ALERT MEMORANDUM

Use of Authorities Under the Defense Production Act in Response to COVID-19

March 30, 2020

There has been significant media and political attention paid to the authorities provided by the Defense Production Act of 1950 (the "DPA") and their possible use to mobilize resources to fight the COVID-19 pandemic.[1] Unfortunately, much of the discussion of the authorities the DPA provides, and how they have been or could be used, has been confused and at times inaccurate. The DPA historically has focused on allocation of existing production and incentives to expand capacity, not government-mandated conversion of existing manufacturing facilities to entirely new uses. The Trump Administration's threat to order manufacturers to supply products entirely outside their normal line of business, if carried through, would break new ground.

There are two primary groups of authorities under the DPA:

Prioritizing and allocating existing domestic production. There is long-standing authority under the DPA to enable the Federal Government to jump to the front of the queue when placing orders for goods essential to national security and to direct the priority in which orders are filled. This authority has been fairly routinely used and, in the case of COVID-19-related products, has been delegated to the Secretaries of Health and Human Services ("HHS") and the Department of Homeland Security ("DHS") (together, the "Secretaries"). The less-frequently used authorities to allocate scarce goods and penalize hoarding have also been invoked and delegated to the Secretaries.

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[1] Codified at 50 U.S.C. § 4501 et seq.

Incentivizing new production. The DPA provides for grants and loans to manufacturers of essential goods to increase production capability. There is also important authority to approve industry agreements to promote the production of essential goods and, subject to government oversight, immunize them from antitrust or breach of contract claims. Each of these authorities has been used in the past, but none has yet been exercised.

Recent public discussions have conflated these well-established authorities with a third possibility, ordering manufacturers to enter entirely new lines of business. In principle, it may be possible to use the DPA to require companies to produce goods and services they do not ordinarily provide, although the authority to do so under the statute is largely untested and would be inconsistent with existing regulations and historical practice. However, President Trump recently threatened to take such action, which to our knowledge would be unprecedented, in his March 27 memorandum to the Secretary of HHS, directing the Secretary to use DPA authorities to require General Motors to "to accept, perform, and prioritize" orders for the number of ventilators that the Secretary determines to be appropriate (the "GM Memorandum").[2]

Whatever the theoretical limits of the DPA, its practical impact has been much more on the provision of incentives to private industry to meet public needs. Clients should consider whether a public-private partnership model within the framework of the DPA presents opportunities to address the crisis from a market perspective.

This memorandum provides an overview of the scope and potential use of the DPA in fighting the COVID-19 pandemic.

I. Background of the DPA

Inspired by the War Powers Acts of World War II[3], the DPA[4] was enacted in 1950 in response to the Cold War with the Soviet Union and the North Korean invasion of South Korea. It has been amended and reauthorized by Congress numerous times since then, most recently in 2018.[5]

As noted above, the DPA confers upon the President (and, through executive delegation, upon numerous executive departments and agencies) an extraordinary array of authorities to direct and incentivize domestic industries in the interest of "national defense." Through gradual amendments to the DPA, Congress has broadly expanded the definition of "national defense" to now include, in relevant part, (i) emergency preparedness activities to prepare for or respond to a disaster[6] and (ii) protection and restoration of "critical infrastructure," including any systems or assets critical to national public health or safety.

The prioritization authorities under the DPA described in Section II below have been most frequently invoked by Presidents.[7] For example, the U.S. Army Corps of Engineers prioritized contracts in support of the Hurricane Katrina recovery efforts, and the Federal Emergency Management Agency

[2] Memorandum on Order Under the Defense Production Act Regarding General Motors Company (March 27, 2020), available at https://www.whitehouse.gov/presidential-actions/memorandum-order-defense-production-act-regarding-general-motors-company.

[3] Congressional Research Service, The Defense Production Act of 1950: History, Authorities, and Considerations for Congress, updated March 2, 2020, available at https://fas.org/sgp/crs/natsec/R43767.pdf.

[4] Four of the seven titles in the DPA (relating to requisitioning of materials and property, rationing of consumer goods, wage and price fixing, forced settlement of labor disputes and certain credit controls and regulations) lapsed in 1953.

[5] Sec. 791 of P.L. 115-232.

[6] Disaster declarations and aid, largely administered by FEMA, are governed by the Robert T. Stafford Disaster Relief and Emergency Assistance Act, 42 U.S.C. § 5121 et seq. ("Stafford Act"). President Trump has also invoked disaster authorities under the Stafford Act, which provides a means of channeling assistance to state and local authorities, and may continue to do so.

[7] The Department of Defense routinely requires that government contractors prioritize its military equipment purchases over competing customers.

("FEMA") used the authority extensively during the 2017 disaster season, including prioritizing contracts for manufactured housing units, food and bottled water and the restoration of electrical transmission and distribution systems in Puerto Rico.[8]

II. Prioritizing and Allocating Existing Production

On March 18, 2020, President Trump issued Executive Order 13909 in response to the COVID-19 pandemic ("EO 13909"). EO 13909 invoked authorities under Title I of the DPA to give the Secretary of HHS power to prioritize and allocate "all health and medical resources needed to respond to the spread of COVID-19 within the United States." A second Executive Order issued on March 23, Executive Order 13910 ("EO 13910"), gave the Secretary of HHS authority to prevent hoarding of health and medical resources by prohibiting accumulation of the resources beyond reasonable needs or for purposes of resale at above market prices. A third Executive Order issued on March 27 (the "March 27 EO") extended these authorities to the Secretary of DHS as well. Taken together, these authorities permit the Secretaries to direct and allocate existing production capacity and stockpiles of COVID-19 essential goods. Although the prioritization and allocation authorities were granted to the Secretaries, they may be used on behalf of any government agency (for example, the Department of Defense). However, to our knowledge there has not yet been any reported use of the delegated authorities.

A. Priority Authority

Section 101(a)(1) of the DPA authorizes the President to require (i) contractors to prioritize the performance of their government contracts over other customers and (ii) any person capable of meeting the government's needs to accept and perform contracts, even if such person has no prior relationship with the Federal Government; however, as noted above, the current presumption (and historic practice) only requires acceptance where the person already produces the items in question. Effectively, the authority gives government orders priority over competing commercial contracts.

The Federal Priority Allocation System ("FPAS") is a harmonized set of rules developed to implement DPA authorities across agencies.[9] The FPAS provides that the Secretaries may prioritize a government contract above private-sector contracts and may also set the priority of contract performance between two private parties (such as a contract between a prime contractor and a subcontractor), if needed to fulfill a priority contract and promote the national defense.

The FPAS provide the following allowances for when a person is required to or may optionally reject a prioritized contract (although the FPAS also provides that the Secretary of the relevant agency can issue an order superseding any such allowance in its discretion):[10]

(a) **Mandatory Rejection**. A person shall not accept a prioritized order for delivery on a specific date if unable to fill the order by that date; provided that such person inform the ordering party of the earliest date on which delivery can be made and offer to accept the order on the basis of that date.

(b) **Optional Rejection**. A person may reject a prioritized order in certain instances, including if (i) the ordering party is unwilling or unable to meet regularly established terms of sale or payment, (ii) the order is for an item not supplied or for a service not capable of being performed or (iii) the order is for an item or service produced, acquired, or provided only for the supplier's own use for which no orders have

[8] The Department of Defense routinely requires that government contractors prioritize its military equipment purchases over competing customers.

[9] The Heath Resources Priorities and Allocations System ("HRPAS") applicable to HHS is found at 45 C.F.R. Part 101; the Defense Priorities and Allocations System ("DPAS") applicable to DHS is found at 15 C.F.R. Part 700. *See* U.S. Dept. of Commerce, DPAS Delegation 4 (Mar. 8, 2016) (delegating authority under DPAS for HHS programs to the Secretary of HHS). The FPAS standards are consistent in relevant part.

[10] HRPAS at § 101.33; DPAS at § 700.13.

been filled for two years prior to the date of receipt of the prioritized order.

B. Allocation Authority

Section 101(a)(2) of the DPA broadly authorizes the President to "allocate materials, services, and facilities in such manner, upon such conditions and to such extent as he shall deem necessary or appropriate to promote the national defense."[11] This authority has also been delegated to the Secretaries. The FPAS further specifies that three types of allocation orders may be issued:

1. **Set-Asides**, requiring a person to reserve resource capacity in anticipation of receipt of prioritized orders;
2. **Allocation directives**, requiring a person to take or refrain from taking certain actions (e.g., to stop or reduce production of an item, prohibit the use of selected items, divert supply of one type of product to another or to supply a specific quantity, size, shape, and type of an item within a specific time period); and
3. **Allotments**, specifying the maximum quantity of an item authorized for use in a specific program or application.[12]

In addition, the FPAS specifies that (i) use of allocation orders to ration materials or services at the retail level is prohibited[13] and (ii) no person shall be required to relinquish a disproportionate share of the civilian market.[14]

C. Anti-Hoarding

Section 102 of the DPA permits the President to designate materials based on scarcity or the threat of supply disruptions as a result of hoarding, whereupon it is prohibited to "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." Although the Secretaries have been delegated this authority with respect to COVID-19 materials, there has been little discussion of employing it.

III. Incentivizing New Production

Title III of the DPA permits the President to provide financial incentives to develop and expand production capability essential to national defense. In the event these authorities are invoked, the Federal Government may, among other things, (i) purchase or make purchase commitments of goods or services, (ii) make subsidy payments, (iii) make direct loans and loan guarantees and (iv) install or purchase equipment for government or privately owned industrial facilities to expand their productive capacity. These incentives provide the primary authority under the DPA for increasing domestic capacity to produce critical goods. While these provisions have not yet been invoked, in the recent Coronavirus Aid, Relief, and Economic Security Act ("CARES Act") Congress provided a number of key waivers allowing exercise of loan and loan guarantee authorities and appropriated $1 billion for "Defense Production Act Purchases."[15] As a practical matter for potential suppliers, the Title III incentive authorities are likely to be among the most important.

In addition, Section 708 of the DPA authorizes the President to "consult with representatives of industry, business . . . and other interests in order to provide for the making by such persons, with the approval of the President, of voluntary agreements and plans of action to help provide for the national defense" by collaborating to produce scarce and critical materials. Subject to certain monitoring and approval

[11] Section 101(b) of the DPA provides that the authorities in this section may not be used to control the "general distribution" of a material in the civilian market unless the President makes a finding (i) related to the scarcity of such material and (ii) that the requirements of national defense "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." While this power has rarely been invoked, President Trump made such findings in the EO 13909.

[12] HRPAS at § 101.53; DPAS at § 700.33.

[13] HRPAS at § 101.50(a)(2); DPAS at § 700.30(a)(2).

[14] HRPAS at § 101.50(b); DPAS at § 700.30(b).

[15] Pub. L. 116-136, § 4017; *id.*, Div. B.

requirements,[16] parties taking action in good faith pursuant to such voluntary agreements are shielded from antitrust liability and claims for breach of contract.

While the President has not yet invoked Section 708, on March 24, 2020, in a joint statement by the Department of Justice and the Federal Trade Commission announcing an expedited antitrust process to review joint efforts by companies to combat the coronavirus outbreak, the agencies additionally noted that "where the government enlists help from private businesses in addressing COVID-19, the Agencies stand ready to assist, such as by working with [HHS] to effectuate the [DPA]."[17] Furthermore, FEMA (a component of DHS) has regulations in place for the establishment of industry agreements, which outline a process for private parties to propose voluntary industry agreements for critical goods.[18]

IV. Mandated Changes in Business

As noted above, the DPA arguably provides statutory authority for the President to require manufacturers to produce goods and services they do not ordinarily provide, given that Section 101 of the DPA requires only that the President (or his designee) find that the person ordered to accept a government contract is capable of performing the contract.[19] In addition, the presumption in the FPAS that a manufacturer may refuse a contract on the basis that it does not provide the goods or services in question may, as with other grounds for refusal, be overridden by the Secretaries.

However, to our knowledge, the DPA has not historically been used to commandeer production facilities and order a fundamental change in its use, from automobiles to ventilators or pajamas to respirators, for example.[20] Any such action by the Federal Government (pursuant to the GM Memorandum or otherwise) would enter into uncharted waters raising serious legal and policy questions. For example, it seems clear that this would qualify as a public purpose for takings purposes and that a compensation obligation would attach, but beyond that high-level framework little detail has been established. Product liability where an unqualified supplier is ordered to supply but not given detailed specifications by the government is another open question. Finally, of course, there is the practical question of marshalling unrelated resources to competently produce complex goods on short notice. All of these present difficult, unresolved questions. In that context, it is notable that the GM Memorandum did not actually have any direct effect; rather it directed the Secretary of HHS to require General Motors to produce "the number of ventilators that the Secretary determines to be appropriate," leaving implementation for further negotiation and action. It remains to be seen whether and how the potential coercive authority of the DPA will be used.

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[16] Any such agreement is subject to consultation with and monitoring by the Department of Justice and Federal Trade Commission to monitor its competitive effects.
[17] U.S. Department of Justice and Federal Trade Commission: Joint Antitrust Statement Regarding COVID-19 (2020), available at https://www.justice.gov/atr/joint-antitrust-statement-regarding-covid-19?utm_medium=email&utm_source=govdelivery.
[18] 44 C.F.R. Part 332.
[19] Such finding could be bolstered by the Federal Government's use of its authority to procure and install equipment in privately-owned plants, pursuant to Section 303(e) of the DPA.
[20] In the 1960s, the DPA was used by the Federal Government to compel agricultural chemical companies to produce a specific herbicide formula for the U.S. military, code-named Agent Orange. While these companies did not previously produce Agent Orange specifically, they were generally in the business of producing herbicides. See *Hercules v. United States*, 516 U.S. 417 (1996).