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New Interim Regulation And Agency Guidance Implement Recovery Act Buy American Restriction

On March 31, the Obama administration issued an interim regulation, effective immediately, to implement the statutory "Buy American" restriction for federal buildings and public works funded by the American Recovery and Reinvestment Act. On April 6, the Office of Management and Budget issued guidance to agencies for implementing grants to states and local governments for stimulus projects, including implementation of the Buy American restriction.

The regulation and agency guidance provide standards and procedures for determining the country of origin for steel and other manufactured goods. They are intended to comply with U.S. international obligations under the World Trade Organization and bilateral free trade agreements (FTAs). Steel and equipment producers in non-trade agreement countries such as China, India and Brazil, are the parties most adversely affected by the legislation. As one might expect, the Buy American implementation in the regulation and in the OMB agency guidance are largely the same, but there are some notable differences discussed below. Except as otherwise noted, the principles outlined below apply both to federal contracts and to state or local contracts under federal grants.

Scope—The interim rule adds a new subpt. 25.6 to the Federal Acquisition Regulation, and four new clauses for use in covered contracts. It applies to all contracts for the construction of public buildings and public works awarded by federal agencies using stimulus funds. The OMB guidance adds a new part 176 to title 2 of the *Code of Federal Regulations*. It applies to all federal grants to other entities for public buildings and public works stimulus projects.

To be considered a public work or public building, the construction must be procured through a contract for a "public" purpose, but the government does not need to retain title to the building or work. The rule and guidance further provide that no stimulus funds may be used for a building or public works project unless the project is located in the U.S., including U.S. territories. Whereas there are global markets for materials and products, the labor component of a construction project is necessarily local. Therefore, given the general intent to stimulate the U.S. economy, it is not surprising that a limitation to U.S. building sites would be adopted, although the legislation has no such limit.

The FAR rule promulgates two sets of two contract clauses. The first set applies to construction contracts worth less than $7.44 million, which is the threshold above which construction projects are covered by the WTO Government Procurement Agreement (GPA). FAR 52.225-21, 22. Other FTAs have similar thresholds. The second pair of clauses applies to contracts valued over the $7.44 million threshold, and incorporates provisions for identifying and giving equal treatment to products of GPA and other FTA countries. FAR 52.225-23, 24.

Similarly, the OMB guidance includes separate grant terms to be used, depending on whether the GPA and FTAs apply. They apply if the project cost exceeds the $7.44 million threshold *and* the procuring body is otherwise treaty-covered. An appendix to the guidance identifies covered states and authorities, as well as limitations on their coverage. It should be noted that several states have an exception for construction-grade steel. Highway and transit projects funded by federal grants are also excluded from the GPA and other agreements. Thus, some state and local stimulus projects will generally be limited to U.S. sources, others will be open to GPA and FTA sources, and others will be open to GPA and FTA sources for manufactured goods except steel.

As we predicted in an earlier article, the stimulus Buy American provision in the interim rule resembles in most respects the Buy America regulations applicable to highway and transit projects funded by Department of Transportation grants to states and local agencies.

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See Burgett, Leibowitz and Ertley, Feature Comment, "How Will Buy America Restrictions Affect Economic Stimulus Spending?" 51 GC ¶ 51.

Eligible Sources—The stimulus law requires that the Buy American provision be applied according to international agreements. Therefore, steel and manufactured goods produced in GPA member countries, including EU members, Japan, Korea and nine other developed nations, as well as other FTA countries, will be treated the same as steel and manufactured goods produced in the U.S. under direct federal contracts and state or local contracts covered by international agreements.

For federal contracts, the FAR rule further provides that listed "least developed" nations are also included, even though they are not parties to U.S. FTAs and not explicitly protected by the legislative language. The legislative history includes a statement that these least-developed countries should be eligible to participate in stimulus projects, and the FAR rulemakers implemented that intent. However, products of least-developed countries are not eligible for state and local projects under the OMB guidance. Products from Caribbean Basin Economic Recovery Act countries, which benefit from certain other procurement trade preferences, are not eligible to participate in Recovery Act-funded projects, whether conducted by federal, state or local agencies.

The net result is that construction contractors for substantially all direct federal stimulus projects, and many federally funded state stimulus projects, can choose from a variety of country sources, but some countries, including China, Brazil and India, will be excluded unless waivers are granted in particular instances. Some state and local projects will generally be limited to U.S. steel and other manufactured goods.

Iron and Steel—The origin test for foreign iron and steel is the same for federal, state and local projects, whereas the tests for domestic iron and steel may diverge, depending on the interpretation of the OMB guidance. Under both the FAR and OMB guidance, the country of origin of foreign steel is determined by the "substantial transformation" test used under the GPA and the Trade Agreements Act (TAA), and for other purposes. Substantial transformation does not require that all production take place in an eligible country. Rather, the article must be sufficiently transformed in that country to take on an identity, function and use that distinguish it from its components imported from other countries.

As for domestic steel, the FAR rule is clear and follows the approach of the Buy America steel provisions. For steel to be deemed "produced in the U.S.," all manufacturing processes, with the exception of metallurgical processes for steel additives, must be performed in the U.S. These include melting and pouring, as well as rolling, drawing, bending and shaping. Therefore, under the FAR, a Canadian mill could supply a girder made from steel poured in China, but a U.S. mill could not.

The policy section of the OMB guidance contains the same definition of "produced in the U.S." as the FAR. The word "produced" is used in the award term applicable to projects *not* covered by international agreements, but it is *absent* from the definition of "Domestic iron, steel, and/or manufactured good" used in connection with covered procurements. There the word "product" is only used in the phrase "wholly the growth, product, or manufacture of the United States." As to goods manufactured in the U.S. that include foreign content, the substantial transformation test applies. By the time steel is delivered to a project site, it is a manufactured good. Therefore, under a literal interpretation, a steel product merely substantially transformed in the U.S. from foreign steel would be acceptable, whereas under the rule for federal contracts and in state and local procurements not covered by international agreements, essentially *all* of the productive steps would have to be performed in the U.S. An alternate interpretation of the OMB definition would focus on the fact that the introductory clause refers to "Domestic iron, steel, and/or manufactured good" whereas the subclause that applies the substantial transformation test refers only to "manufactured good." Relying on that distinction, one might argue that the subclause only applies to manufactured goods *other than* iron and steel products. This alternate interpretation would enable the provision to be applied in the same manner as the FAR rule.

Under both the FAR and the OMB guidance, the steel restriction does not apply to components or subcomponents. The restriction in the FAR covers steel and iron "used as construction material." "Construction material" is defined as "an article, material, or supply brought to the construction site by the Contractor ... for incorporation into the building or work." Steel construction material includes girders and reinforcing bar, for example, but not steel components of manufactured goods, e.g., a fan blade made of steel. A steel screw or bolt might be covered if delivered in bulk and affixed to a structure at the site, but a screw or bolt incorporated in a pre-assembled article would not. Although a literal

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reading of the law could lead to the conclusion that contractors must account for the origin of steel in each screw and bolt in manufactured goods, the rulemakers evidently determined that this would be extraordinarily burdensome and would not provide a commensurate benefit to U.S. steel producers. Similarly, the OMB guidance clarifies that the steel requirements do not apply to iron or steel used as components of manufactured goods. In these respects, the steel coverage is similar to preexisting coverage for transit and highway projects. A key difference, however, is that the transit and highway provisions require U.S. steel, but federal stimulus projects and covered state and local projects may also use steel construction materials from GPA, FTA and least-developed countries.

Manufactured Goods: No Restriction on Origin of Components or Subcomponents—The rule of origin for manufactured goods applies only to the place of creation of the end product, i.e., each item in the form in which it is delivered to the work site. No country is excluded as a source of components or subcomponents of such products, nor are such products required to contain a minimum level of domestic component content. In focusing on the end item, this origin standard is similar to the most widely applicable origin requirement in U.S. procurement law—the TAA. It contrasts with other standards that have domestic component content requirements, such as the Buy American Act of 1933 and the Buy America Act requirements for trains, buses and manufactured goods in federally funded state and local transit projects.

An item "manufactured in the U.S." qualifies as domestic. "Manufactured" is not defined in the FAR rule, but an article substantially transformed in the U.S. would almost certainly qualify, and the substantial transformation test applies explicitly to products of a GPA, FTA or least-developed country. FAR 52.225-23(a). The OMB rule explicitly applies the substantial transformation test to both U.S. and designated-country manufactured goods. The net effect is that manufactured goods purchased by general contractors for these projects will be treated as if the federal agency purchased them directly in a TAA-covered procurement.

For most manufactured goods, the "substantial transformation" test will be applied to the end product in the form that it is brought to the construction site. However, the FAR rule includes a carve-out for emergency life safety systems such as emergency lighting, fire alarms or audio evacuation systems. Each such system will be evaluated as a single discrete manufactured good regardless of how or when the components are delivered to the construction site. Assuming the system is assembled and integrated at the U.S. construction site, it appears that any emergency system would comply, regardless of the origin of the system's components.

Unmanufactured Goods: No Change in Coverage from Buy American Act of 1933—Unmanufactured construction material, e.g., sand and gravel, is not covered by the legislation, but the FAR rule covers it because it is covered by the Buy American Act of 1933. 41 USCA § 10a–10d. Bids based on use of unmanufactured construction material from other than preferred countries are subject to a six-percent price evaluation penalty. When the awarding agency evaluates prices of competing bids, an amount equal to six percent of the cost of the disfavored material will be added to the evaluated bid price. If such material costs more than six-percent less than material from preferred sources, its use might be advantageous despite the price evaluation penalty.

Requests for Exceptions—Both the FAR rule and the OMB guidance allow bidders and grantees, as applicable, to request waivers of the Buy American restriction on any of three authorized grounds: unavailability, unreasonable cost or public interest. It seems unlikely that any of these exceptions will be widely used or have much impact. Unavailability typically will not apply, since there are more than 50 eligible country sources, including most major industrial nations. Cost is unreasonable only if the exclusion of a source increases the cost of the *entire project*, not just the item in question, by at least 25 percent. This will rarely, if ever, be the case. And if a product meets the criteria of "availability" from authorized sources at a "reasonable cost," it is unlikely that an agency head would find a sufficiently compelling "public interest" to support a waiver. Although the waiver provisions are similar to those of the Buy America Acts applicable to federally funded highway and transit projects, the stimulus law and the FAR rule and OMB guidance require that an agency granting a waiver for a stimulus project publish a detailed written justification in the *Federal Register*.

If possible, waiver requests must be made at or before bid submission. Post-bid requests must explain why a pre-bid request was not feasible. If a post-award request is granted, the contracting officer must negotiate consideration for it. If the waiver was based on cost, the consideration must at least equal the "unreasonable cost" standard—25 percent of project cost, or, in the case of unmanufactured construction material, six percent of its cost. FAR 25.606.

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Sanctions for Noncompliance—For both federal and state and local projects, a procuring agency may require that noncompliant materials be removed and replaced. However, both rules also recognize that removing a component after a building project is completed may be prohibitively expensive or impossible.

For federal contracts, if the violation is "sufficiently serious," other potential consequences are termination of the contract for default and suspension and debarment of the contractor from Government contracting for a period of time, typically three years. Although the FAR rule does not mention the False Claims Act, 31 USCA § 3729–33, as a potential sanction, a false certification of origin to a federal agency provides a basis for a civil FCA claim. The FCA provides for damages up to three times the damage suffered by the Government, plus penalties. It is unclear how a court would quantify the damage suffered by the Government, if any, if a project included technically compliant products of unauthorized origin.

The FAR interim rule notes that other, unspecified contractual remedies may apply, but the regulation does not create such remedies, and it is not clear what monetary remedy would apply under a typical Government contract. There is no provision for liquidated damages for use of non-eligible construction materials. An equitable adjustment for the supply of nonconforming goods is possible, but an agency might be hard-pressed to quantify the difference in value to the agency of identical girders made in the U.S. and in Brazil. The difficulty arises because the policy is designed to benefit the private economy, not the Government as purchaser.

The OMB guidance mentions the same type of remedies, but provides a more explicit potential measure of damages that is absent from the FAR rule. It refers to the "Federal Government's right to reduce the amount of the award [to the state or local grantee] by the cost of the [unauthorized] steel, iron, or manufactured goods." If the grantee is clever, it may pass this liability on to the contractor in the form of liquidated damages.

Overall Impact: Makers of Steel and Manufactured Products in Non-GPA/FTA Countries Will be Most Adversely Affected—The interim rules comply with the statute while limiting the administrative burden of compliance for contractors and agencies, notably by focusing solely on materials as delivered to the work site, and not requiring any analysis of origin or cost of components incorporated in manufactured goods, other than U.S. iron and steel products, before delivery. For all federal projects and for state and local projects covered by international agreements, pricing for construction materials generally should be competitive due to the number of eligible country sources. In such procurements, the main impact will be to exclude steel construction materials and other manufactured goods, but not components thereof, from ineligible countries such as China, Brazil and India. However, many state and local projects will not be covered by international agreements and therefore will be limited to U.S. steel and manufactured goods.

This article was written for International Government Contractor *by* **David W. Burgett**, **Lewis E. Leibowitz** *and* **Andrew C. Ertley**. *Mr. Burgett is a partner and Mr. Ertley is an associate in the Government Contracts Group of Hogan & Hartson LLP, resident in Washington, D.C. Mr. Leibowitz is a partner in the firm's International Trade Group.*

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