

UNCLASSIFIED

STATEMENT BY

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COMMITTEE ON ARMED SERVICES

ON

DEPARTMENT OF DEFENSE COVID-19 RESPONSE TO
INDUSTRIAL BASE CHALLENGES

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Chairman Smith, Ranking Member Thornberry, and distinguished Members of the House Committee on Armed Services, thank you for the opportunity to testify today on matters related to the Department's response to the COVID-19 pandemic. While COVID-19 has had an unprecedented impact on the Nation, under Secretary Esper's leadership the Department of Defense (DoD) has contributed immensely to the Administration's Whole of Government response. Today I will describe key elements of how the acquisition enterprise under my direction has used authorities available to it and new authorities provided by the Coronavirus Aid, Relief, and Economic Security (CARES) Act in support of other Federal agencies and the Defense Industrial Base (DIB). I also appreciate the opportunity to speak today on matters related to the Defense Logistics Agency's response to the COVID-19 pandemic. Through the Under Secretary for Acquisition and Sustainment, DLA supported the Department's response and the Administration's Whole of Government approach.

Use of the Defense Production Act

The 1950 Defense Production Act (DPA) grants the President a broad set of authorities to influence domestic industry in the interest of national defense. The authorities can be used across the federal government to shape the domestic industrial base so that, when called upon, it is capable of providing the essential materials and goods needed for the national defense. There are three active titles in use today within the DPA.

DPA Title I includes the priorities and allocation system, of which Defense Priorities and Allocation System (DPAS) is one of the regulations. DPAS, a regulation administered by the Department of Commerce (DOC), allows the President to require persons (including businesses and corporations) to prioritize contracts and orders for materials and services that are industrial resources. DoD has authority under the DPAS to place priority ratings on DoD contracts and orders; DoD uses two types of ratings: a "DO" and "DX", a higher priority used on a very small number of DoD programs.

The Department of Health and Human Services (HHS) has Title I authority for health resources, including Personal Protective Equipment (PPE) used in response to the COVID-19. This was reaffirmed when the President issued Executive Order 13909 on March 18, 2020.

Title III of the DPA authorizes the use of direct purchases, purchase commitments,

guarantees of purchases or leases of advanced manufacturing equipment, and loans or loan guarantees in order to “develop, maintain, modernize, restore, and expand the productive capacities 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.”

Title III authorities can be used to increase domestic production capacity for suppliers of medical resources used in response to COVID-19. The Department’s DPA Title III investment in response to COVID-19 remains on increasing manufacturing capacity and throughput. DoD continues to use the DPA Title III for two lines of effort: DIB resiliency and security; and industrial expansion for Medical and Healthcare resources, with HHS and Federal Emergency Management Agency (FEMA) coordination.

Title VII of the DPA provides an array of authorities including hiring subject matter experts and civilian executives for Federal Government service, review of foreign investment in the United States, and providing for voluntary agreements among industry with protection from criminal or civil antitrust proceedings.

Industrial Expansion

The COVID-19 pandemic identified critical shortfalls in the personal protective equipment (PPE) and medical supplies supply chain. On March 18, President Trump issued Executive Order 13909 invoking the Defense Production Act (DPA) delegating authority to the Secretary of Health and Human Services (HHS) to determine the proper nationwide priorities and allocation of all health and medical resources, including controlling the distribution of such materials (including applicable services) in the civilian market, for responding to the spread of COVID-19 within the United States. Under this Executive Order, and EO 13911 dated March 27, 2020, the DoD has been supporting HHS in execution of DPA authorities, both Title I and Title III, to prioritize and/or increase the production capacity of much-needed medical equipment and supplies to combat the novel coronavirus.

On March 27, 2020 the CARES Act was signed including language authorizing and providing resources for DPA projects to mitigate critical shortfalls that aligned with the traditional DoD DPA Title III scope and mission to create and expand domestic industrial base capabilities in response to COVID-19. The DoD, in support of HHS and FEMA, initiated several projects utilizing the DPA Title III authorities and funding to procure medical equipment for COVID-19 response (approximately \$210M).

The CARES Act also provides authorities and resources to HHS to invest in industrial expansion. As a result, the policy decision was made to leverage CARES Act funding appropriated to HHS to support pandemic response requirements and that the remaining DoD DPA Title III funding would be allocated to the DIB impacted by the COVID-19 pandemic in support of national security requirements.

Under the Economy Act, which authorizes federal agencies to order goods and services from other federal agencies, DoD has been providing acquisition assistance to HHS in acquiring critical medical resources and expanding industrial capacity and manufacturing throughput for medical resources to address the critical shortfalls identified during this public health emergency. Our collaboration supports accelerating COVID-19 response and recovery and the HHS strategy to replenish and modernize the Strategic National Stockpile (SNS).

To ensure the Department was postured to leverage all its resources, I created the COVID-19 Joint Acquisition Task Force (JATF) on March 25, 2020. Led by the Principal Deputy Assistant Secretary for Acquisition, Stacy Cummings, the JATF has been the single-entry point to the DoD acquisition enterprise throughout this crisis. The JATF team has created processes to enable HHS and FEMA to quickly and effectively access DoD acquisition workforce, expertise, and authorities in support of the COVID response. The JATF's work with HHS has evolved from an initial focus on supporting the immediate response to the national health crisis to its current support to HHS in expanding and replenishing the SNS (known as SNS 2.0). This line of effort includes procuring critical medical supplies and PPE for the SNS and, where determined appropriate by HHS, expanding the domestic manufacturing base for some of those items.

It's worth noting here that the JATF is not directly involved in Operation Warp Speed (OWS). OWS is being executed by a full-time dedicated interagency team that includes our most talented subject matter experts from around DoD. General Gustav Perna has been selected to be the Chief Operating officer for OWS and he reports directly to Secretaries Azar and Esper.

The JATF's goals are to:

- Bring analytic, program management, and contracting expertise from the Services and DoD Agencies to quickly respond to demand from FEMA and HHS;
- Utilize DoD's supply chain expertise to forecast gaps and identify opportunities for the industrial base expansion; and

- Prioritize solutions from industry to connect suppliers to FEMA or HHS, including industrial base expansion efforts.

The JATF is organized into six product lines, led by subject matter experts (SMEs) from the Services:

- Ventilators
- N95 respirators and surgical masks
- Screening and diagnostics
- PPE
- Pharmaceuticals
- Critical Care Drugs

The product lines are in turn supported by three functional teams:

- Supply chain
- Industry portal
- Additive manufacturing

The functional teams provide expertise and analytic support to the product lines, and have enabled the interagency to understand the complexities of our domestic and foreign sources of medical supplies.

In order to decrease our dependence on foreign suppliers for medical resources, DoD has focused on increasing domestic industrial capacity and capabilities as well as procuring end-items. To that end, we executed \$284.1 million in industrial expansion efforts during the first two weeks of May 2020:

- \$138 million awarded to ApiJect on May 8, 2020 increasing its capacity for injection technology by 45 million per month;
- \$126 million awarded to 3M on May 1, 2020 increasing its capacity for N95 respirator masks by 26 million per month;
- \$20.1 million awarded to Moldex on May 8, 2020 increasing its capacity for N95 respirator masks by 5 million per month.

The JATF is actively working with HHS to identify additional industrial base expansion efforts for medical resources as well as sub-tier suppliers of critical components. The results of these efforts to increase domestic capacity will be accomplished with new machinery, tooling, and personnel, and these efforts will have long term economic and national security impacts, enabling

HHS to replenish the stockpile and ensure the country is prepared for future pandemics as they arise.

The JATF is in close coordination with HHS regarding replenishment of the SNS. JATF and HHS leadership meet weekly to discuss proposed industrial expansion projects and determine prioritization of resources. Leveraging an interagency steering committee, critical medical resources are prioritized based on actual use during the pandemic, PPE, critical care drugs, ventilators and airway management supplies and other products necessary to prevent and treat COVID-19. Reconstituting domestic production or creating new production that shifted offshore years ago often requires capital equipment expenditures, retooling, and re-training of the workforce. It can be months before a supplier is fully capable of producing components or end-items at scale, and these timelines are taken into account when reviewing projects to ensure production increases align to prospective needs of medical items.

On May 15, 2020, the President announced the initiation of Operation Warp Speed (OWS). OWS is a joint HHS and DoD effort to achieve the priority goal of accelerating development, testing, supply, production, and distribution of effective diagnostics, therapeutics and vaccines to counter COVID-19. General Gustave F. Perna, as the Chief Operating Officer, is establishing a team of DoD experts. I have directed the JATF to share lessons learned and to provide any policy guidance and oversight to assist him in achieving our National goals, while divesting JATF functions that would be duplicative or redundant to OWS functions.

DPA Purchases for National Security and Pandemic Recovery

Medical Response

DoD, in coordination with HHS and FEMA, is executing \$312 million of CARES Act funding to implement a combination of capital investment and purchases focused on increasing the bandwidth of the industrial base equipment, tooling and related services (e.g., construction and training) for companies that manufacture masks, ventilators, and coronavirus test kits. Projects include:

- \$133.4 million for scale-up production capacity for respirator (N95 Mask) production capacity to meet HHS/FEMA procurement and total U.S. consumption. This funding is fully committed in support of contracting actions to expand domestic productive capacity for N-95 masks with 3M, Honeywell, and O&M Halyard. These agreements will be

negotiated and finalized in the coming weeks.

- \$76.0 million to increase domestic manufacturing capacity for swab production - a key constraint in scaling COVID-19 testing.
 - This funding is fully committed in support of a project with Puritan Medical Products to expand domestic productive capacity for testing swabs.
- \$2.2 million to increase sub-tier suppliers to ensure materials are made available to support final product production. Hollingsworth and Vose was awarded this funding to increase production of filter media for N95 masks.

Defense Industrial Base Issues Directly Impacted by COVID-19 Effects

The DPA Title III program will use the remaining \$688 million of CARES Act funding to address impacts to the DIB caused by COVID-19 by directly offsetting financial distress in the DIB and providing investments to regions most severely impacted to sustain essential domestic industrial base capabilities and spur local job creation. The Industrial Base Council (IBC) has identified prioritized risks to address utilizing this funding. Newly identified issues are continually coming in and the IBC will continue to prioritize efforts for execution. At present, planned investments include:

- \$150.0 million for shipbuilding industrial base in areas such as castings and forgings and submarine launch equipment, including funding to support continuous production of essential components such as launch tubes.
- \$171.0 million to sustain and preserve the aircraft propulsion industrial base including:
 - Funding to preserve essential workforce through support to sustained operations at key repair facility and stabilizing sub-vendors essential to a healthy propulsion industrial base.
 - Funding to support initiatives to certify and approve new parts sources for needed TF33 parts essential to multiple programs. Initiatives will catalyze sub-tier vendor base and mitigate risk of sub-tier vendors exiting the propulsion business.
 - Funding to sustain operations for essential suppliers, maintenance and repair operations, and essential suppliers for Navy aircraft programs and mitigate negative financial impacts resulting from COVID-19.
- \$150.0 million to support and maintain a competitive space launch industrial base.
- \$80.0 million to support and maintain a competitive microelectronics industrial base

including maintaining several critical suppliers and protect the domestic capacity to ensure radiation hardened microelectronics testing capability, and key subcompacts such as substrates and wafer are available for DoD weapon systems.

- \$35.0 million to preserve at-risk essential materials suppliers. This will:
 - Maintain and sustain lithium ion batteries industrial base to prevent vulnerabilities and potential shortfalls.
 - Maintain capacity and development timelines on advance fiber materials for next generation soldier textiles.
- \$62.0 million to support body armor, force protection, survivability equipment, increasing soldier survivability industrial base including support of critical carrier manufacturers producing of the modular survival vest equipment and blast pelvic protector for all Army contracts.
- \$40.0 million to support and maintain the hypersonics industrial base including the support of several key suppliers to protect high-temperature material industry partners. An expanded, sustainable domestic production capability for hypersonic systems is essential to the Department achieving its modernization priorities.

The Department is expeditiously executing the spend plan I have outlined to support the DIB during the COVID-19 pandemic. To date, the Department has obligated \$26.1 million of CARES Act funding to support essential DIB partners in the shipbuilding and space industrial base with several pending contracting actions across the critical defense covered by our spend plan. Current investments in the DIB include:

- \$11.5 million to support essential suppliers in the space industrial base for microelectronics materials and space qualified solar cells.
- \$14.6 million to support the shipbuilding industrial base.

DPA Title III Loans through the U.S. International Development Finance Corporation

“\$100.0 million to provide a subsidy for multiple federal loans to create, maintain, protect, expand, or restore domestic industrial base capabilities to support national COVID-19 response and the execution of authorities provided under Executive Order 13922 in collaboration with the U.S. International Development Finance Corporation (DFC). Under the President’s delegated authority,

the U.S. International Development Finance Corporation (DFC) is authorized to make loans under the Defense Production Act, something DoD has not historically done. This authority was delegated to DFC for two years in conjunction with DPA loan-related waivers provided by Congress in the CARES Act. We are working with the DFC to create an arrangement in which DoD can leverage this expertise and support from a DPA loan program because DFC will be able to leverage a smaller amount of DPA funds to go further than contracting or purchase commitments can.

DFC is synchronized with DOD, among other federal agencies, to ensure our approach and response to COVID-19 is completely coordinated. Funds will support the following HHS SNS priorities areas: (1) N95 respirators, (2) other Personal Protective Equipment, (3) pharmaceuticals, (4) ventilators, (5) airway management consumables, and (6) testing supplies.

OSD Guidance and CARES Act Implementation

Since early March, we have taken proactive measures in response to the COVID-19 crisis by implementing Congressional direction, empowering the contracting workforce, and ensuring a healthy DIB through continued guidance and direction. We established a COVID-19 specific webpage to ensure the widest dissemination of COVID-19 related guidance to the contracting community. This site is regularly updated and currently contains OSD guidance documents, Military Component memorandums, and a variety of acquisition related resources pertaining to COVID-19. These COVID-19 related policy documents focus on allowing companies to continue to work (while maintaining workforce safety), providing liquidity to the industrial base, implementing legislation beneficial to industry, improving speed of contracting activity, and providing spending transparency.

Today I will focus on two key areas where we have provided guidance: section 3610 of the CARES Act and industrial base viability and health.

As you know, section 3610 of the CARES Act allows agencies to reimburse contractors for payment associated with the preservation of workforces prevented from working due to COVID-19 facility closures or other restrictions. The Department moved out swiftly to provide the contracting community the ability to implement this legislation. On April 8, 2020, my Defense Pricing and Contracting (DPC) office issued a class deviation to the Federal Acquisition Regulation (FAR) and the Defense Federal Acquisition Regulation Supplement (DFARS)

entitled, “CARES Act Section 3610 Implementation.” The next day, DPC issued implementation guidance to include various frequently asked questions (FAQs) providing additional detail concerning 3610 relief. DoD’s deviation and implementation guidance provides a framework for contracting officers to assess any claimed allowable paid leave, including sick leave, a contractor or subcontractors provide to keep their employees in a ready state associated with the declared public health emergency. This effort recognizes the importance of supporting affected contractors to ensure that, together, we remain a healthy, resilient, and responsive total force.

It is important to note that section 3610 authorized, but did not appropriate, the funds needed to make these reimbursements. While the Department may be able to use other appropriated funds to reimburse contractors, the cost for 3610 is likely well beyond the Department’s resourced ability to do so without significantly jeopardizing modernization or readiness efforts. For example, just one of our major primes estimates that 3610 impacts could be up to \$1.5 billion for their company and their associated suppliers.

Despite the funding uncertainty, the Department provided industry an early engagement opportunity to submit comments on additional draft guidance, namely a checklist for information required to process 3610 payments, and mechanisms to efficiently process the reimbursements, whether at the contract level or company level. We are taking the time to carefully consider each of the industry inputs and expect to have that additional guidance published in the next few weeks.

Section 3610 leave costs are just one category of COVID-19 related costs being experienced by the DIB. Other COVID-19 related costs include costs associated with contracting officer direction such as a stop work, the purchasing of PPE, cleaning and sterilization costs, impacts related to implementing Centers for Disease Control guidance such as spacing out factory floor activity, and the costs associated with schedule delays emanating from the supply chain. Where these costs are allowable they can be recoverable on cost-reimbursement and incentive contracts. Additionally, where actions were directed by the Government, like the issuance of a stop work, contractors may also seek reimbursement through defined regulatory means as a request for equitable adjustment. However, outside Government direction under fixed price contracts, there is no clear regulatory authority to adjust contract price. The Department is working this issue and will be issuing guidance on it shortly, however, as with section 3610, the Department does not have the funding to cover these costs. The same prime contractor noted

earlier estimates these non-3610 COVID-19 related costs to be in excess of \$1 billion.

The Committee is aware that in the early stages of the pandemic, the Department increased the progress payment rate from 80% to 90% for large businesses, and from 90% to 95% for small businesses, to address what industry identified as the number one issue it was facing due to COVID-19, namely liquidity or cash flow issues, specifically within the supply chain and with small businesses. This change will infuse an estimated \$3 billion in cash to all levels of the DIB. As of the end of May 2020, over \$2 billion has already been paid out. Further, the Department partnered with the major primes to ensure this increase in cash was quickly making its way throughout the supply chain. As was stated in one of our calls with the industrial associations, “the flow down of cash from DoD and the prime contractors has been the key to many small businesses surviving or not.”

Additionally, while not a preferred approach, DPC has issued two separate class deviations (one for the Air Force and one for the Navy) allowing for advanced payments for a company especially hard hit by the impacts to the aviation industry—a business sector that has been severely impacted by the pandemic. This company does not have any contracts with progress payments and so it was appropriate and necessary to provide this cash infusion through advanced payments.

In addition to providing much needed increased cash flow, the Department has endeavored to accelerate awards in order to keep the DIB working. The Navy has increased new award activity such that it is 36 percent ahead of their prior year obligation rate through May 2020. Likewise the Army and Air Force have accelerated dozens of awards, often leveraging Undefined Contract Actions (UCAs) to speed the awards. The Department’s COVID-19 related contracts have utilized UCAs significantly, approximately \$1 billion to date, allowing for rapid contract awards for medical items and hospital construction. In all, the Department is making COVID-19 related awards through contracts and other transactions at the speed of relevance during this crisis. The data we carefully examine and share weekly with Congressional staff includes procurement administrative lead time (PALT) as one of the metrics. That data set depicts PALT on COVID items, plotted against the average for all FY2019 awards in the same dollar range. Consequently, the Department’s efforts to accelerate awards in response to COVID-19 have resulted in an average PALT of roughly one week, compared to three months or more for awards analyzed in FY2019. I’m proud of the Department’s ability to meet these needs

smartly and swiftly.

Additional Contracting Considerations

The Small Business Innovation Research (SBIR) program helps domestic small businesses to engage in research and development to explore their technological potential and stimulate high-tech innovation. The Department continues to leverage this important program during the pandemic. For example, the Navy awarded more than \$51 million in additional SBIR awards from January to May 2020, an increase of 12 percent when compared to the same timeframe in 2019. Navy SBIR awards to small businesses across the U.S. have totaled approximately \$495 million in this fiscal year.

As with the rest of the country, the Department's acquisition professionals pivoted to a teleworking environment and most have been operating this way for almost 3 months. We have not seen a significant degradation to the critical tasks of awarding contracts, getting invoices paid, or inspecting and accepting products and services. While early on we encountered some significant challenges in connection speeds, ability to teleconference, and not having all the equipment needed for the workforce, many of those issues have been resolved or have improved. The primary request I would make in order to continue to respond to the impacts of the pandemic would be the funding discussed earlier related to the COVID-19 cost impacts being experienced by the DIB.

Impact of Efforts

While the JATF has focused on sharing the DoD's acquisition expertise with HHS and FEMA, DLA has played a critical role supporting the White House Supply Chain Task Force since its creation and supplying badly needed medical supplies. In addition to supporting our Military Services and Combatant Commands, DLA routinely supports over 40 Federal agencies and Whole of Government partners. Our existing relationships and agreements with FEMA and HHS were vital to the success of initial operations, enabling a rapid transition to full integration with FEMA, HHS and the Supply Chain Task Force. These arrangements facilitated swift augmentation of 20 DLA personnel to FEMA, HHS, the White House Supply Chain Task Force, the Joint Acquisition Task Force, and provided critical reach-back to the resources of the entire Defense Logistics Agency. Additionally, DLA provided 18 personnel to support U.S. Northern Command and DoD

operations.

Under the leadership of LTG Darrell K. Williams, DLA has executed over 8,000 contract actions, obligating over \$752 million through the end of May, to provide critical lifesaving medical supplies including test kits, ventilators, pharmaceutical drugs, and Personal Protective Equipment (PPE) such as masks, gloves, and gowns. Additionally, DLA has supplied food, clothing, fuel, construction materials, and repair parts to DoD and Whole of Government partners. This \$752 million support includes DLA's execution of nine FEMA mission assignments and three HHS interagency agreements, valued at over \$630 million.

This support is comprised of numerous notable initiatives, including the on-going effort to supply nearly 15 thousand nursing homes across our Nation with a two-week supply of PPE. DLA also supplied critical PPE items to the Javits Center in New York City (\$107 million), Hospital Ships USNS Comfort and Mercy (\$14.4 million), as well as the United States Coast Guard (\$1.1 million).

Conclusion

The Department's response to COVID-19 addresses a full spectrum of needs. This includes contributing acquisition expertise and personnel to HHS and FEMA; expeditiously yet appropriately using all available authorities including the Defense Production Act; taking actions to expand industrial capacity; supporting the Defense Industrial Base through CARES Act guidance and increased cash flow mechanisms; and also through direct purchases of medical equipment and services. I am incredibly proud of the Department's response to this national emergency and to our dedicated individuals who have worked so diligently on behalf of the American people. I look forward to answering your questions.