impact of local directives addressing business closures (for instance, in the San Francisco Bay Area) and personnel shortages on supply chain capacity. If supplies are required that are not normally rated using a priority rating due to such circumstances, be prepared to request priority rating authority under 15 C.F.R. § 700.51. This authority can also be used to expand plant facilities.
7. Consider contacting customers pursuant to 15 C.F.R. § 700.13 to advise of anticipated delays in shipment or performance of supplies and services under a rated order, if necessary.