

Proposed Semiconductor Buy Ban May Rattle Supply Chains

By **Alexander Hastings, Giovanna Cinelli and Barron Avery** (May 23, 2024, 4:53 PM EDT)

The Federal Acquisition Regulatory Council, the body charged with drafting the regulations affecting government contracts, recently released an advanced notice of proposed rulemaking outlining how it will implement the semiconductor prohibitions found in Section 5949 of the National Defense Authorization Act for fiscal year 2023.

This action follows on the heels of restrictions on exports of certain semiconductors and semiconductor equipment to China as well as on U.S. person support to China related to semiconductors.

The NDAA fiscal year 2023 semiconductor prohibition applies to products and services from three Chinese companies named in the legislation, Semiconductor Manufacturing International Corp., ChangXin Memory Technologies and Yangtze Memory Technologies Corp., along with their affiliates and subsidiaries, and could also apply to additional companies connected to the government of a foreign country of concern.

These prohibitions generally apply in two parts.

- The government may not procure or obtain — including through contract renewals — electronic products or electronic services that include covered semiconductor products or services; and
- The government may not procure or obtain — including through contract renewals — electronic products that use covered semiconductor products or services, when the part will be used in a critical system.

FAR Council's Proposed Rulemaking

The FAR Council's advanced notice of proposed rulemaking explains that contractors will be required to perform a reasonable inquiry to determine whether any products or services provided to the U.S. government include or use covered semiconductor products or services.

If a contractor becomes aware of such information, the FAR Council anticipates that contractors will be required to report it to the government within 60 days and, as a practical matter, will likely be required to remove the offending semiconductor products or services. The FAR Council further anticipates that



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the contractor will have the benefit of a safe harbor for timely disclosure, including certain protections from civil liability and potential suspension or debarment.

These restrictions and the associated consequences for violation may seem familiar to many who do business with the U.S. government. For instance, the Section 889 prohibitions in the NDAA for fiscal year 2019 generally prohibit the U.S. government from procuring any systems or services that use telecommunications equipment or services from certain Chinese companies and from contracting with any entities that use such equipment or services.

This prohibition, which also requires contractors to conduct a reasonable inquiry to identify any such prohibited telecommunications equipment or services, has been in government contracts for several years through Federal Acquisition Regulation 52.204-25, and in most respects contractors have adapted to these requirements.

That said, while the FAR Council's approach to implementing the Section 5949 semiconductor prohibitions in the NDAA for fiscal year 2023 seems familiar on its surface, the breadth and scope of these new prohibitions have the potential to disrupt information technology and related supply chains.

For instance, the use prohibition in the Section 889 telecommunications ban does not flow down to subcontractors, whereas the FAR Council anticipates that both requirements of the semiconductor prohibition will apply throughout a contractor's supply chain, at least where a critical system is involved.

Further, the FAR Council "anticipate[s] this [prohibition] would impact a large majority of contracts and orders," noting that it will be included in every contract issued by the U.S. government, including contracts below the micro-purchase threshold, simplified acquisitions, and commercial item/service purchase and commercially available off-the-shelf acquisitions.

Anticipated Impact on Supply Chains

The impact that this prohibition will have on supply chains, including supply chains for supporting legacy systems, may be immense. Additionally, it is difficult to anticipate how contractors will be able to adjust supply chains that are already burdened and contracted to capacity several years in advance, although there is a reference to certain exceptions that may apply as outlined below.

The FAR Council suggests that

As friendly and allied nations expand their production and the United States continues to build out [its] domestic semiconductor production capacity through the CHIPS and Science Act and the Department of Commerce's CHIPS for America program, DoD, GSA, and NASA anticipate this additional rulemaking will help ensure that Federal contractors will increasingly have a diverse and more trustworthy source of suppliers that can provide secure and resilient semiconductors.

Despite this statement, there is uncertainty that this capacity will be available to meet demands for contractors that must implement this rule across a wide array of acquisitions — including far down their supply chains with vendors that otherwise may be unable or unwilling to adjust solely for the purpose of meeting supply for U.S. government orders.

Additionally, the FAR Council has, for now, largely left open the available waivers under this prohibition, noting that it will clarify certain waiver authority in the future while recognizing that the head of each

executive agency has authority under the legislation.

Indeed, the legislation provides waiver authority after determining that (1) no compliant product is available at a price that is not prohibitively expensive, and (2) a waiver is not reasonably expected to compromise the critical national security interests of the U.S.

However, it remains unclear how agencies could grant waivers in practice, including whether they will be granted on a product or class basis and how prohibitive pricing will be measured. Without guidance for the agencies in exercising this waiver authority, contractors may be faced with uncertainty when seeking a waiver of the semiconductor prohibitions.

Next Steps

The FAR Council is accepting comments on the advanced notice of proposed rulemaking until July 2, including on the impact of the prohibition, areas for further clarity and the need for waivers.

Companies that engage in business with the U.S. government — either directly or as a member of a supply chain — may consider submitting comments. In addition, given the bipartisan support that this prohibition has received, companies that engage in business with the U.S. government would be well advised to begin assessing their supply chains to identify covered semiconductor products and services and consider measures to respond to the forthcoming prohibition.

At a policy level, the FAR Council's anticipated actions are aligned with the Biden administration's overall policy toward semiconductors, with a focus on the redevelopment of indigenous U.S. capability as well as ally and partner capacity.

The advanced notice of proposed rulemaking identifies the nature of the restrictions, which focus on the import of the covered semiconductors into the U.S. government supply chain. On the export side, the administration is focused on restricting, through the Export Administration Regulations, products, materials, equipment, technology and software that could advance China's capabilities in the semiconductor space.

As leadership within the U.S. Department of Commerce's Bureau of Industry and Security has publicly stated, one of the goals of the export restrictions is to delay or limit the continuing development in China of advanced semiconductors.

In part, delaying China's progress in these areas may make it less likely that semiconductors from China will find their way into the supply chains of the U.S. government.

By publishing this advanced notice of proposed rulemaking, the government is looking at the concerns in this area from both the development and eventual use side, reflecting a coordinated approach toward managing concerns in the semiconductor space.

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