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FEATURE COMMENT: Specialty Metals Compromise Forged

The National Defense Authorization Act for Fiscal Year 2008 (2008 Act) contains new provisions reflecting a compromise on domestic source requirements for specialty metals. Although the specialty metals provisions were revised comprehensively last year in the John Warner National Defense Authorization Act for FY 2007 (the 2007 Act), the subject was reopened in this legislative session as a result of dissatisfaction, on both sides of the debate, with how last year's reforms were implemented by the Defense Department. Thus, to fully understand this year's changes, it is helpful to recap the history of the domestic source requirements and discuss the relevant provisions in the 2007 Act, as well as DOD's subsequent policy guidance and implementing regulations.

Since 1972, defense contractors have been obliged to use domestically melted specialty metals to manufacture supplies tendered to DOD. This requirement was first imposed as an expansion of the so-called Berry Amendment, a provision first introduced in 1941 as a spending restriction in annual DOD appropriations acts and later codified at 10 USCA § 2533a. Before 1972, the Berry Amendment applied primarily to textile and food products. However, by the early 1970s, specialty metals were becoming more important for defense article production. Titanium components, for example, constituted over 30 percent of the weight of military aircraft such as the McDonnell Douglas F-15 "Eagle" and the Grumman F-14 "Tomcat." The Rockwell B-1 "Lancer" bomber produced during this time used approximately 200,000 pounds of titanium per aircraft. After specialty metals were added to this list of covered items in 1972, then-Secretary of Defense Melvin Laird issued a memorandum, since known as the Laird Memo, stating, in effect, that literal compliance with the new law was impossible and that DOD would enforce the requirement at the subcontract level only for contracts in excess of the small purchase threshold (then $2,500), and only for six categories of procurements—aircraft, missiles, ships, tank-automotives, weapons and ammunitions. At the time (and today), these products constituted the bulk of the specialty metals procured (indirectly) by DOD. The Laird Memo's guidance remained undisturbed for over 30 years, and eventually was set forth in the Defense Federal Acquisition Regulation Supplement at 252.225-7014 (Alternate 1). However, over the years, enforcement became spotty, at best, and many argued that DOD's move toward sourcing commercial and "commercial derivative" military items made compliance more difficult.

In response to these developments, the 2007 Act significantly changed the existing Berry Amendment coverage for specialty metals. First, it codified much of existing DOD policy, including the definition of "specialty metals" and the six categories of end items for which DOD had mandated compliance at every subcontract tier, i.e., aircraft, missile and space systems, ships, tank and automotive items, weapon systems, or ammunition. Direct purchase of specialty metals by DOD also was expressly covered. Second, the 2007 law moved domestic source requirements for specialty metals to a new section of the U.S. Code, 10 USCA § 2533b, "Requirement to buy strategic materials critical to national security from American sources." The domestic metals industry welcomed this change because its products were recognized as "strategic," as distinguished from other materials subject to domestic source requirements. This change had unforeseen consequences, however. By putting specialty metals into a new statutory provision, it became politically feasible for DOD to devise regulatory exemptions

to § 2533b, such as an exception for commercial-off-the-shelf (COTS) items, that could apply to specialty metals without creating backlash from manufacturers of other items—clothing, shoes, fish sticks, etc.—still covered by the old Berry Amendment provisions at § 2533a.

The 2007 Act also attempted—in hindsight, not very successfully—to clarify the coverage and scope of the so-called "availability" exemption in § 2533a that allowed DOD to waive the domestic source provisions if a "satisfactory quality and sufficient quantity of ... specialty metals ... produced in the United States cannot be procured as and when needed at United States market prices." Over the years, DOD agencies, and the Air Force in particular, took the position that the end item or major component (e.g., a jet engine) was the "specialty metal" for purposes of applying this "availability" exception. Under this interpretation, a noncompliant jet engine arguably could be accepted if the manufacturer elected, for whatever reason, not to make compliant ones. The 2007 Act clarified that the domestic source requirement applied to "end items, or components thereof, containing a specialty metal." This clarification distinguished end items or components from the "specialty metal" itself. However, Congress recognized that some flexibility was required, so the 2007 Act also modified "availability exception" to permit waivers if the secretary of defense "determines that compliant specialty metal of a satisfactory quality and sufficient quantity, *and in the required form*, cannot be procured as and when needed" (emphasis added).

This new availability exception contained three major changes. First, the availability at U.S. "market prices" test was eliminated. It was not clear whether this change was intended to give DOD more flexibility (by permitting different tests, such as "global" market prices), or less (by *precluding* waivers based on cost if the specialty metals were available at some price). Second, waivers could be granted if the metals were not available in the *required form*, a change that reportedly was made to appease fastener manufacturers who complained that certain types and grades of specialty metals (e.g., 8740 gauge wire or "rod stock") sometimes were not available when needed. Again, however, the law was subject to interpretation. After the 2007 Act, DOD granted waivers for noncompliant fasteners and other hardware items because compliant parts were unavailable in the "required form" of a fastener or a clip, notwithstanding the metals industry's argument that domestic specialty metals needed to manufacture such items were readily available. The third change allowed subcontractors as well as prime contractors to request waivers, with the goal of helping fastener and other lower-tier manufacturers. Regardless, DOD subsequently refused to accept waiver requests from subcontractors on the basis that there was no privity of contract with those suppliers and because DOD lacked sufficient resources to process waivers from all levels of the supply chain. All in all, the attempt to clarify and tinker with the "availability" exception failed to yield the hoped-for clarity.

One relatively successful change implemented by the 2007 law was an exception for "electronic components whose specialty metal content is *de minimis* in value compared to the overall value of the lowest level electronic component" containing specialty metals. It is important to understand that the Berry Amendment never applied to many electronic components (e.g., Blackberries) purchased by DOD. However, for the six categories to which the Berry Amendment applied for both prime contracts and all subcontracts (e.g., aircraft), this exception for electronic components could be significant. Interestingly, this change was supported by the domestic specialty metals industry because it was perceived to have little, if any, adverse impact on the specialty metals industry, even after DOD announced in its Dec. 6, 2006 policy guidance that "de minimis" meant up to 10 percent of the overall value of the component. Even this change, however, was perceived to be inadequate by the electronics industry, which argued that electronic components simply should be exempt.

Finally, the 2007 Act created a "one-time waiver"—a "get-well" or amnesty period (expiring on Sept. 30, 2010)—that allows a contracting officer, with the approval of the undersecretary of defense for acquisition, technology and logistics, to accept noncomplying end items or components if replacing the metal in order to comply with the domestic source requirement would not be "practical or economical." This waiver authority applied only to items produced before enactment of the Act, and only if the noncompliance was not willful and the contractor or subcontractor had a plan to ensure future compliance with the law. Many argued that this "one-time waiver" was useful, but did not give DOD enough flexibility if, for example, the contractor already had used its "one-time" waiver opportunity or if noncompliant parts unintentionally

found their way into end items. This perceived lack of flexibility was publicly debated last year when the Army said that it was unable to accept Family of Medium Tactical Vehicle (FMTV) trucks needed in Iraq because they contained noncompliant transmissions and engines.

Thus, although the 2007 Act was viewed by most observers as a step in the right direction, it ultimately did not satisfy concerns on either side of the debate.

The 2008 Act includes three sections dealing with specialty metals, two of which address the contentious issues discussed above. The three provisions, discussed below, are:

- Section 803, Reinvestment in Domestic Sources of Strategic Materials
- Section 804, Clarification of the Protection of Strategic Materials Critical to National Security
- Section 884, Requirements Relating to Waivers of Certain Domestic Source Limitations Relating to Specialty Metals

Section 803—This section tasks the "Strategic Materials Protection Board" (established via the 2007 Act) to provide Congress a report on whether "domestic producers of strategic materials" are investing in domestic infrastructure and workforce training. The provision was substituted for one in the House bill that required defense procurements to include as an evaluation factor a criterion that assesses the extent to which offerors have a record of "sustained reinvestment" in domestic production of materials. The House provision did not garner much support, and the replacement provision and report will have limited consequence (assuming the report is produced) other than as a reference for those advocating that either enough or too little is being done in terms of reinvestment in domestic production capacity for strategic materials.

Section 804—This section is the most significant provision in the 2008 Act with respect to specialty metals.

Elimination of Antideficiency Act Liability: Section 804 amends 10 USCA § 2533b to prohibit the acquisition of noncompliant items—items not complying with, or otherwise exempt from, the requirement to incorporate only domestic specialty metals—instead of prohibiting the *expenditure of appropriated funds* for such noncompliant items. This eliminates Antideficiency Act liability for noncompliance by COs. It remains to be seen whether this change affects DOD's ability to "conditionally accept" noncompliant items by deducting the cost of the noncompliant part from the price of the end item, as DOD has done in the past. DOD curtailed this practice after the specialty metals provisions were revised and codified at § 2533b. The Dec. 6, 2006 "Class Deviation" issued by the undersecretary of defense for acquisition, technology and logistics stated this policy change was a result of new statutory language precluding purchase of "end items, or components thereof," containing noncompliant metal. Since this language remains the same, it is not clear what effect, if any, the elimination of Antideficiency Act liability will have on DOD's procurement practices.

Section 804 also amends the law to clarify that § 2533b *does* apply to COTS items. This had been a hotly debated issue centering on whether the statute (as previously written) contained such a COTS exception—either intentionally or unintentionally. The new language states that § 2533b applies to acquisitions of commercial items "notwithstanding sections 34 and 35 of the Office of Federal Procurement Policy Act." These sections of the OFPP Act allow DOD to promulgate a list of Government-unique procurement laws that will not apply to commercial-item and COTS-item procurements. On Nov. 8, 2007, DOD published a final rule—which now will have to be revisited—exempting COTS items from the specialty metals law because of the omission of "and 35" (the section specifically addressing COTS) from the prior statute. However, after clarifying that § 2533b applies to COTS items, the new section includes an express exception (some refer to these carve-outs as "exemptions") for COTS items "other than" certain listed types, i.e.:

- specialty metals mill products, e.g., bar, billet, slab and sheet;
- forgings and castings of specialty metals, unless they are incorporated into a COTS item or subassembly;
- high-performance magnets; and
- fasteners, unless incorporated into COTS end items or subassemblies.

Thus, producers cannot avoid the domestic source requirements for specialty metals themselves (mill products) or forgings or castings made entirely of specialty metals, unless they are incorporated in a COTS item. The definition of a COTS item for purposes of § 2533b is the same as the one previously codified at 41 USCA § 431(c), which states:

> (c) "Commercially available off-the-shelf item" defined:
>
> (1) As used in this section, the term "commercially available off-the-shelf item" means, except as provided in paragraph (2), an item that—
>
> (A) is a commercial item (as described in section 403(12)(A) of this title);
>
> (B) is sold in substantial quantities in the commercial marketplace; *and*
>
> (C) is offered to the Government, without modification, in the same form in which it is sold in the commercial marketplace.

The key phrase above is "without modification." Anything contained in a COTS end item would be exempt. Subcontracts for COTS subassemblies used in non-COTS end items arguably also would be exempt. However, forgings and castings and fasteners that go directly into a non-COTS end item or non-COTS subassemblies would not be exempt.

Fasteners: These items have unique rules. COTS fasteners incorporated into a COTS subassembly or end item are exempt. Commercial-item fasteners (non-COTS) comply if the producer certifies that it has purchased domestic metal for "not less than 50 percent of the total amount of the specialty metal that it will purchase to carry out production of such fasteners." This has been referred to as a "market basket" approach. Military-unique fasteners still must be manufactured with domestic specialty metal and are not subject to compliance via the market basket approach.

Electronic Components: These items previously were exempt if they were commercially available and the amount of specialty metal in the component was deemed to be de minimis, which DOD in the Dec. 6, 2006 "Class Deviation" letter defined as less than 10 percent of the value of the component. The new law exempts electronic components altogether, eliminating the de minimis test. However, the secretary of defense can impose domestic source requirements if a particular electronic component is "critical to national security." In addition, structural or mechanical elements of electronic equipment, for example, a radar dish or a specialty metal cover, are not covered by this exception.

A new de minimis exception now applies to all items, with the exception of high performance magnets. The defense agencies may accept an item containing up to two-percent noncompliant metal, based on the total *weight* of all of the specialty metals in an item. This exception might apply, for example, to small specialty metal parts in a jet engine if the source of the parts cannot be ascertained. It may take some time to work out the ground rules for measuring compliance by total weight because this is a completely new approach.

There also is a new "streamlined" compliance process for "commercial derivative military articles" (CDMAs), so-designated by a service secretary. A CDMA is one produced in "the same production facilities, [with] a common supply chain, and the same or similar production processes." In addition, these facilities must be used to produce articles that are "predominantly used by the general public or by non-governmental entitles." Thus, aircraft, trucks and ships that are sold primarily to non-Government customers that are modified for Government use should qualify as CDMAs. Contractors supplying a CDMA can comply using a modified "market basket" approach whereby the manufacturer of the end item or component certifies that it has purchased the *greater of* 120 percent of the amount of specialty metal used for the CDMAs to be delivered to DOD, or 50 percent of the specialty metal used by the contractor for producing CDMAs and "the related commercial article." Thus, under the second test, if modified 737 aircraft are sold to the Navy for use as submarine hunters, Boeing would have to purchase from U.S. domestic sources 50 percent of the specialty metal used to manufacture *all* 737's "during such period of production." For purposes of computing the total amount of specialty metal under these rules, the weight of COTS items *is included*. Thus, one cannot use the COTS exception *and* the CDMA process for streamlined compliance—*it is one or the other*. Conference report language directs DOD to promulgate rules ensuring that, in implementing the minimum threshold quantities of specialty metals for the streamlined compliance procedure, the thresholds are applied to the specialty metals contained in an item, rather than "on a piecemeal basis to a subsystem or component of such item." Thus, if the end item does not pass the streamlined compliance test, the test does not apply to subassemblies below the end-item level.

The law also contains a "national security waiver" that allows the deputy secretary of defense or undersecretary of defense for acquisition, technology and logistics to accept a noncompliant end item after determining that accepting the item is "necessary to national security" and notifying Congress. To invoke

this exception, DOD must determine whether the noncompliance was "knowing and willful." If not, DOD should ensure the contractor implements future plans for compliance. If so, DOD must require a compliance plan and consider whether the contractor should be suspended or debarred from Government contracting. This provision likely was added as a result of a well-publicized inability to accept FMTV vehicles, discussed above. According to the conference report, the intent of the revisions is "to ensure that defense contractors comply with requirements to purchase domestic specialty metals without impeding the ability of the Department of Defense to acquire weapon systems when and as needed."

"Required form": This has been clarified as meaning that the "form" is specialty metal "mill products" to prevent DOD from continuing to invoke the existing "availability" exception to grant waivers for noncompliant end items and components. As noted above, during the past year, the availability exception was used, for example, to exempt noncompliant fasteners, even though domestic stock needed to manufacture compliant fasteners was available to fastener manufacturers. The conference report notes that the recently published DOD rule regarding COTS items and domestic nonavailability determinations (DNADs) "that apply to multiple contracts and which were based on the availability of components, rather than specialty metals, will have to be reviewed to comply" with § 2533b, as amended. Any DNAD, however, presumably will be effective "as is" until reviewed.

Finally, the law revises the rules for granting DNADs. First, it requires that DOD reexamine previously granted DNADs and amend them, if necessary, to comply with the changes in the law, most notably the more precise "required form" definition. However, previously granted DNADs will continue to apply to any contract entered into before the statute was enacted. Second, the law requires more "transparency" in the use of exceptions and the DNAD approval process. DOD must report to Congress on the first and second anniversaries of the legislation concerning the types of items that are being procured under the new COTS exception to show how it has implemented the new rule. As discussed below, § 884 of the 2008 Act also imposes DNAD requirements.

Section 884—This section increases transparency by providing that 30 days before granting a DNAD applicable to *more than one contract*, DOD must publish a notice in FedBizOpps *and* solicit information from "interested parties, including producers of specialty metal mill products." Additionally, the rationale for granting such DNADs must be made public "to the maximum extent consistent with the protection of national security ... and confidential business information." The conference report also states that "the conferees encourage the Department to ensure that the exceptions provided by subsections (b) through (k) of the revised § 2533b are utilized through an open and transparent process" (while protecting national security and confidential business information). The section addresses a criticism that DOD does not properly investigate the availability of domestic specialty metals (in the required form) before granting DNADs, and it replaces more onerous House bill language that would have required DNADs covering more than one contract to be subject to formal rulemaking.

All in all, the new legislation appears to strike a reasonable balance and should resolve many contentious issues that plagued the process after enactment of the 2007 Act. Hopefully, as a result of the above refinements, the law will become settled and give defense contractors and the specialty metals industry greater certainty in an area that has for the past several years been roiled by controversy.

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