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United States Government Accountability Office
Washington, DC 20548

June 13, 2011

Congressional Committees

Subject: Legislative Restrictions on Contractor Use of Mandatory Arbitration Agreements Have Had No Reported Impacts on National Security

Section 8102 of the Department of Defense (DOD) and Full-Year Continuing Appropriations Act for fiscal year 2011 directed us to evaluate the effect on national security resulting from the section's requirements.¹ These requirements, as well as those previously included in Section 8116 of the DOD Appropriations Act for fiscal year 2010,² prohibit DOD's use of funds appropriated by the respective acts for any contract over \$1 million unless the contractor agrees not to use or enforce mandatory arbitration agreements³ to resolve specified employee claims, such as those under Title VII of the Civil Rights Act of 1964.⁴ These statutes also provide that the Secretary of Defense can waive the application of these restrictions on mandatory arbitration to avoid harm to U.S. national security interests.⁵

To address this mandate, we reviewed the DOD appropriations acts for fiscal years 2010 and 2011, and documentation associated with DOD's implementation of the restrictions on the use of mandatory arbitration, including the rulemaking process leading to the adoption of the Defense Federal Acquisition Regulation Supplement (DFARS) final rule on December 8, 2010.⁶ We interviewed officials from DOD and the military departments, including those with duties related to awarding contracts over \$1 million or determining eligibility for a waiver to the application of the provisions on mandatory arbitration agreements. We reviewed information compiled by the Office of Defense Procurement and Acquisition Policy (DPAP) pertaining to the number of DOD contracts covered under this provision. We asked about the number of waivers, if any, that had been requested and processed through May 2011. We also reviewed all public comment letters submitted to DOD as part of the DFARS rulemaking

¹Pub. L. No. 112-10, § 8102(e).

²Pub. L. No. 111-118, § 8116 (2009).

³Some employers have adopted internal alternative dispute resolution (ADR) approaches to resolve employee complaints in order to reduce the costs—in time and money—associated with litigating these complaints in court. Arbitration is an example of an ADR approach where disputes are submitted to a neutral third person—an arbitrator—for resolution. Some employers require all employees to agree to mandatory, binding arbitration of complaints as a condition of their employment.

⁴Among other things, Title VII prohibits employment discrimination based on race, color, religion, sex, and national origin. Pub. L. No. 88-352 (codified as amended at 42 U.S.C. § 2000e et seq.).

⁵Pub. L. No. 111-118, § 8116(d) (2009); Pub. L. No. 112-10, § 8102(d).

⁶The final rule was updated to DFARS at Subpart 222.74, effective December 8, 2010. 75 Fed. Reg. 76.295. For the full text of the regulation, see enclosure II.

process. We interviewed the authors of these letters, which included trade associations representing major defense contractors, in order to understand the various perspectives on potential impacts to U.S. national security interests. For our full scope and methodology, see enclosure I.

We conducted this performance audit from April to June 2011 in accordance with generally accepted government auditing standards. These standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Summary

None of the DOD officials, trade association representatives, or others we contacted identified any specific national security impacts as a result of DOD's implementation of the legislative requirements regarding the use of mandatory arbitration agreements. As of May 2011, DOD had not issued any waivers and had not received any waiver requests. DOD officials stated, however, that administrative challenges in including the contract clause restricting mandatory arbitration hindered implementation across applicable contracts. Finally, some trade association representatives and others we contacted stated there are aspects of the regulation, such as the waiver process, that remain unclear.

Background

The DOD Appropriations Act for fiscal year 2010 included a provision prohibiting DOD's use of appropriated funds on federal contracts unless contractors agreed to certain conditions related to the use and enforcement of mandatory arbitration agreements—including making certifications related to subcontractor use and enforcement of these agreements. Generally, mandatory arbitration agreements can require that the employee waive the right to file a lawsuit, and instead submit disputes to a neutral third party for resolution. The provision was introduced in response to claims brought by former employees of DOD contractors, including multiple claims of sexual assault and civil rights violations allegedly perpetrated by contractor employees in contractor-managed facilities in Iraq. The alleged victims had previously agreed to mandatory arbitration as a condition of their employment. Section 8116 of the act prohibited the use of funds appropriated by the act for any contract in excess of \$1 million awarded after February 17, 2010, unless the contractor agreed not to (1) require as a condition of employment that employees or independent contractors agree to resolve through arbitration any claim under Title VII of the Civil Rights Act of 1964 or any tort related to or arising from sexual assault or harassment, including assault and battery, intentional infliction of emotional distress, false imprisonment, or negligent hiring, supervision, or retention, and (2) enforce any existing employment agreement containing such mandatory arbitration provisions.⁷ In addition, Section 8116 prohibited the use of fiscal year 2010 funds on any contract awarded after June 17, 2010, unless the contractor certified that it required each subcontractor with a subcontract over \$1 million to similarly agree not to enter into or

⁷Pub. L. No.111-118 was signed on December 19, 2009, and Section 8116(a) applied to DOD expenditure of funds on all federal contracts over \$1 million awarded 60 days after the effective date of the act; therefore, the requirements applied to the expenditure of funds on covered contracts awarded on or after February 17, 2010.

enforce mandatory arbitration provisions in their respective employment contracts.⁸ Section 8116 also allowed for waivers of the application of these requirements to a particular contractor or subcontractor on a particular contract or subcontract if the Secretary of Defense personally determined that the waiver was necessary to avoid harm to U.S. national security interests, and that the term of the contract or subcontract was not longer than necessary to avoid such harm. In such cases, the Secretary of Defense is required to transmit to Congress and simultaneously make public any such determination at least 15 business days before the applicable contract or subcontract may be awarded.

Once the provision took effect, DOD implemented it through a series of mechanisms. The first of these was a class deviation issued February 17, 2010, which was followed by an interim rule on May 19, 2010, and a final rule on December 8, 2010.⁹ In each case, DOD instructed contracting officers to include a specific clause within relevant contracts, when using funds made available by the act, that restrict the contractors' use of mandatory arbitration agreements. Four respondents submitted public comments on the class deviation, and four commented on the interim rule. (See enclosure III for a list of these entities and a summary of their comments.) In implementing the law, DOD added DFARS Subpart 222.74 on May 19, 2010, which describes the scope and application of the restrictions on mandatory arbitration, and outlines the process through which the Secretary of Defense may waive the application of those restrictions to a particular contract or subcontract.¹⁰ Section 8102 of the Department of Defense and Full-Year Continuing Appropriations Act, 2011, signed into law April 15, 2011, reiterated the prohibitions described in the 2010 Act—now applicable to fiscal year 2011 funds—with no substantive changes.¹¹ Section 8102 also required this report. On May 6, 2011, DOD issued another class deviation to inform contracting officers that the restrictions on the use of mandatory arbitration agreements applies to funds appropriated or otherwise made available by the DOD Appropriations Act for fiscal year 2011. This class deviation will be incorporated into DFARS.

No Identified National Security Impacts from the Restrictions on Mandatory Arbitration Agreements, though Implementation Has Been Slow and Is Only Recently Under Way

None of the DOD officials or others with whom we spoke, as of May 2011, identified any impact to national security as a consequence of the restrictions on the use of mandatory arbitration agreements. However, DOD officials stated that challenges with including the contract clause restricting mandatory arbitration hindered implementation across applicable contracts. For the DOD contracting entities that responded to a November 2010 DPAP request for information, the clause had been implemented in only 14 percent of applicable contracts, as of March 2011.

⁸Pub. L. No. 111-118, § 8116(b) applies to DOD expenditure of funds on all federal contracts over \$1 million awarded 180 days after the effective date of the act (Dec. 19, 2009); therefore, the requirements applied to the expenditure of funds on covered contracts awarded on or after June 17, 2010.

⁹Class deviations are deviations from the Federal Acquisition Regulation (FAR) or DFARS that affect more than one contract action. See FAR 1.401, 1.404.

¹⁰DFARS 252.222-7006 contains the specific contract clause text that contracting officers are required to include in all applicable contracts.

¹¹Pub. L. No. 112-10, § 8102. This Act did not include 60 and 180 day delayed effectiveness dates. The requirements of this Act were effective immediately. Previously, on January 19, 2011, DOD issued a memorandum to contracting officers informing them that during the period of continuing resolutions, the restriction on mandatory arbitration agreements was effectively extended.

No Reported Impacts to National Security

DOD officials stated that, as of May 2011, they had not identified any adverse impacts to national security. Additionally, DOD had not issued any waivers to the restrictions on mandatory arbitration, and no contractors had requested any waivers. Trade associations we spoke with also stated that their member companies had neither requested waivers nor identified any specific impacts to national security from the provision. Further, according to the associations we spoke with, many of the contractors they represent did not use mandatory arbitration agreements prior to the DOD restrictions. One association and one law firm, both of which submitted public comments to DOD, mentioned a hypothetical scenario in which open court proceedings, as opposed to arbitration, could potentially increase the risk of inadvertent disclosure of national security information. However, none of the DOD, military service, or other association officials we spoke with identified this as a concern.

Implementation Challenges Identified

According to DOD, as of early 2011, the implementation rate of including the clause restricting mandatory arbitration in relevant contracts was low. Despite the fact that the DFARS class deviation was issued on February 17, 2010, not all covered contracts immediately included the specified clause restricting the use of mandatory arbitration agreements. To understand the number of covered contracts containing the clause and whether waivers were issued, among other items, since the effective date of the legislation through the end of fiscal year 2010, DPAP issued a request for information from DOD contracting entities in November 2010. According to DPAP, of those that responded as of March 1, 2011, approximately 14 percent of 11,504 covered contracts included the clause.¹² Thirteen of 20 respondents to the DPAP request for information reported that they had experienced challenges in incorporating the clause into all relevant contracts. For example, contracting representatives within both the Army and Air Force told us that their automated contract writing systems did not readily highlight the clause restricting arbitration as a required clause. Consequently, the clause was included in a given contract only if the contracting officer recognized the need to include it and manually selected the clause for inclusion. Air Force officials told us that they have since resolved this issue by updating the contract writing systems. An Army official told us that they plan to resolve this by issuing updated policy guidance to contracting officers. Data provided by DPAP indicated that the Navy and Missile Defense Agency, among others, will also modify some contracts to ensure the clause is included in all of their covered contracts.

Groups representing defense contractors expressed concerns about the difficulty of ensuring subcontractor compliance, and also the lack of clarity with how the waiver process would work. Regarding compliance, trade associations noted the difficulty in ensuring the clause is appropriately incorporated into subcontracts that are several tiers removed from the prime contractor. Further, one association noted that prime contractors cannot be certain of compliance by all subcontractors because they normally have no visibility into the business

¹²The period covered by the data request for those contracts, task orders, delivery orders, and modifications adding new work was from February 27, 2010, through September 30, 2010. According to DOD, the total number of contracts and the rate of implementation are not representative of all DOD contracting entities, as the information given was only provided by 20 DOD entities, and not all recipients of the data request responded. Further, one official stated that the number of contracts reported as covered by the act may have been overstated by some contracting entities.

practices of their lower-tier subcontractors.¹³ Finally, representatives we spoke with expressed concerns that the waiver process was not clearly defined. For example, one representative had questions about what information a waiver request should contain and under what conditions it would be granted.

Concluding Observations

We found no evidence that the legislative requirement restricting the use of mandatory arbitration agreements has had any impact on national security. Officials at DOD are currently taking steps to identify and address the administrative challenges to implementing the requirement and expect that all covered contracts will include the new clause. Because these actions are ongoing, we are making no recommendations at this time.

Agency Comments

DOD provided technical comments on a draft of this report, which we incorporated as appropriate.

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We are sending copies of this report to the Secretary of Defense; the Secretaries of the Army, Navy, and Air Force; and the Director of the Office of Management and Budget. In addition, the report will be available at no charge on the GAO Web site at <http://www.gao.gov>.

Should you or your staff have questions concerning this report, please contact me at (202) 512-4841 or woodsw@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report are listed in enclosure IV.



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Enclosures - 4

¹³Our prior work has discussed the need for improved visibility over the tiers of subcontracting used in many DOD contracts. See GAO, *Defense Acquisitions: Additional Guidance Needed to Improve Visibility into the Structure and Management of Major Weapon System Subcontractors*, GAO-11-61R (Washington, D.C.: Oct. 28, 2010).

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Enclosure I: Details on Audit Scope and Methodology

Section 8102 of the Department of Defense and Full-Year Continuing Appropriations Act, 2011, directed us to submit a report evaluating the effect that the requirements contained in this section have had on national security, including recommendations, if any, for changes to these requirements within 60 days after enactment of the act.¹⁴

In order to understand the restrictions imposed by Section 8116 of the Department of Defense Appropriations Act, 2010, and Section 8102 of the Department of Defense and Full-Year Continuing Appropriations Act, 2011, we reviewed these pieces of legislation,¹⁵ as well as the legislative history contained in the *Congressional Record*.¹⁶ Because these legislative provisions are implemented through Department of Defense (DOD) policies, regulations, and contract clauses, we also reviewed the 2010 class deviation issued by DOD on February 17, 2010, and the associated preliminary contract clause—Defense Federal Acquisition Regulation Supplement (DFARS) 252.222-7999—implementing the 2010 Appropriations Act, and the 2011 class deviation issued on May 6, 2011.¹⁷ We also reviewed the 2010 interim and final rules in the *Federal Register*.¹⁸ We reviewed the relevant parts of the DFARS regulation, specifically Subpart 222.74, which implements the requirements, and the clause at 252.222-7006, which is to be included in covered contracts. We obtained data and interviewed officials from the Office of Defense Procurement and Acquisition Policy (DPAP) pertaining to the number of DOD contracts covered under this provision, as well as the number of waivers (if any) that had been approved as of September 30, 2010. We did not independently verify the information we obtained from DOD. However, we asked officials from DPAP, Army, Navy, and Air Force to explain their processes for collecting this information. The DPAP official responsible for compiling this information said that while 20 offices responded, it is not representative of all possible DOD contracting entities, and therefore may not include all contracts covered by the class deviation and DFARS regulation. However, the officials stated that it is the most current, available information on the inclusion of the clause in DOD contracts, task and delivery orders, and bilateral modifications, and is the best available information on the extent to which contracting officers have included the clause in all relevant contracts.

We also interviewed officials with duties relating to awarding contracts over \$1 million, or determining eligibility for a waiver to the restrictions on mandatory arbitration agreements. The DOD components and services we spoke with were the following:

- Office of the Under Secretary of Defense for Acquisition, Technology and Logistics
Office of Defense Procurement and Acquisition Policy
- Defense Acquisition Regulations System Directorate
- Air Force Acquisition Law and Litigation Directorate

¹⁴Pub. L. No. 112-10, § 8102(e).

¹⁵Pub. L. No. 111-118 (2009) and Pub. L. No. 112-10, respectively.

¹⁶155 Cong. Rec. S10028 (daily ed. Oct. 1, 2009) and 155 Cong. Rec. S10146-S10150 (daily ed. Oct. 6, 2009).

¹⁷Class deviations are deviations from the Federal Acquisition Regulation (FAR) or DFARS that affect more than one contract action. See FAR 1.401, 1.404. The final rule was updated to DFARS at Subpart 222.74, also on December 8, 2010. For the full text of the regulation, see enclosure II.

¹⁸75 Fed. Reg. 27,946 (May 19, 2010); 75 Fed. Reg. 76,295 (Dec. 8, 2010).

- Air Force Office of the Deputy Chief, Policy and Implementation Division, Deputy Assistant Secretary (Contracting), Assistant Secretary (Acquisition)
- Office of the Deputy Assistant Secretary of the Army (Procurement)
- Office of the Assistant Secretary of the Navy – Research, Development and Acquisition
- Office of the Deputy Assistant Secretary of the Navy – Acquisition and Logistics Management

To understand industry and other relevant third-party perspectives on the implementation and impact of the legislative provision and subsequent regulation, including the impact on U.S. national security interests, we reviewed all letters submitted to DOD as part of the public comment periods for the class deviation and rulemaking process that implemented Section 8116 of the 2010 DOD Appropriations Act, which resulted in DFARS 222.74, and contacted the authors:

- Aerospace Industries Association
- American Bar Association Section of Public Contract Law
- Council of Defense and Space Industry Associations
- Equal Employment Advisory Council
- Jenner & Block LLP
- The Honorable Al Franken, United States Senate

We also spoke with another trade association that co-signed one of the letters, the Professional Services Council, and contacted three additional co-signers, which did not respond by the conclusion of our review.

**Enclosure II: Full Text of Defense Federal Acquisition Regulation Supplement
Subpart 222.74—Restrictions on the Use of Mandatory Arbitration Agreements**

**SUBPART 222.74—RESTRICTIONS ON THE USE OF MANDATORY ARBITRATION
AGREEMENTS** *(Revised Dec. 8, 2010)*

222.7400 Scope of subpart.

This subpart implements section 8116 of the Defense Appropriations Act for Fiscal Year 2010 (Pub. L. 111-118).

222.7401 Definition.

“Covered subcontractor,” as used in this subpart, is defined in the clause at 252.222-7006, Restrictions on the Use of Mandatory Arbitration Agreements.

222.7402 Policy.

- (a) Departments and agencies are prohibited from using funds appropriated or otherwise made available by the Fiscal Year 2010 Defense Appropriations Act (Pub. L. 111-118) for any contract (including task or delivery orders and bilateral modifications adding new work) in excess of \$1 million, unless the contractor agrees not to—
 - (1) Enter into any agreement with any of its employees or independent contractors that requires, as a condition of employment, that the employee or independent contractor agree to resolve through arbitration—
 - (i) Any claim under title VII of the Civil Rights Act of 1964; or
 - (ii) Any tort related to or arising out of sexual assault or harassment, including assault and battery, intentional infliction of emotional distress, false imprisonment, or negligent hiring, supervision, or retention; or
 - (2) Take any action to enforce any provision of an existing agreement with an employee or independent contractor that mandates that the employee or independent contractor resolve through arbitration—
 - (i) Any claim under title VII of the Civil Rights Act of 1964; or
 - (ii) Any tort related to or arising out of sexual assault or harassment, including assault and battery, intentional infliction of emotional distress, false imprisonment, or negligent hiring, supervision, or retention.
- (b) After June 17, 2010, no funds appropriated or otherwise made available by the Fiscal Year 2010 Defense Appropriations Act (Pub. L. 111-118) may be expended unless the contractor certifies that it requires each covered subcontractor to agree not to enter into, and not to take any action to enforce, any provision of any agreement, as described in paragraph (a) of this section, with respect to any employee or independent contractor performing work related to such subcontract.

222.7403 Applicability.

This requirement does not apply to the acquisition of commercial items (including commercially available off-the-shelf items).

222.7404 Waiver.

- (a) The Secretary of Defense may waive, in accordance with paragraphs (b) through (d) of this section, the applicability of paragraphs (a) or (b) of 222.7402, to a particular contract or subcontract, if the Secretary or the Deputy Secretary personally determines that the waiver is necessary to avoid harm to national security interests of the United States, and that the term of the contract or subcontract is not longer than necessary to avoid such harm.
- (b) The waiver determination shall set forth the grounds for the waiver with specificity, stating any alternatives considered, and explain why each of the alternatives would not avoid harm to national security interests.
- (c) The contracting officer shall submit requests for waivers in accordance with agency procedures.
- (d) The Secretary of Defense will transmit the determination to Congress and simultaneously publish it in the Federal Register, not less than 15 business days before the contract or subcontract addressed in the determination may be awarded.

222.7405 Contract clause.

Use the clause at 252.222-7006, Restrictions on the Use of Mandatory Arbitration Agreements, in all solicitations and contracts (including task or delivery orders and bilateral modifications adding new work) valued in excess of \$1 million utilizing funds appropriated or otherwise made available by the Defense Appropriations Act for Fiscal Year 2010 (Pub. L. 111-118), except in contracts for the acquisition of commercial items, including commercially available off-the-shelf items.

Enclosure III: Summary of Public Comments to DOD on DFARS Implementation of Restrictions on Mandatory Arbitration

DOD implemented the legislative provision in Section 8116 of the DOD Appropriations Act for fiscal year 2010 through a series of mechanisms in DFARS, the first of which was a class deviation issued February 17, 2010, followed by an interim rule on May 19, 2010, and the final rule on December 8, 2010. Upon issuing the class deviation and interim rule, DOD provided the opportunity for the public to submit comments. DOD received four public comments on the class deviation and four public comments on the interim rule.¹⁹ The table below identifies the parties that commented and summarizes their substantive issues, requests for clarification, or suggested revisions to the interim and final rules.²⁰

Table 1: Summary of Comments on the Interim and Final Rules

Parties commenting on class deviation	Date submitted	Summary of comments
Jenner & Block LLP	March 2, 2010	<ul style="list-style-type: none"> The regulation should not include task and delivery orders and bilateral modifications for contracts that were in place before the effective date of the legislation, since the statute applies only to new contracts awarded after its effective date.
The Honorable Al Franken, United States Senate	March 2, 2010	<ul style="list-style-type: none"> The regulation should include the information the Secretary of Defense must provide to justify waivers, including any alternatives considered, and information on the transmittal of waivers to Congress. The regulation should apply to all levels of covered subcontracts. With respect to the prime contractor, the regulation should apply to all employees and independent contractors, not just those performing work on the contract.²¹
Council of Defense and Space Industry Associations	March 3, 2010	<ul style="list-style-type: none"> The regulation should define the terms <i>contractor</i>, <i>applicable item or service</i>, and <i>covered subcontractor</i>. The regulation should not apply to ongoing arbitration proceedings or preexisting arbitration awards. The regulation should require contracts and modifications to specify if they are using fiscal year 2010 funds in order to identify covered subcontracts. The regulation should state that implementing the restrictions on mandatory arbitration in bilateral modifications could have associated additional costs.

¹⁹A total of six organizations or individuals commented overall, with two commenting at both opportunities.

²⁰Several of the letters included comments that were more technical in nature, such as on DOD's process for publicizing the regulation in the *Federal Register*. We did not include those comments in this table.

²¹Senator Franken's letter was addressed to DOD, but some of these comments responded to issues raised in a letter to DOD from the Council of Defense and Space Industry Associations that was published prior to the formal DOD rulemaking process.

		<ul style="list-style-type: none"> Assumes the restriction on mandatory arbitration only flows down to first-tier subcontractors. The regulation should apply to those employees performing work on the specified contract.
American Bar Association Section of Public Contract Law	March 17, 2010	<ul style="list-style-type: none"> The regulation should define the term <i>covered contract</i>. The regulation should clarify its applicability to subcontractors. The regulation should clarify when prime contractors are required to certify the compliance of subcontractors.
Parties commenting on interim rule	Date submitted	Summary of comments
Equal Employment Advisory Council	July 12, 2010	<ul style="list-style-type: none"> The regulation should clarify which employees and what types of arbitration are covered under the provision. The regulation should include a detailed explanation of the waiver request process.
American Bar Association Section of Public Contract Law	July 16, 2010	<ul style="list-style-type: none"> The regulation should define the term <i>covered contract</i>. The regulation should provide that prime contractors are only required to certify the compliance of first-tier subcontractors. If prime contractors must certify all subcontractor tiers, then the regulation should require that the clause restricting mandatory arbitration be included in all subcontracts.
Aerospace Industries Association	July 19, 2010	<ul style="list-style-type: none"> The regulation should not apply to delivery orders, task orders, or modifications because they are not "new contracts." The regulation should not define the term <i>subcontract</i>, as that definition is already contained in the Federal Acquisition Regulation. The regulation should not apply to the acquisition of commercial or commercial off-the-shelf items. The regulation should specify the effective dates for applicability.
The Honorable Al Franken, United States Senate	July 19, 2010	<ul style="list-style-type: none"> The regulation should define the term <i>contractor</i> more broadly so as to apply not only to the entity within a corporation that has the contract with DOD, but to the parent corporation and any subsidiaries as well. The regulation should specify that when granting a waiver, the Secretary of Defense must transmit to Congress and the public the grounds for the waiver, alternatives considered, and why the alternatives would not mitigate harm to national security.

Source: GAO analysis of public comments to DOD

Note: We used the term *regulation* in this table to apply to both the interim and final rules, because the comments included suggested revisions to one or both rules.

Enclosure IV: GAO Contact and Staff Acknowledgments

GAO Contact

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Staff Acknowledgments

Key contributors to this report were Brian Mullins, Assistant Director; Raj C. Chitikila; Stephen V. Marchesani; Sally Williamson; Laura Greifner; Julia Kennon; and Alyssa B. Weir.

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