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How the Defense Production Act May Affect Healthcare and Medical Supply Companies

Due to rising concerns about the recent outbreak of the novel coronavirus, President Trump signed an executive order on March 18, 2020, invoking his authority under the Defense Production Act (DPA). The order designates "health and medical resources" as scarce and critical materials essential to the national defense, and gives the Secretary of Health and Human Services (HHS) significant power over their distribution and allocation in the civilian market.

If utilized, this order could have significant effects on companies that manufacture and supply such "health and medical resources," even if they do not normally contract with the federal government. This update provides an overview of the president's order, the government's powers under the DPA, and what companies need to be aware of.

The Defense Production Act

The Defense Production Act was originally enacted in 1950. Its purpose was to allow the government to allocate industrial resources towards the production of articles identified as necessary to the national defense.

Although originally intended for times of war, the meaning of "national defense" has steadily expanded to include more than military readiness. As amended, the act authorizes a variety of governmental powers designed to facilitate responses to natural disasters, terrorist attacks, and other national emergencies (including virus outbreaks). The president's March 18 order invokes the DPA powers of prioritization and allocation, which are authorized by 50 U.S.C. § 4511.

These powers authorize the government to issue two types of orders: "rated" orders and "allocation" orders. These are discussed more fully below.

Rated Orders

The DPA allows the president to prioritize government purchase orders and contracts by giving them either a "DX" or "DO" rating. Companies receiving these "rated orders" must accept them and give them preferential treatment over lower-rated and nonrated orders, including commercial orders. DX rated orders are higher in priority than DO rated orders, which are higher in priority than nonrated orders. Rated orders can be used to procure either supplies or services.

Additionally, companies who receive rated orders must place like-rated orders with their suppliers, in effect "flowing down" the rating through the supply chain.

Allocation Orders

The DPA also allows the president to control the distribution of designated materials in the civilian market by making "allocation orders." The president may issue three different types of allocation orders:

- Set-asides, which direct a company to reserve materials, services, or facility capacity in anticipation of receiving a DX or DO rated order
- Directives, which, among other things, can order a company to stop or reduce production of an item, or divert the use of materials, services, or facilities from one purpose to another
- Allotments, which place a cap on the maximum quantity of a material, service, or facility authorized for a specific use

The Executive Order

Normally, materials in the civilian market cannot be procured via rated order under the DPA. However, the March 18 order designates certain "health and medical resources" as scarce and critical materials essential to the national defense under 50 U.S.C. § 4511(b), making them eligible to be procured via rated orders under the DPA.

The order specifically mentions only "personal protective equipment and ventilators" as covered articles. However, the order delegates to the HHS Secretary the authority to identify additional civilian-market medical resources to procure via rated order.

The president's order further delegates to the HHS Secretary the authority to determine the proper nationwide priorities and allocation of health and medical resources and services, including controlling their distribution in the civilian market, and to issue orders and adopt and revise regulations as necessary to implement the executive order.

What Can Companies Expect?

Acceptance and Rejection of Rated Orders

Generally, companies must accept any rated orders issued to them, even if they do not normally contract with the government. Additionally, a company may not charge a premium price or otherwise discriminate against rated orders (as compared to unrated orders). Willful violation of the DPA is a criminal offense that can result in a fine, imprisonment, or both.

On the other hand, a company is sometimes required to reject a rated order. For example, a company must reject the order if it would be impossible to complete by the date required, or if the order would delay a higher-rated order or a previously accepted, equally rated order.

In certain narrow circumstances, a company has the option to either accept or reject a rated order, such as if the order is for an item the company does not normally supply, or a service the company is not capable of performing. Therefore, it is likely that only companies working in healthcare-related supplies or services will have mandatory obligations under this executive order.

In light of the serious consequences of failing to carry out a rated order, companies should be prepared to promptly notify the government if they are unable to perform on the timeline given in the order.

How Do Companies Know They Have Received a Rated Order?

A rated order must have certain elements. Just because the order states it must be filled "immediately" or "as soon as possible" does not make it a rated order. A rated order must state in substance it is a rated order certified

for national defense use, and that companies are required to follow all applicable regulations. Moreover, the order must state that it is rated as either "DX" or "DO."

Liability Protection from Interfering with Other Contracts

The DPA protects companies from liability stemming from compliance with a rated order. This means that a company cannot be held liable for breach of an unrelated contract if the breach occurred directly or indirectly as a result of complying with the rated order.

Look for Additional Guidance from HHS

As stated above, the HHS Secretary is authorized to identify additional scarce and critical articles to procure via rated order under the DPA. Companies that anticipate possibly receiving a rated order in response to the COVID-19 outbreak should keep an eye out for additional information from HHS regarding which articles in the civilian market will be deemed subject to the DPA.

Additionally, before issuing allocation orders, the HHS Secretary must develop a plan that states which materials, services, or facilities could be subject to an allocation order, and what types of allocation orders the Secretary expects to issue.

Companies that provide healthcare and medical supplies and services that may be subject to orders under the DPA should watch for further guidance as the country continues to combat COVID-19.

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