



THE UNDER SECRETARY OF DEFENSE
3010 DEFENSE PENTAGON
WASHINGTON, DC 20301-3010

ACQUISITION
AND SUSTAINMENT

July 14, 2022

The Honorable Jack Reed
Chairman
Committee on Armed Services
United States Senate
Washington, DC 20510

Dear Mr. Chairman:

Section 1684(c), of the National Defense Authorization Act for FY 2022 (Public Law 117-81), directs the Secretary of Defense to provide a review and briefing related to the determination on certain activities with unusually hazardous risks. The briefing shall: inform on the extent to which each Military Department Secretary is implementing consistently title 10, United States Code, section 2354 (now codified at section 3861), and Executive Order 10789; and identify discrepancies and potential remedies in the Military Departments with respect to such implementation.

On March 16, 2022, the Department submitted an interim letter to Congress indicating the Department would provide the final response by the end of July 2022. The enclosed detailed report is a substitute for the briefing.

I am sending identical letters to the other congressional defense committees.

Sincerely,

A handwritten signature in black ink that reads "William A. LaPlante". The signature is written in a cursive style.

William A. LaPlante

Enclosure:
As stated

cc:
The Honorable James M. Inhofe
Ranking Member



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ACQUISITION
AND SUSTAINMENT

July 14, 2022

The Honorable Adam Smith
Chairman
Committee on Armed Services
U.S. House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

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William A. LaPlante

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cc:
The Honorable Mike D. Rogers
Ranking Member



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ACQUISITION
AND SUSTAINMENT

July 14, 2022

The Honorable Patrick J. Leahy
Chairman
Committee on Appropriations
United States Senate
Washington, DC 20510

Dear Mr. Chairman:

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cc:
The Honorable Richard C. Shelby
Vice Chairman



THE UNDER SECRETARY OF DEFENSE
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WASHINGTON, DC 20301-3010

ACQUISITION
AND SUSTAINMENT

July 14, 2022

The Honorable Rosa L. DeLauro
Chair
Committee on Appropriations
U.S. House of Representatives
Washington, DC 20515

Dear Madam Chair:

Section 1684(c), of the National Defense Authorization Act for FY 2022 (Public Law 117-81), directs the Secretary of Defense to provide a review and briefing related to the determination on certain activities with unusually hazardous risks. The briefing shall: inform on the extent to which each Military Department Secretary is implementing consistently title 10, United States Code, section 2354 (now codified at section 3861), and Executive Order 10789; and identify discrepancies and potential remedies in the Military Departments with respect to such implementation.

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Enclosure:
As stated

cc:
The Honorable Kay Granger
Ranking Member

Report to Congress On Determination on Certain Activities with Unusually Hazardous Risks



Office of the Under Secretary of Defense
for Acquisition and Sustainment

July 2022

The estimated cost of this report or study for the Department of Defense is approximately \$3,340 for the 2022 Fiscal Year. This includes \$0 in expenses and \$3,340 in DoD labor.
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Requirement

Section 1684(c) of the National Defense Authorization Act (NDAA) for FY 2022 (Public Law 117-81) directs the Secretary of Defense to conduct a review and provide a briefing related to the Department's implementation of regulations relating to indemnifications for certain activities with unusually hazardous risks. The briefing is to include: a determination of the extent to which each Military Department Secretary is implementing section 2354 of title 10, United States Code (U.S.C.), (now recodified as § 3861) and Executive Order (EO) 10789 consistently; and identification of discrepancies and potential remedies in the Military Departments with respect to such implementation. The Office of the Under Secretary of Defense for Acquisition and Sustainment, Defense Pricing and Contracting (DPC) conducted the review required by Section 1684(c) and prepared this report in lieu of a briefing.

Section 1684 defines "indemnification request" as a request for indemnification made by a covered contractor under section 3861 of title 10 U.S.C., or EO 10789, as amended, pursuant to Public Law 85-804 (50 U.S.C. 1431 et seq.) that includes sufficient justification to underpin a determination as required under those provisions. Neither section 3861, nor EO 10789 specifically define unusually hazardous risk, but instead refer to risks the contract defines as unusually hazardous or nuclear in nature. However, section 1684(d) explicitly defines "unusually hazardous risk" as risk of burning, explosion, detonation, flight or surface impact, or toxic or hazardous material release associated with one or more of the following products or program:

- (A) Products or programs relating to any hypersonic weapon system, including boost glide vehicles and air-breathing propulsion systems.
- (B) Products or programs relating to rocket propulsion systems, including, at a minimum, with respect to rockets, missiles, launch vehicles, rocket engines or motors, or hypersonic weapons systems using either a solid or liquid high energy propellant inclusive of any warhead, if any, in excess of 1,000 pounds of the chemical equivalent of TNT.
- (C) Products or programs relating to the introduction, fielding or incorporating of any item containing high energy propellants, inclusive of any warhead, if any, in excess of 1,000 pounds of the chemical equivalent of TNT into any ship, vessel, submarine, aircraft, or spacecraft.
- (D) Products or programs relating to a classified program where insurance is not available due to the prohibition of disclosure of classified information to commercial insurance providers, and without such disclosure access to insurance is not possible.
- (E) Any other product or program for which the contract under which the product or program is carried out includes a risk that the contract defines as unusually hazardous.

Background

Section 3861 of title 10 U.S.C., authorizes the Secretary of a Military Department to approve indemnification of a contractor under a research or development-based contract against certain claims and loss or damage to property from a risk that the contract defines as unusually hazardous, but only to the extent that they arise out of the direct performance of the contract and to the extent not compensated by insurance or otherwise.

Similarly, EO 10789 authorizes agencies of the Government to approve contractor requests for indemnification in connection with national-defense functions. The Department of Defense (DoD) is authorized to indemnify against claims or losses resulting from risks the contract defines as unusually hazardous or nuclear in nature. This is predicated on those claims or losses not being caused by willful misconduct or lack of good faith on the part of the contractor. The EO reminds officials of the importance of their decision: “In deciding whether to approve the use of an indemnification provision and in determining the amount of financial protection to be provided and maintained by the indemnified contractor, the appropriate official shall take into account such factors as the availability, cost and terms of private insurance, self-insurance, other proof of financial responsibility and workmen's compensation insurance.” The Department considers all of these factors in deciding whether to indemnify a contractor under a particular contract.

The DoD implements these indemnification provisions in contracts with the defense industry through the Federal Acquisition Regulation (FAR), the Defense FAR Supplement (DFARS), and component specific guidance. This includes the inclusion of a FAR clause (52.250-1 – Indemnification Under Public Law 85.804) in contracts whenever the approving official determines that the contractor shall be indemnified against unusually hazardous or nuclear risks. The DFARS, in Part 235 – Research and Development Contracting, reminds contracting officers of the importance of clearly defining the specific unusually hazardous risks to be indemnified. The DFARS also requires inclusion of indemnification-related clauses (252.235-7000 - Indemnification Under title 10 U.S.C. § 2354—Fixed Price, or 252.235-7001 - Indemnification Under title 10 U.S.C. § 2354—Cost Reimbursement), as appropriate.

In the joint explanatory statement accompanying the FY 2022 NDAA, Congress indicated its intent to provide a more transparent framework for the Department and its contractors to address financial risks. In particular, Congress expressed concern that inconsistent application of indemnification approvals by the Department, as well as an increase in programs that include unusually hazardous risks, could have negative near-term effects on the Department’s ability to field multiple advanced weapons systems. Congress seeks assurance that the Department gives full consideration to appropriate requests for indemnification of programs with unusually hazardous risks, including obtaining a common understanding with the contractor of available insurance for such programs and how the Government would have the contractor address costs over the limits or sub-limits of such insurance in the event of a catastrophic incident. While the review outlined in section 1684(c) required only implementation data from the Services, DPC expanded the focus to include United States Transportation Command (USTRANSCOM), Missile Defense Agency (MDA), Defense Logistics Agency (DLA), and Defense Contract Management Agency (DCMA).

Discussion

In conducting the review, DPC requested data from the components on the number and disposition of indemnification requests received from October 2018 to April 2022. The Air Force (USAF), Department of Navy (DON), USTRANSCOM, and MDA all provided instances of indemnification requests and narrative explanations of their indemnification process. Of the 76 contractor requests for indemnification, 13 were in process or pending at the time the data was requested. Of the 63 processed requests, 94 percent (59 out of 63) were approved. The

Army and DCMA confirmed they received no indemnification requests during this period. The table below uses the section 1684 definition of unusually hazardous risk and categorizes each contractor request for indemnification accordingly:

Contractor Requests - Indemnification for Unusually Hazardous Risk				
Hypersonic Weapon System	Rocket Propulsion System	High Energy Propellant	Classified Program	Any other product or program
5	20	22	0	29

Of the two DON-denied requests, DON followed its review and consideration process in accordance with applicable regulations and validated the denial using its standard practices. DON uses annual indemnification memoranda, designed primarily to cover nuclear risk, to execute its authority. Through this policy, DON approved 20 of the 24 requests for indemnification (two requests were pending at the time of the data requested). The denied requests from General Dynamics Electric Boat and Lockheed Martin Corporation for hypersonic Conventional Prompt Strike (CPS) and Tomahawk missiles were based on a lack of nuclear or otherwise unusually hazardous risk. In the past, DON approved indemnification requests for nuclear-capable Tomahawk missiles (TLAM-N) and related systems. In 2015, the Navy completed all actions related to the retirement of the TLAM-N, but the Tomahawk continued to be included in the Secretary of the Navy (SECNAV) annual indemnifications through 2018. The period of coverage for the non-nuclear version of the Tomahawk was brief, and DON adjusted its indemnification decision in a reasonable period of time. To clarify, DON never considered Tomahawk propellants to present an unusually hazardous risk on their own, nor does DON believe contractors lack the ability to obtain adequate insurance for the risks this missile system now presents. In regard to hypersonic CPS missiles, DON views those propellants similarly to Tomahawk. However, DON continues to discuss CPS with Lockheed Martin and seeks more information notwithstanding the initial denial.

General Dynamics Electric Boat’s request for indemnification is different, as the company is under contract solely for the launch systems, not the missiles. Most recently, General Dynamics Electric Boat and Lockheed Martin have submitted new requests for the same contracts as those which were previously denied. In both instances, DON is requesting more information, as the requests did not comply with FAR Part 50 requirements for support. Notably, both contractors were included in DON’s most recent annual nuclear indemnification review.

Finally, at the time of the data request, DLA had one outstanding request for indemnification in process. DLA was addressing lack of sufficient detail from the vendor, and consideration of that request was ongoing.

In addition to collecting data, DPC established a policy integration team among the components to collect internal guidance and policies governing the indemnification process. For example, the Air Force offered its Indemnification Guide (updated 15 Feb 2018) as a comprehensive resource to support its indemnification reviews. As a result of conversations with the integrated policy team and review of component guidance, DPC did not observe any negative

effects on the ability to review a wide variety of contractor requests for indemnification. While at least five component requests were based on unusually hazardous nuclear risks, the majority were based on non-nuclear risks related to space launches and missiles with large rocket engines.

Specifically, USTRANSCOM's nearly 30 indemnification approvals are all non-nuclear for coverage beyond that of Non-Premium War Risk Insurance (NPWRI). The Federal Aviation Administration provides NPWRI as a supplement to commercial air carrier insurance to operate certain DoD missions due to specific risks or exclusions. However, certain missions may require contract performance in circumstances under which NPWRI does not cover a potential loss. Thus, indemnification is a necessary, final-level safety net to ensure commercial air carriers can support DoD without delay due to inadequate risk of loss coverages specific to DoD missions.

Relatedly, DPC has been made aware of industry concerns that requests for indemnification for hypersonic programs have been denied. After meeting with component colleagues regarding recent indemnification concerns, DON and Defense Advanced Research Project agency (DARPA) confirmed working on hypersonic programs but not approving any requests, as other contractors have found commercial coverage for the same or similar programs. A recent legislative change proposal submitted by one of the industry associations also suggested that classified contracts pose a unique risk to obtaining indemnification. While the variety of indemnifications reviewed for this report revealed no industry requests for indemnification based on classified work, DPC's policy integration team engaged one major prime contractor and is receptive to engage others to better understand the challenges contractors face in securing insurance in support of DoD programs. These engagements will inform DoD's response to any future requests for contractor indemnification on the basis that losses under classified contracts are difficult to insure due to the level of classification.

In addition to data collection, DPC requested components share best practices in managing indemnification requests. DCMA offered its use of their Contractor Insurance/Pension Review (CIPR) Center. The center employs actuaries who are subject matter experts on insurance-related matters. They regularly review the insurance programs for many of the contractors for which DCMA is the cognizant administrative contracting agency. The CIPR Team does not make any final decision, or review all aspects of an indemnification request but has advised Procurement Contracting Officers (PCOs) in other DoD component agencies/branches (e.g., MDA, US Space Force, USAF, etc.). When requested, the CIPR Team provides the PCO with a recommendation about whether the contractor's insurance program is reasonable and satisfactory under normal business conditions, or whether greater insurance coverage should be required before the Government agrees to indemnify losses not covered by the contractor's insurance. The CIPR Team may also provide a recommendation to the approving official as to whether or not the indemnification request should be approved. For additional guidance, the CIPR Team references the aforementioned USAF Indemnification Guide, which outlines various requirements for approval, along with the applicable acquisition regulations.

DCMA identified its on-site Safety Reviews as a best practice. DCMA safety managers ensure contractors comply with applicable contractual safety requirements and have adequate safety programs. These officials advise PCOs whether additional safety requirements should be implemented before considering indemnification against unusually hazardous risks.

DON submitted best practices for consolidating indemnification requests for approval. DON processes requests for indemnification on nuclear programs on an annual (or class) basis, and on an individual basis for any other requests. Annually, the Deputy Assistant Secretary of the Navy for Procurement formally requests all DON contracting activities submit information under FAR 50.104-3 to cover the upcoming fiscal year. Once the information is provided by contractors and contracting offices, the SECNAV issues a letter at the beginning of each fiscal year identifying approved contractor indemnification requests, as well as contracts, programs and risks covered.

Conclusion

As a result of this review, the Department concludes—notwithstanding the DON clarification of CPS and Tomahawk missile indemnification—there is generally consistent application of indemnification approvals. The review found that 94 percent of indemnification requests were approved. While all risks associated with nuclear systems were indemnified, the vast majority of approvals were for conventional programs. Denials were consistent with component and federal guidance, and efforts to work with contractors to resubmit requests are ongoing. In particular, DON clarified contractor concerns regarding indemnification of conventional missiles and systems. DoD components give full consideration to appropriate requests for indemnification of nuclear and non-nuclear unusually hazardous risks.