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***Buy American Act***

**91 FCR 423**

# A Series of Unintended Consequences: Implementing the Buy American Provision of the American Recovery and Reinvestment Act of 2009

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On March 24, 2009, a communication was circulated to World Trade Organization (WTO) members stating that the European Union was seeking further clarification from U.S. officials on Section 1605 (the "Buy American" provision) of the American Recovery and Reinvestment Act of 2009 (the Act). [1] The EU's concerns stem from the lack of guidance with respect to key terms under the Buy American provision. Namely, "manufactured goods," "produced in the United States," "public building," and "public work" were not defined in the Buy American provision or elsewhere in the Act. [2] Furthermore, the EU requested that the United States provide support for its position that the Buy American provision does not violate the WTO Government Procurement Agreement (GPA). This is not the first time the EU has raised concerns about the Buy American provision of the Act. Prior to the enactment of the Act the EU stated that if the Buy American provision remained in the Act it would file a complaint with the WTO and warned that similar protectionist legislation or retaliatory moves from the U.S. trading partners should be expected. [3] These fears over retaliation were echoed in the United States by opponents of the Buy American provision.

[1] Public Law No. 111-5.

[2] Daniel Pruzin, "EU Raises New Questions on U.S. 'Buy American' Provisions in Stimulus Law", 91 FCR 256 (March 31, 2009).

[3] Neil King Jr., "Obama Risks Flap on 'Buy American'", February 4, 2009 Wall Street Journal (http://online.wsj.com/article/SB123370411879745425.html).

During the debate, Sen. John McCain (R-Ariz.) introduced an amendment that would have removed the Buy American provision from the Act. McCain stated that "[t]he Buy American provision in the current bill has echoes of the disastrous [Hawley-Smoot] [T]ariff [A]ct." [4] Passed by Congress in 1930, the Hawley-Smoot Tariff Act [5] imposed high tariffs on many of the U.S. trading partners. Many of those trading partners responded to Hawley-Smoot by placing tariffs on U.S. products. This "tariff war" started by Hawley-Smoot was one of the contributing factors to the Great Depression and the fear is that the Buy American provision could trigger a "trade war" that would result in similar protectionist measures being passed by the U.S. trading partners. Congress attempted to assuage these fears by including in the Buy American provision language stating that "[t]his section shall be applied in a manner consistent with United States obligations under international agreements." [6] Unfortunately, no further guidance was provided with respect to how the Buy American provision would be applied in a manner that respects international treaties. The only hint that was provided is in Title XVI — General Provisions of the Act, where Congress noted that it anticipated that the "administration" would exercise its power under 19 U.S.C. §2511(b), which allows the president to bring the United States into compliance with U.S. international obligations through the waiver of the discriminatory purchasing requirements, such as the Buy American provision, for certain designated countries. [7]

[4] S. Amdt. 279 to H.R..1

[5] *See* Public Law No. 71-361, June 17, 1930; 19 U.S.C. §1654.

[6] Public Law No. 111-5, Section 1605(d).

[7] Conference Report 111-16, Title XVI — General Provisions

Some of the uncertainty surrounding the application of the Buy American provision was resolved on March 31, when the Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council (Councils) issued an interim rule amending the Federal Acquisition Regulation to implement the Act's Buy American provision as applied to federal procurements, [8] . On April 3, the Office of Management and Budget issued an interim rule to implement the Act's Buy American provision as applied to grants, cooperative agreements and loan awards funded with Act funds. [9] Unfortunately, the Councils' implementation and OMB's implementation of the Buy American provision are different, and the Councils' implementation is, arguably, inconsistent with the United States' obligations under international agreements.

[8] 74 Fed. Reg.14, 623 (March 31, 2009).

[9] 74 Fed. Reg. 18,449 (April 23, 2009) (OMB original released its interim rules on April 3, 2009).

## Buy American Provision

The Buy American provision requires, subject to certain exceptions, that no funds made available under the Act be used on

projects for a public building or public work unless all of the iron, steel, and manufactured goods used in the project are produced in the United States. [10] As implemented, the Buy American provision covers the iron, steel (except iron or steel used as components or subcomponents of manufactured goods used in a covered project), [11] and other manufactured goods incorporated into a covered project (i.e., construction material). It also covers, at least under the FAR implementation, unmanufactured construction materials. [12] The projects covered under the Act are construction, alteration, maintenance, and the repair of a public building or public work.

[10] FAR 25.602; 2 C.F.R. §§176.60 and 176.70.

[11] The Buy American provision does not apply to iron or steel used as components or subcomponents of manufactured goods used in a covered project. FAR 25.602; 2 C.F.R. §§176.70, 176.160.

[12] Unmanufactured construction materials are not specifically covered under the Buy American provision, but they remain covered by the provisions of the Buy American Act. The Councils noted that the rationale for applying the Buy American Act unmanufactured construction material requirement is that "the Recovery Act's purpose of creating jobs and stimulating domestic demand is well served by applying the Buy American Act to unmanufactured construction material." 74 Fed. Reg. 14,624.

The FAR interim rule cross references the definition of "public building" and "public works" from FAR 22.401, which is a broad definition that includes the construction, prosecution, completion, or repair of a building or work "that is carried on directly by authority of, or with funds of, a federal agency to serve the interest of the general public regardless of whether title thereof is in a Federal agency." OMB's interim rule takes a different approach and in 2 C.F.R. §§176.140 and 176.160 provides a non-exhaustive list of the types of projects that are covered. The OMB definition is also not solely tied to funding; rather, the project must be a building of, or work of, a governmental entity. [13] Although the definitions of "public works" and "public building" found in the FAR and OMB interim rules are different in application, there will likely be little difference. However, there could be a project that is carried out with Act funds at the direction of the government that serves the interest of the general public (and the government does not retain title), but is not a building of, or work of, a governmental entity, and thus would be covered if the project was covered under the FAR interim rule, but not the OMB interim rule.

[13] Governmental entity is defined as "the United States; the District of Columbia; commonwealths, territories, and minor outlying islands of the United States; State and local governments; and multi-State, regional, or interstate entities which have governmental functions."

The interim rules also include three exceptions to the Buy American provision. A concern is permitted to use foreign material if: (1) the construction material (including iron and steel) is not mined, produced, or manufactured in the United States (or a designated country when applicable) "in sufficient and reasonably available commercial quantities of a satisfactory quality," (2) the cost of domestic (or designated country when applicable) construction material is unreasonable, or (3) applying the Buy American provision to a particular construction material "would be inconsistent with the public interest." [14]

[14] FAR 25.603; 2 C.F.R. §176.80.

With respect to the unreasonable cost exception, the cost of manufactured domestic construction material (including iron and steel) — or domestic and designated country construction material (including iron and steel) when applicable — will be considered unreasonable if its use would result in a twenty-five percent increase to the overall contract cost. [15] Practically speaking, because this differential is so large, this exception will likely rarely apply.

[15] FAR 25.604(c)(1); 2 C.F.R. §176.110.

The FAR interim rule, but not the OMB interim rule, also has a separate evaluation factor of six percent to be applied to unmanufactured construction material. Unlike the evaluation of manufactured construction material (including iron and steel), the unmanufactured construction material evaluation factor is applied on a material-by-material basis and not a project basis. In addition, the unmanufactured construction material evaluation factor is to be applied separately from the manufactured construction material (including iron and steel) evaluation factor. [16]

[16] FAR 25.604(c)(2).

The determination as to whether an exception applies is made by the government. These exceptions/waivers are requested by a concern to the government and should be submitted prior to submission of a proposal; however, the request may be made post proposal submission. Furthermore, a post award exception/waiver may be granted if the contractor provides consideration to the government.

In addition, as noted above, the Buy American provision also requires that the restriction be applied in a manner consistent with the U.S. obligations under international agreements. In an effort to comply with this requirement, both OMB and the Councils chose to follow a quasi-Trade Agreements Act (TAA) approach, though their approaches are not identical. Under the Councils' implementation, when the value of an acquisition/project is more than $7,443,000—the WTO GPA threshold for construction contracts—an award can be made, absent the application of an exception, only to a concern offering either designated country construction material (including iron and steel) or domestic construction material (including iron and steel). For concerns subject to the OMB interim rules, designated country construction material (including iron and steel) meets the requirements of the Buy American provision if the value of the project is more than $7,443,000 and it is conducted by one of the states that have agreed to apply the WTO GPA or another Free Trade Agreement (FTA) to their procurements. [17] However, Note 5 to Annex 2 of the WTO GPA excludes from coverage "Federal funds for mass transit and highway projects... ." This provision could significantly

lessen the impact of the application of the WTO GPA, as many of the infrastructure projects funded by the Act will be mass transit or highway projects. In addition, several of the states with pre-existing restrictions (Delaware, Florida, Illinois, Iowa, Maine, Maryland, Michigan, New York, New Hampshire, and Oklahoma) do not apply the requirements of the WTO GPA to the procurement of construction-grade steel, motor vehicles, and coal. [18] Unfortunately, because only certain states have agreed to apply the WTO GPA or another FTA to their procurements, this provision well may lead to vastly different award selections based solely on the state in which the procurement/project is being conducted. In those states that have not agreed to apply the WTO GPA to their procurements, e.g., New Jersey, designated country manufactured construction material (including iron and steel) would only be acceptable in projects funded with Act funds if an exception applied, e.g., unreasonable cost; whereas designated country manufactured construction material (including iron and steel) would be acceptable in projects funded with Act funds where the project was valued over $7,443,000 when the state has agreed to apply the WTO GPA to its procurements.

[17] Appendix to Subpart B of 2 C.F.R. Part 176. It is interesting to note that for all of the states listed in the appendix that have agreed to apply the WTO GPA all include a parenthetical that states "except Canada." What this means is that for projects covered under the Buy American provision that are valued over $7,443,000, Canadian iron, steel, and manufactured goods would not be designated country products. This approach is consistent with U.S. General Notes to the WTO GAP, number 5, which states that the WTO GPA does not apply to state procurements, even where the state has agreed to apply the WTO GPA, when the goods and services (including construction) are Canadian.

[18] WTO GPA Annex 2, Note 1. These states also do not apply the terms of the WTO GPA to: (1) preferences or restrictions associated with programs promoting the development of distressed areas and businesses owned by minorities, disabled veterans and women (Note 2); (2) prevent any state entity from applying restrictions that promote the general environmental quality in that state, as long as such restrictions are not disguised barriers to international trade (Note 3); or (3) any procurement made by a covered entity on behalf of non-covered entities at a different level of government (Note 4).

There are several similarities between how the FAR and OPM interim rules apply the quasi-TAA approach; however, there is one significant difference. Unlike the FAR interim rule, under OMB's interim rule, the country of origin test applies to determine whether a material is a designated country construction material or a domestic construction material is the same. The fact that the FAR interim rule applies a different test to determine whether a material is a designated country construction material or a domestic construction material raises concerns whether the interim FAR rule is consistent with international agreements as required by the Buy American provision.

**Is the FAR Implementation Inconsistent with International Agreements?**

Since its introduction, opponents have argued that the Buy American provision violates the U.S. obligations under the WTO GPA, which, with some exceptions, requires that goods, services and service suppliers of signatories must be given non-discriminatory treatment. [19] The WTO GPA does not require that identical treatment; it only requires that a signatory's goods, services and service suppliers be treated no less favorably than domestic goods, services and service suppliers. On its face, the FAR rule fails to meet this requirement because it treats domestic construction material more favorably than designated country construction material. [20] Specifically, the country of origin test used to determine if material is domestic construction material is less stringent than the country of origin test used to determine if material is designated country construction material (which includes WTO GPA construction material).

[19] WTO GPA, Article III. Other FTAs contain similar requirements. *See e.g.*, North American Free Trade Agreement, Article 1003.

[20] The phrase designated country construction material is used as short hand for WTO GPA country, FTA country and least developed country construction material.

The FAR interim rule defines domestic construction material as

> ... .
>
> (2) A construction material manufactured in the United States. [21]

[21] FAR 52.225-21(a); FAR 52.225-23(a).

The term "manufactured" is not defined in the FAR interim guidance, although it is likely that the term has the same meaning it does under the Buy American Act. [22] Under the Buy American Act, "manufactured means" completion of the article in the form required for use by the government. [23] Conversely, the FAR interim rule defines a WTO GPA country construction material [24] as construction material that:

[22] 41 U.S.C. 10a *et seq.*

[23] *See Marbex, Inc.*, B-225799, May 4, 1987, 87-1 CPD ¶ 468.

[24] The same test is used for FTA country and least developed country construction material.

> (1) Is wholly the growth, product, or manufacture of a WTO GPA country; or
>
> (2) In the case of a construction material that consists in whole or in part of materials from another country, has been substantially transformed in a WTO GPA country into a new and different construction material distinct from the materials from which it was transformed. [25]

[25] FAR 52.225-21(a); FAR 52.225-23(a).

Under the WTO GPA, the Councils were required to apply this country of origin test, which is the test used by Customs and Border Protection, because signatories are required to apply the country of origin rules that are the same as the "rules of origin applied in the normal course of trade and at the time of the transaction in question to imports or supplies of the same products or services from the same [signatory]." [26] However, as noted above, the country of origin standard for domestic construction material appears to be lower than the country of origin standard for designated country construction material (which includes WTO GPA construction material).

[26] WTO GPA, Article IV.

Also as noted above, the term "manufactured" is not defined, but presumably it has the same meaning it does under the Buy American Act. Under the Buy American Act, when dealing with a multiple component product, [27] it is not necessary "for the process performed in the United States to result in a substantial or fundamental change ... [for] it to constitute manufacture." [28] In fact, the mere assembly of components—which is required to meet the government's requirements—can satisfy the manufacturing requirement of the Buy American Act. [29] Although more recent cases appear to be moving the definition of "manufactured" closer to substantial transformation, these cases focus more on components and hold that minimal manufacturing processes that do not alter the essential nature of a core component that is the essence of the end product may not be used to circumvent the requirements of the Buy American Act. [30]

[27] *City Chemical LLC*, B- 296135.2, B- 296230.2, June 17, 2005, 2005 CPD ¶ 120 ("In cases involving an end product derived from a single component or material, we have looked to whether the component/material has undergone substantial changes in physical character in determining whether manufacturing has occurred.").

[28] *Saginaw Mach. Sys., Inc.*, B-238590, June 13, 1990, 90-1 CPD ¶ 554.

[29] *General Kinetics, Inc., Cryptek Div.*, B-242052.2, May 7, 1991, 91-1 CPD ¶ 445 at 7.

[30] *TRS Research*, B-285514, Aug. 7, 2000, 2000 CPD ¶ 128.

In addition to the shift in the manufactured test, there is also an apparent lessening, in certain cases, of what Customs and Border Protection will consider a substantial transformation. [31] However, even with these shifts the manufacturing standard of the Buy American Act is not the equivalent of the "substantial transformation" standard of the TAA because "the term 'manufacture' connotes something less than the more stringent 'substantial transformation[.]'" [32] This is an issue because the Buy American Act's manufacture test, minus the cost of component requirement, is an easier test to comply with than the substantial transformation test. Consequently, it would violate the WTO GPA because WTO GPA construction material would be treated less favorably than domestic construction material.

[31] HQ H026666, July 21, 2008 (Customs and Border Protection determined that a digital multimeter with some U.S. parts, which had subassemblies combined in the U.S., and which was tested and calibrated in the U.S. was the product of the U.S. as it was substantially transformed in the U.S.).

[32] *CompuAdd Corp. v. Department of Air Force*, GSBCA 12021-P et al., 93-2 BCA ¶ 25811(citing *Tropicana Products v. United States*, 789 F. Supp. 1154, 1158 (Ct. Int'l Trade 1992)).

This of course assumes that the manufacture test under the Buy American provision is the same as it is under the Buy American Act, which might not be the case. This issue could be easily resolved by following the approach taken in the OMB rule that requires both domestic or designated country [33] covered articles to be items that are wholly grown, produced or manufactured in the U.S./designated country or are substantially transformed in the U.S./designated country. [34] The Councils could take this approach for all cover projects or they could apply an alternate definition of domestic construction material (applying the substantial transformation test) only when an international trade agreement applies. This is the approach currently taken under FAR 25.403 when dealing with funds not provided under the Act.

[33] Under the FAR interim rule the designated countries are WTO GPA signatories, FTA countries and least developed countries. Under the OMB interim rule the designated countries are WTO GPA signatories, FTA countries and United States-European Communities Exchange of Letters (May 15, 1995) countries.

[34] It is not clear if the definition of domestic construction material found in 2 C.F.R. §176.60 would apply to projects covered under 2 C.F.R. §176.140 (acquisitions under $7,443,000). The term domestic construction material is not defined in 2 C.F.R. §176.140, which merely states that "all iron, steel, and manufactured goods used in the project are *produced* in the United States." 2 C.F.R. §176.140(b) (emphasis added). It is likely that the definition found in 2 C.F.R. §176.60 would apply to all projects covered under the OPM interim rule.

FAR 25.403(c)(1) requires, with some exceptions, that when an acquisition is over the WTO GPA threshold, the government is to acquire only U.S.-made or designated country end products or U.S. or designated country services. If the value of the acquisition for supplies is under the WTO GPA threshold, then the Buy American Act applies and the government may purchase domestic end products or certain FTA end products depending on the value of the acquisition without applying the Buy American Act's evaluation factor. The difference between a U.S.-made end product and a domestic end product under the FAR (non-Act procurements) is that for the latter, the product must be manufactured in the United States and the cost of domestic components must exceed 50 percent of the cost of all the components (the component requirement does not apply to commercial off-the-shelf goods), and the former must be wholly grown, produced or manufactured in the United States or be substantially transformed in the United states. Following this approach, the FAR interim rule would be amended and for acquisitions over $7,443,000, only U.S.-made or designated country construction material could be purchased. [35] U.S. made

construction material would require a substantial transformation or that the product be wholly manufactured in the United States. Domestic construction material would only require that the construction material be manufactured in the United States and only domestic construction material could be acquired for Act covered acquisitions under $7,443,000. This would resolve the issue with respect to whether the Buy American provision as implemented by the Councils violates international trade agreements with respect to manufactured goods. However, this does not resolve all of the potential problems caused by the fact that the Councils and OMB chose to implement the Buy American provision differently.

[35] FAR 25.003.

**Unmanufactured Articles**

The FAR interim guidance contains a separate definition for unmanufactured goods. Under the FAR interim guidance unmanufactured construction material is

> raw material brought to the construction site for incorporation into the building or work that has not been—
>
> (1) Processed into a specific form and shape; or
>
> (2) Combined with other raw material to create a material that has different properties than the properties of the individual raw materials. [36]

[36] FAR 25.601.

Although the FAR rule covers unmanufactured construction material, unmanufactured construction material is not covered under the OMB interim rule. On its face, the OMB interim rule appears to exclude unmanufactured construction material from its coverage. The OMB rule covers iron, steel, and manufactured goods used in public building or public work projects funded with funds appropriated under the Act, and defines manufactured goods in a manner that excludes raw materials. [37] Consequently, because raw materials are the very type of construction material that the FAR interim rule seeks to capture under its definition of unmanufactured construction material, the exclusion of raw material from the coverage of the Buy American provision under the OMB implementation will likely lead to vastly different products being supplied under covered federal contracts than supplied under those transactions covered by the OMB interim rule.

[37] 2 C.F.R. §§176.30, 176.60 and 176.70.

**Iron and Steel-The Qualifying Country Conundrum Revisited**

The FAR interim rule implements the iron and steel restriction of the Buy American provision in a manner similar to the qualifying country exception of the specialty metal restriction found at DFARS 252.225-7014 (June 2005) and Alternate 1 (April 2003). Under this exception, the specialty metal restriction does not apply if the specialty metal is "[m]elted in a qualifying country or incorporated in an article manufactured in a qualifying country." This exception has been criticized by U.S. specialty metal manufacturers because it allows qualifying country manufacturers to have a less difficult time complying with the specialty metal restriction than U.S. manufacturers. The same is true for firms providing domestic iron and steel under projects covered under the FAR interim rule.

In order to be considered domestic iron and steel under the FAR interim rule all the manufacturing processes used to produce the iron or steel used as construction material must take place in the United States, except metallurgical processes involving refinement of steel additives. However, designated country iron and steel need only be substantially transformed in a designated country. Domestic iron and steel essentially must be wholly produced in the United States; substantial transformation in the United States would be insufficient to meet the FAR requirement. Consequently, the Buy American provision, as implemented under the FAR, favors designated country manufacturers over U.S. manufacturers because they could more easily comply with the requirements of the Buy American provision. In fact, the Buy American provision, as implemented under the FAR, will likely result in the government being provided with more designated country iron and steel than domestic iron and steel, under acquisitions over $7,443,000, which clearly was not the intent of Congress.

Arguably, under OMB's implementation of the Buy American provision, domestic and designated country iron and steel are treated equally. [38] The OMB interim rule, unlike the FAR rule, requires that iron and steel be wholly grown, produced or manufactured in the United States or a designated country, or substantially transformed in the United States or a designated country. [39] This equal treatment is more inline with Congress' intent, and thus the FAR interim rule should follow this approach instead of its "specialty metals like" approach.

[38] It is possible to read OMB interim rule so that it is consistent with FAR interim rule with respect to domestic iron and steel. If this is the reading accepted by OMB then the same "specialty metal" qualifying country issue present under the FAR interim rule would also be present under the OMB interim rule and should be corrected.

[39] 2 C.F.R. §176.60.

**A New Trade Agreements Approach — Another Unintended Consequence**

Unfortunately, the manner in which manufactured goods, unmanufactured goods, and steel and iron is treated are not the only unintended consequences of the implementation of the Buy American provision and the vagueness of the language of the provision. Of these other unintended consequences, one of the more puzzling issues, briefly discussed above, is why the Buy American provision was not implemented like the Buy American Act has been implemented. The Buy American provision could have simply applied to all acquisitions under $7,443,000 and for all acquisitions over this threshold, the TAA would apply. By not requiring that a true TAA approach be taken when implementing the Buy American provision, Congress in a sense created an

unreasonable cost exception for projects that would have been covered under the TAA.

The TAA is the means in which the trade agreements negotiated under the Trade Act of 1974 are approved/implemented, [40] and provides the authority to modify discriminatory purchasing requirements in federal procurements. [41] There is no question that if the Councils and OMB followed a Buy American Act/TAA approach when implementing the Buy American provision, this approach would be consistent with international agreements. However, what is not as clear is whether this approach would have been consistent with Congressional intent. Perhaps Congress intended for the unreasonable cost exception to apply to those projects that are covered by FTAs to ensure that Act funds are spent in the most efficient manner.

[40] 19 U.S.C. §2502(a)(1).

[41] 19 U.S.C. §2511. This authority includes the authority to designate those countries with free trade agreements with the United States or that meet one of the requirements set forth in 19 U.S.C. §2511(b)(1)-(4) as eligible countries, and thus qualify for non-discriminatory treatment.

What is clear is that Congress intended the Buy American provision to be applied in a manner consistent with the United States' obligations under international agreements, and there is a question as to whether the FAR interim rule meets this requirement. This coupled with other differences between the Councils' and OMB's implementation of the Buy American provision could potentially create some confusion. This confusion could be significantly reduced if the Councils and OMB took a more uniform approach to applying the Buy American provision. Comments on the FAR interim rule are due by June 1, 2009 and are due by June 22, 2009 for OMB's interim rule. These comment periods provide the Councils and OMB with an opportunity to resolve the issues raised herein and other issues that industry may raise.

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