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FEATURE COMMENT: Real Steps Towards 'Buy American' Compliance—Part II: Demystifying BAA And TAA Requirements

In the one month since publication of Part I of this series, we have already experienced additional tremors in the "Buy American" landscape in the form of new tariffs on foreign steel and aluminum. See "Remarks by President Trump in Listening Session with Representatives from the Steel and Aluminum Industry" (March 1, 2018). While an assessment of the tariffs' implications and interplay with domestic sourcing requirements could be an entire Feature Comment unto itself, we note it here only as another example of impending restrictions on the acquisition of foreign products and services.

The recent tariff announcement fits squarely within the priority actions set forth in the president's national security strategy, which highlights multiple "priority actions" related to domestic sourcing requirements. Notably, the plan promises that the U.S. will "pursue bilateral trade and investment agreements with countries that commit to fair and reciprocal trade and will modernize existing agreements to ensure they are consistent with those principles," "counter all unfair trade practices that distort markets using all appropriate means," "emphasize fair trade enforcement actions when necessary," and "promote policies and incentives that return key national security industries to American shores." Donald J. Trump, National Security Strategy, at 20, 30 (Dec. 18, 2017). "Why," one might ask, "focus on 'Buy American' requirements that are likely to undergo further changes?" As with the adage, "you have to know the rules before you can break them," we maintain that contractors should have a firm understanding of the current "Buy American" regime before they can react and adapt to any future revisions to these policies.

In Part I of this series, we focused on the applicability of various domestic sourcing preference laws and regulations, providing a series of questions to help contractors determine which acts might apply to various types of contracts. See Nibley, Conant and Bakies, Feature Comment, "Real Steps Towards 'Buy American' Compliance—Part I: Unpacking FAR Pt. 25 And The Application Of 'Buy American' Laws," 60 GC ¶ 52.

Here in Part II, the discussion moves past *which* acts apply and focuses instead on *how* the acts apply. In other words, now that we have determined that a particular act applies to a procurement, how do we assess compliance with the requirements of that act? The simple answer is to look to the requirements delineated in the Federal Acquisition Regulation. However, anyone who has delved into FAR pt. 25 knows that domestic sourcing requirements are a maze of exceptions and exceptions to the exceptions. Accordingly, here in Part II, we adhere to our promise of small, manageable steps toward "Buy American" compliance by breaking down the basics of compliance with the two largest and most widely applicable regimes: the Buy American Act (BAA) and the Trade Agreements Act (TAA).

Although often conflated, the BAA and the TAA are two separate and distinct domestic content preference regimes with different requirements and applications. The BAA encourages the use of articles, materials, and supplies that have been mined, produced or manufactured in the U.S. in fulfilling federal governmental procurement and construction contracts by imposing a price penalty during proposal evaluation on offerors using foreign materials. See 41 USCA §§ 10A–10D. The TAA, in contrast, acts as a strict prohibition against the use of foreign end products in Government procurement; however, products from certain designated

countries are subject to a waiver and therefore exempt from TAA requirements. See 19 USCA § 2501 et seq. Together, these laws constitute the primary domestic sourcing requirements for U.S. federal contractors.

Demystifying Buy American Act Requirements—Recall from Part I of our series that the BAA applies to purchases (excluding service contracts) *over* the micropurchase threshold ($3,500 for civilian agencies and $5,000 for Department of Defense agencies) and *under* the TAA threshold (currently $180,000 for supply contracts and $6,932,000 for construction contracts). The BAA also applies to certain categories of acquisition regardless of whether the contract exceeds the TAA threshold: (1) small business set-asides; (2) acquisitions of arms, ammunition or war materials, or purchases indispensable for national security or for national defense purposes; (3) acquisitions from Federal Prison Industries Inc. or nonprofit agencies employing people who are blind or severely disabled; and (4) sole source awards. FAR 25.401(a).

These are the requirements for BAA applicability, but what are the requirements for BAA compliance? As noted above, the BAA mandates that federal agencies conducting procurements for public use purchase "[o]nly unmanufactured articles, materials, and supplies that have been mined or produced in the United States, and only manufactured articles, materials, and supplies that have been manufactured in the United States substantially all from articles, materials, or supplies mined, produced, or manufactured in the United States." 41 USCA § 8302(a)(1).

The FAR implements this mandate by requiring agencies to apply a price preference for certain supplies and construction materials if the lowest offer in a procurement is not for the domestic articles, materials or supplies described above. See FAR 25.104 (supplies), 25.204 (construction materials). Civilian agencies apply a six-percent "price penalty" to foreign offers (12 percent if the next-in-line offeror is a U.S. small business), while DOD agencies provide a more outcome-determinant 50-percent penalty to foreign offers (regardless of small business competition). If, after the application of the pricing preference, the lowest offer is for the designated foreign articles, materials or supplies, then the agency may select the foreign offer for award. In short, the BAA requires that prime contractors provide domestic end products or receive a price penalty during proposal evaluation and contract award.

Although FAR pt. 25 lays out the basic requirements for BAA compliance, without a careful reading (and re-reading, and re-re-reading) of the applicable provisions, it is easy to misinterpret the requirements. We have therefore broken the requirements down into a series of common misconceptions, or "myths," about the BAA (though we acknowledge that the term "myth" might be a bit hyperbolic for BAA misconceptions).

BAA Myth 1: The BAA requires the use of U.S. content: The BAA does not in fact require agencies to "buy American" exclusively. This myth highlights one of the key contrasts between the BAA and the TAA. As we noted above, the BAA acts as a *preference*, not a prohibition. The BAA only "restricts" the use and purchase of foreign supplies and construction material by promoting the purchase of domestic supplies and materials. The policy promotes domestic supplies by requiring agencies to apply a price preference during proposal evaluation. Civilian agencies apply a price penalty of six percent to foreign offers (12 percent if the lowest domestic offer is a small business); DOD agencies apply a price penalty of 50 percent to foreign offers.

For example, if one offeror proposes a domestic widget for $80,000 and another offeror proposes a foreign widget for $60,000, a civilian agency would evaluate the foreign widget as if it cost $63,600 (a six-percent increase), or $67,200 if the foreign offerors was competing against a U.S. small business (a 12-percent increase). If price were the deciding factor in the competition, the foreign widget would still prevail, because even with the price penalty, the foreign product is cheaper. A DOD agency would evaluate the foreign widget as if it cost $90,000 (a 50-percent increase). If price were the deciding factor in the competition, the domestic widget would prevail, because the price preference pushed the foreign widget price higher than the domestic price.

BAA Myth 2: The BAA price preference causes the Government to pay more for foreign products: It is important to understand that the price preference applies *for evaluation purposes only*. So in the example above, in the first scenario in which the foreign offer prevailed with a price of $63,600 (a six-percent price penalty), the agency would ultimately still pay the original proposed price of $60,000.

BAA Myth 3: To be BAA compliant a product must be 100-percent domestic: It is true that *non-manufactured* products must be mined or produced in the U.S.

FAR 25.003. *Manufactured* products, however, need only consist of 51-percent domestic content, although manufacturing must occur in the U.S. Manufactured products must meet a two-part test to be considered "domestic end products" under the FAR: (1) manufacturing must occur in the U.S., and (2) the end product must consist of more than 50-percent U.S. component parts. The FAR defines "component" as "an article, material, or supply incorporated directly into an end product or construction material." Id. Agencies calculate the percentage of U.S. components by cost.

For example, if an end product consists of 90-percent domestic material, but it is manufactured in China, it will not be considered a domestic end product under the BAA because the BAA requires manufacturing to take place in the U.S. If instead an end product consists of 90-percent foreign parts, but is manufactured in the U.S., it still does not meet the definition of a domestic end product under the BAA. A product must meet *both elements* of the two-part test to constitute a domestic end product.

For DOD procurements, contractors can take advantage of the "qualifying country" exception as well (not to be confused with the "designated country" delineation for TAA procurements, discussed in greater detail below). DOD has exempted end products and components from a number of countries as a result of various memoranda of understanding. These countries are listed in Defense FAR Supplement 225.872-1, and DOD will treat end products and components from those countries as "domestic" for purposes of BAA and TAA analysis.

BAA Myth 4: I have to rely on my contracting officer's interpretation of what constitutes 'manufacturing': It is true that neither the BAA nor the FAR defines "manufacture" for purposes of BAA's two-part test for domestic end products. However, various tribunals provide guidance and factors to consider. The Government Accountability Office interprets whether processes constitute "manufacturing" when a protester challenges an awardee's compliance with BAA requirements. GAO loosely defines the term "manufacture" as "completion of an article in the form required for use by the government." *Marbex, Inc.*, Comp. Gen. Dec. B-225799, 87-1 CPD ¶ 468. GAO considers a number of factors, such as whether there were "substantial changes in physical character." See *City Chem. LLC*, Comp. Gen. Dec. B-296135.2, 2005 CPD ¶ 120 (citing *A. Hirsch, Inc.*, Comp. Gen. Dec. B-237466, 90-1 CPD ¶ 247). GAO has also considered whether separate manufacturing stages were involved, or whether there was one continuous process. See *Cincinnati Elec. Corp.*, Comp. Gen. Dec. B-185842, 76-2 CPD ¶ 286. GAO generally does not view operations performed after an item has been completed (e.g., packaging, testing) as significant enough to constitute manufacturing. See *Marbex, Inc.*, Comp. Gen. Dec. B-225799. Boards of contract appeals (Armed Services Board of Contract Appeals and Civilian Board of Contract Appeals) have also weighed in on the definition of "manufacturing" for BAA purposes. The ASBCA has considered, for instance, whether the article is completed in the form required by the Government. See *Valentec Wells, Inc.*, ASBCA 41659, 91-3 BCA ¶ 24,168.

The most useful resource for interpretations of "manufacturing" comes from U.S. Customs and Border Protection's ruling program. A ruling is a written decision in the form of a letter issued by Regulations and Rulings pursuant to 19 CFR pt. 177 that tells the requester how CBP will treat a good or conveyance when it is imported into or arrives in the U.S. See CBP, "What Every Member of the Trade Community Should Know About: U.S. Customs & Border Protection Rulings Program," December 2009. CBP is required to publish these rulings. See 19 USCA § 1625. The published rulings provide the international trade community with guidance on how CBP will handle similar transactions.

BAA Myth 5: To calculate total domestic content, I need to know the country of origin of each component part's subcomponents: As stated above, a contractor does need to know the country of origin of each component part of an end product because, to qualify as domestic, an end product must consist of 51-percent domestic component parts.

So what qualifies as a domestic component part? To understand the analysis, it is helpful to break the elements down into three categories: (1) the end product, (2) components of the end product, and (3) *subcomponents* of each component part. For example, a vehicle (end product) has an engine (component) that includes a spark plug, valves, piston, crankshaft and pump (subcomponents). Do these subcomponents have to be 51-percent (or perhaps 100-percent) domestic as well? The answer is no.

The BAA does not require contractors to take the country of origin analysis to the subcomponent level. To qualify as a "domestic component" for purposes of calculating total domestic content of an end product,

a component part need only be *manufactured* in the U.S. See FAR 25.003 (defining a domestic end product as "[a]n end product manufactured in the United States, if [t]he cost of its components *mined, produced, or manufactured in the United States* exceeds 50 percent of the cost of all its components." (emphasis added)). In short, determination of a manufactured "domestic component" requires a different (and simpler) analysis than does determination of a manufactured domestic end product: A component manufactured in the U.S. will be considered "domestic" regardless of the foreign content of its subcomponents. To use our engine example, the engine will be considered a domestic component for purposes of determining 51-percent domestic content of the end product vehicle as long as the engine was manufactured in the U.S., even if the spark plug, valves, piston and crankshaft (subcomponents of the engine) were all manufactured in a non-qualifying foreign country.

Note, however, that the analysis gets trickier if it is not clear from the procurement what constitutes an "end product" and what constitutes a "component." In the example above, the agency procured a vehicle, of which the engine was a component. If instead the engine *itself* is the end product (i.e., procured independently of the vehicle, perhaps as a replacement or a spare), then the analysis changes. In that case, the spark plug, valves, piston and crankshaft parts can no longer be considered *subcomponents* of the component engine, because the engine is now the end product. Instead, these parts become *components* of the end product engine, and therefore require domestic manufacture.

BAA Myth 6: If my products qualify as commercial items, I do not have to comply with the BAA: The BAA does not exclude commercial items or commercial-off-the-shelf (COTS) items, with two exceptions. The FAR states that the BAA does not apply to "information technology that is a commercial item." FAR 25.103(e). Therefore, agencies can procure commercial-item information technology regardless of its domestic content and place of manufacture.

The FAR also provides a limited exception for COTS items by waiving part two of the BAA test (the 51-percent domestic content requirement). A COTS item therefore meets the BAA definition of a domestic end product if it is manufactured in the U.S., regardless of the foreign content. To use the example above in which an end product consisted of 90-percent foreign parts and was manufactured in the U.S., typically, such a product would not comply with the BAA's definition of a domestic end product because the foreign content is above 50 percent. If the end product qualified as a COTS item, however, the product would constitute a domestic end product under the BAA, because COTS items need only meet the domestic manufacturing element, not the domestic content requirement.

BAA Myth 7: I do not have to comply with the BAA if the supplies or construction procured by the agency will be used overseas: This one is a half-myth, as it applies only for civilian agency procurements. The BAA typically only restricts purchases of supplies and construction "for use within the United States." For DOD agencies, however, the Balance of Payments Program restricts the purchase of foreign end products for use outside the U.S. See DFARS 225.7501.

Demystifying Trade Agreements Act Compliance—The TAA allows the president to waive domestic sourcing requirements, including the BAA, so that the U.S. can comply with its obligations under various international trade agreements. It requires that products and services from select countries ("designated countries") receive equal consideration with domestic offers. The TAA waiver applies when three circumstances are present: (1) the anticipated procurement value is below the threshold established in the relevant trade agreement, (2) the procurement involves goods or construction materials listed in the relevant trade agreement, and (3) none of the other exceptions outlined in the trade agreements apply—e.g., the procurement is set aside for small business concerns or it is being conducted as a sole-source procurement.

Thresholds for TAA applicability vary depending on the trade agreement. The most widely applicable trade agreement is the World Trade Organization's Agreement on Government Procurement (GPA), although the U.S. participates in a number of other free trade agreements (FTAs) as well. The U.S. trade representative establishes the TAA thresholds for the WTO GPA and other FTAs, which are published at FAR 25.402(b) and updated biennially. The U.S. trade representative updated the thresholds most recently in January 2018. The thresholds for the WTO GPA are currently $180,000 for supply and service contracts, and $6,932,000 for construction contracts; FTA applicability thresholds currently range from $25,000 to $191,000 for supplies and services and $7,358,000 to $10,079,365 for construction. To explain the specific

obligations for TAA compliance, we have once again broken down the requirements into a series of common TAA myths or misconceptions.

TAA Myth 1: The TAA applies the same restrictions as the BAA, but waives the requirements for certain countries: Many contractors appear to believe that the TAA simply allows certain countries to be treated as domestic for purposes of BAA analysis. In fact, the laws require separate and distinct analyses. In each situation, one or the other act applies, not both.

As discussed above, the BAA uses a two-part test to define "domestic end product": (1) the end product must be manufactured in the U.S., and (2) domestic components must exceed 50 percent of component cost. The origin of component parts is therefore a significant factor in the analysis. The TAA, in contrast, uses a "substantial transformation" test. It requires that domestic products be either: (1) "[w]holly the growth, product or manufacture" of the U.S. or a designated country, or (2) "[s]ubstantially transformed [in the U.S. or a designated country] into a new and different article of commerce with a name, character, or use distinct from that of the article or articles from which it was transformed." FAR 25.003.

Thus, for TAA analysis, the country of origin of the underlying components ultimately incorporated into the end product is largely irrelevant. Unlike the BAA, the TAA allows end products with more than 50-percent foreign, non-designated country components (in fact, it allows end products with 100-percent foreign, non-designated country components), provided that those components are "substantially transformed" in the U.S. or a designated country.

TAA Myth 2: The TAA requires the same 'price preference' evaluation as the BAA does: Although the BAA requires application of a "price preference," as described above, the TAA does not apply a similar price preference. Instead, in procurements above the relevant threshold, the TAA *prohibits* the purchase of products from non-designated countries, regardless of the potential cost savings. If the TAA applies to the procurement, the agency must (1) review the products or services being purchased for their country of origin, and (2) only award to offerors utilizing U.S. or designated-country origin end products or services. See FAR 25.403(c)(1). The only exception is if DOD enters into a reciprocal agreement for the purchase of supplies with a particular country. See FAR 25.403(c)(2). The TAA's prohibition is consistent with the U.S. policy to *encourage* trade with certain countries and *discourage* trade with all others.

TAA Myth 3: The TAA's 'substantial transformation' requirement is the same as BAA's 'manufacturing' requirement: When analyzing a product's or service's country of origin, the TAA's "substantial transformation" requirement is not actually synonymous with the BAA's "manufacturing" requirement. See *Becton Dickinson Acutecare*, Comp. Gen. Dec. B-238942, 90-2 CPD ¶ 5 (rejecting both the agency's and protester's country of origin analyses because "they concern the definition of a 'domestic end product' under the Buy American Act, which has been waived by the President for procurements subject to the TAA."). Rather, the TAA's substantial transformation requirement employs a more demanding standard, as the article must have "been substantially transformed into a new and different article of commerce with a name, character, or use distinct from that of the article or articles from which it was so transformed." 19 CFR § 177.22 (defining "Country of origin").

CBP, the responsible authority for determinations of "substantial transformation," undertakes a fact-intensive analysis and employs considerable judgment in determining whether specific processes rise to the level of "substantial transformation." In its rulings, which CBP publishes in an online database called the Customs Rulings Online Search System, CBP has considered a multitude of factors, including: the number of components and subassemblies; whether parts "lose their identities" and become integrated into the new article; the extent of processing (i.e., whether it is minimal or simple as compared to whether it is complex or meaningful); whether worker skill is required during the actual manufacturing process; the overall importance of the imported article to the finished product; and whether the imported article is functionally necessary or simply an accessory with respect to the finished product. As you can see, there is no hard-and-fast rule that applies to a particular type of product or the extent of processing; however, CBP's prior rulings provide an excellent place to start when trying to determine a product's country of origin.

CBP also provides advanced rulings upon request if a contractor cannot determine country of origin using CBP's existing rulings, or if the contractor requires more definitive guidance. A ruling may be requested under pt. 177 of the CBP Regulations (19 CFR pt. 177) by any person who, as an importer or exporter of merchandise, or otherwise, has a direct and

demonstrable interest in the question or questions presented in the ruling request, or by the authorized agent of such person.

TAA Myth 4: The TAA limits the definition of 'designated countries' to those countries that are signatories to the GPA: The GPA is a multilateral agreement that strives to provide open government procurement markets to its cosignatories. Pursuant to the TAA, the U.S. treats the GPA's 45 signatories as "designated countries." While the GPA constitutes a large percentage of designated countries, it does not provide an exhaustive list of countries that the TAA identifies as designated countries. FAR 25.400(a)(1).

The U.S. also maintains FTAs with 18 countries, which the TAA includes in the definition of designated countries. See FAR 25.400(a)(2). Designated countries also include the 46 countries to which the U.S. trade representative applies a "least developed country" designation. See FAR 25.400(a)(3). The U.S. trade representative also extends designated countries coverage to the 21 countries that are part of the Caribbean Basin Trade Initiative. See FAR 25.400(a)(4). Additionally, the "qualifying country" exception still applies to DOD procurements for an (expansive) list of end products. See DFARS 225.401-70.

TAA Myth 5: The TAA applies to all contracts for articles valued over the TAA threshold: Contrary to this "myth," the TAA does not apply to all contracts for supplies and services above the TAA threshold. The FAR explicitly exempts several types of acquisitions from the TAA requirements. These acquisitions include (1) acquisitions set aside for small businesses; (2) acquisitions for arms, ammunition or war materials, or purchases indispensable for national security or for national defense purposes; (3) acquisitions of end products for resale; (4) acquisitions by Federal Prison Industries; and (5) sole-source procurements and other types of competition that do not utilize full-and-open competition. These types of acquisitions instead revert back to BAA compliance, provided that the acquisition involves construction or supplies (because the BAA does not extend to services). The FAR also outlines numerous categories of service contracts that are specifically exempted from the TAA requirements. FAR 25.401(b). These include services such as those that support military services overseas, dredging, and research and development. See id.

Conclusion—Congratulations! You have now completed your second real step towards "Buy American" compliance. The TAA and the BAA requirements—and the interplay between the two—arguably constitute the most complex pieces of the "Buy American" regime. But by following the guidelines above, you can avoid the compliance pitfalls that result from relying on myths and common misconceptions of the BAA and TAA. Please stay tuned for our next installment of our "Buy American" series, in which we explore enforcement of Buy American requirements.

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