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CLIENT ADVISORY

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ADDRESSING THE "BUY AMERICAN" PROVISIONS IN THE RECOVERY ACT

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The economic stimulus legislation recently passed by Congress and signed by President Obama, the American Recovery and Reinvestment Act of 2009, Public Law No. 111-5 (the Recovery Act), included important—and controversial—domestic preference provisions, popularly known as "Buy American" requirements. Although Congress amended these domestic preferences to ensure the United States honors its international obligations, the provisions are still likely to have a significant impact.

This client advisory discusses the new law, and reviews potential next steps in regulation and litigation. While the legislation included two domestic preference provisions, one focused on fabrics purchased by the Department of Homeland Security (Section 604) and one aimed at all procurement conducted under the Recovery Act (Section 1605), this advisory focuses on the latter provision, which will almost certainly affect a broader array of public procurements. The former provision was addressed in a prior client advisory which discussed a wide array of acquisition-related provisions in the Recovery Act, "Acquisition Provisions in the American Recovery and Reinvestment Act of 2009 (H.R. 1)," available at: http://www.arnoldporter.com/resources/documents/CA_AcquisitionProvisionsInTheAmericanRecoveryAndReinvestmentAct_022409.pdf.

LEGISLATIVE HISTORY OF THE "BUY AMERICAN" PROVISION

The key "Buy American" provision in the Recovery Act began with H.R. 1, the bill originally passed by the House of Representatives. The House bill stated that "none of the funds appropriated or otherwise made available by this Act may be used for a project for the construction, alteration, maintenance, or repair of a public building or public work unless all of the *iron and steel* used in the project is produced in the United States" (emphasis added). The House-passed bill notably contained no exception for foreign trade agreements.

On February 2, 2009, Senator Daniel Inouye brought the version of the bill previously approved by the Senate Appropriations Committee to the Senate floor. The Senate version of the bill included a domestic preference provision even more onerous than the House bill. The Senate bill stated, in pertinent part:

> (a) None of the funds appropriated or otherwise made available by this Act may be used for a project for the construction, alteration, maintenance, or repair of 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.

The Senate bill thus would have extended the protections for US products, beyond the iron and steel protected by the House bill, to any "manufactured goods" used in public buildings or public works funded by the stimulus legislation. Paragraph (b) identified a limited exception to this requirement, "in any case in which the head of the Federal department or agency involved finds that…applying [the preference] would be inconsistent with the public interest."

DRAFT LEGISLATION THREATENED TRADE VIOLATIONS

The proposed House and Senate provisions, if enacted and implemented, would almost certainly have violated US obligations under trade agreements, including the North American Free Trade Agreement (NAFTA), several other regional and bilateral free trade agreements, which similarly call for open procurement markets, and the World Trade Organization's (WTO's) Agreement on Government Procurement (GPA). NAFTA, the GPA, and the other trade agreements that the United States has entered into generally prohibit discrimination against foreign suppliers in US procurement, for procurements above certain monetary thresholds. The President has been granted authority by Congress to waive domestic preferences above those thresholds, in accordance with the agreements, and the US procurement regulations have been rewritten over the years to accommodate those agreements. *See generally* FAR Subpart 25.4, 48 C.F.R. Subpart 25.4.

Because of the United States' commitment to open procurement markets around the globe, US law also provides that US contracting agencies generally may purchase *only* from nations with which the US has entered into trade agreements regarding procurement. This "walled garden" encourages other nations to join trade agreements with the United States, and to open their own procurement markets. Because the "walled garden" is *not* required by agreement, but is rather unilaterally imposed by the United States on its own purchases, the "walled garden" and the costs and constraints it imposes on US purchasing reflect the US commitment to opening procurement markets.

OPPOSITION TO DOMESTIC PREFERENCES IN STIMULUS LEGISLATION

There was fierce opposition to the stimulus legislation's proposed domestic preferences. *See,* e.g., John M. Donnelly, "Defense Contractors Lobby Against Buy American Provisions in Stimulus," *CQ Today*, Feb. 3, 2009. The preferences could have harmed at least two groups in US industry: US exporters, which faced potential retaliatory actions abroad, and contractors to the government, which feared heavy costs in complying with these domestic preferences. For the contractors, while some of the additional costs of compliance could be shifted to the US government, past experience with similar requirements (such as requirements regarding specialty metals used for certain Department of Defense materiel) has shown that contractors must bear a large share of the compliance costs.

Strong public opposition came from, among others, Senator John McCain (R-AZ), the recently-defeated presidential candidate. On February 3, 2009, Senator McCain delivered a floor speech in which he argued against the proposed domestic preferences:

> I want to say a word for a minute about ``Buy American.'' The next time I come to debate on the ``Buy American'' provisions, I intend to bring a picture of Mr. Smoot and Mr. Hawley, the two individuals who were responsible, in the view of historians, for taking a country that was in a serious recession into the depths of one of the great depressions in the history of the United States.
>
> Because as we enact protectionist measures, I was interested to hear my friend from North Dakota, Senator Dorgan, say it was not in violation of any treaty. It is in violation of several treaties. It is in violation of what has been an important aspect of America's policy which has been free and open trade.
>
> We have seen this tendency before. In the 1930s, as depression swept the globe, countries around the world enacted protectionist legislation in a counterproductive effort to preserve jobs at home, at the expense of those abroad. It was a fool's errand, and the result was the largest and most prolonged economic downturn of the 20th century. We know better now, and we must have the foresight and the courage to do what is right.
>
> *Congressional Record*, Feb. 3, 2009, S1392-93.

An economic analysis published during the debate, and referenced by Senator McCain, projected that the draft House provision would, on balance, have destroyed more US jobs than the protections would have saved. *See* Gary Clyde Hufbauer & Jeffrey J. Schott, "Buy American: Bad for Jobs, Worse for Reputation," *PIEE Policy Brief* 09-02 (Feb. 2009), http://www.petersoninstitute.org/publications/pb/pb09-2.pdf.

In an important development, on February 3, 2009, President Obama signaled that he, too, was opposed to the proposed domestic preference provisions in the stimulus package. The *Wall Street Journal* reported on his comments as follows:

> Asked his views on the furor, Mr. Obama said in separate television interviews Tuesday that he wanted to avoid any steps would "signal protectionism" or risk fueling trade tensions.
>
> "I think that would be a mistake right now," he told ABC News. "That is a potential source of trade wars that we can't afford at a time when trade is sinking all across the globe."
>
> Neil King Jr. & John W. Miller, "Obama Risks Flap on 'Buy American,'" *Wall Street Journal,* Feb. 4, 2009

SENATE AMENDMENT: "BUY AMERICAN" REQUIREMENT TO BE READ TO BE CONSISTENT WITH TRADE AGREEMENTS

In response to concerns expressed by the White House and loud opposition from many other quarters, Senator Byron Dorgan (D-ND), the sponsor of the "Buy American" provision in the Senate, agreed to a compromise: the domestic preference provision would be retained in the Senate bill, but the legislation would explicitly be made subject to existing US trade commitments. The amendment read as follows:

> *(Purpose: To clarify that the "Buy American" provisions shall be applied in a manner consistent with United States obligations under international agreements)*
>
> On page 430, strike lines 7 through 12 and insert the following:
>
> (d) *This section shall be applied in a manner consistent with United States obligations under international agreements*.
>
> *Congressional Record,* Feb. 4, 2009, at S1528 (emphasis added).

The amendment passed by a voice vote. *Id.* Notably, as is discussed below, while the pivotal Senate amendment *added* a requirement that the provision be applied in a manner consistent with US trade obligations, the amendment *deleted* the legislative definitions of the affected "public buildings" and "public works"; the resulting gap in the law (as is discussed in the following sections) may spawn litigation.

LEGISLATION SIGNED WITH FREE TRADE PROTECTIONS

The Senate amendment, which required that the legislation's domestic preferences be applied in accordance with existing trade agreements, ultimately was accepted in conference and became part of Section 1605 of the new law. *See* Conference Report to Accompany H.R. 1, H. Rep. No. 111-16, 111th Cong., 1st Sess. (Feb. 12, 2009). The final legislation, signed by President Obama on February 17, 2009, thus will:

- Bar the use of funds from the stimulus legislation "for the construction, alteration, maintenance, or repair of 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." *See* Conference Report, *supra,* at 190 (text of Section 1605).
  - But the legislation no longer defines "public building" or "public work," which may well lead to future litigation (discussed below) regarding the scope of those terms.
- Allow agency heads to exercise exceptions, if to do so is in the public interest, if domestic iron, steel, or manufactured goods are not available, or if the bar would increase the cost of the project by more than 25 percent. *Id.* at 190-91.
- Ensure that the "Buy American" requirements are "applied in a manner consistent with United States obligations under international agreements." *Id.*; *see also id.* at 512 (conference report also noted that United States would preserve protections for least developed countries in US procurement).

NEXT STEPS IN IMPLEMENTING RECOVERY ACT

The Recovery Act thus poses something of a paradox. On one hand, as noted, the legislation specifically requires that only

US-produced iron, steel and manufactured goods be used on public projects funded by the billions of dollars appropriated by the new law. On the other hand, the new legislation must be read in accordance with the United States' many trade agreements regarding procurement—which seems to mean that the new legislation left the law of domestic preferences much where it began. Nevertheless, the burst of legislative support for domestic preferences, even though checked, will likely yield a number of reactions:

- **Support for Open Procurement Markets:** Foreign governments will likely continue to voice support for open public procurement markets, as part of an effort to stem growing protectionism in the broader commercial marketplace. Those concerns were reflected in comments from Canada's ambassador to Washington during the congressional debate: "We are concerned about contagion, that is, other countries also following protectionist policies. If Buy America becomes part of the stimulus legislation, the United States will lose the moral authority to pressure others not to introduce protectionist policies. A rush of protectionist actions could create a downward spiral like the world experienced in the 1930s." *Congressional Record*, Feb. 4, 2009, at S1529.
- **Increased Pressure on Nations Outside Trade Pacts:** As noted, US law has an anomalous "walled garden" requirement: in a nutshell, federal agencies may not purchase from countries that do not have trade agreements with the United States, including the WTO's GPA. Because of the severe measures contemplated by the Recovery Act, and the hundreds of billions of dollars in spending contemplated by the Recovery Act, those countries outside the "walled garden"—such as China, which has yet to complete its accession to the GPA—will likely feel increased pressure to join the GPA.
- **US Funding May Sidestep Trade Pacts:** There are many exceptions to the US trade agreements, and those could be used to shelter US spending. For example, only listed US agencies are covered by the WTO's Agreement on Government Procurement. In the past—the most famous example arose in 2003, when the United States excluded nations outside the wartime coalition from Iraqi reconstruction contracts—the United States has channeled funds through such exempt agencies, and so has avoided the agreements' obligations.
- **Stimulus Funding May Flow Through States and Agencies Not Covered by Trade Obligations:** Another way to avoid the force of the trade agreements would be to pass the funds to the states, many of which are immune from the trade obligations. Notably, only 37 states have agreed to join the GPA, in whole or in part. The subcentral entities (i.e., states) covered by the GPA under the United States' accession are listed in Annex 2 to the US agreement (http://www.wto.org/english/tratop_e/gproc_e/appendices_e.htm#us). The states listed as covered (at least in part) by the GPA are:

Arizona	Mississippi
Arkansas	Missouri
California	Montana
Colorado	Nebraska
Connecticut	New Hampshire
Delaware	New York
Florida	Oklahoma
Hawaii	Oregon
Idaho	Pennsylvania
Illinois	Rhode Island
Iowa	South Dakota
Kansas	Tennessee
Kentucky	Texas
Louisiana	Utah
Maine	Vermont
Maryland	Washington
Massachusetts	Wisconsin
Michigan	Wyoming
Minnesota	

Annex 2 includes important limitations on the states' commitments (e.g., only a limited number of state agencies covered), and the general notes to the US agreement exempt all grants to entities not specifically covered by the GPA. Moreover, per the list above, it

appears the following 13 states are *not* covered at all by the GPA's obligations:

Alabama	North Carolina
Alaska	North Dakota
Georgia	Ohio
Indiana	South Carolina
Nevada	Virginia
New Jersey	West Virginia
New Mexico	

- **Potential Bid Challenges:** On its face, the "Buy American" provision at issue in the Recovery Act is both broad and vague, and so may spawn litigation. As amended in the Senate, for example, although the provision states that none of the stimulus funding may "be used for…the construction, alteration, maintenance, or repair of 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," the provision does not define any of the key terms; indeed, Senator Dorgan's amendment deleted the prior definitions of "public building" and "public work." Because of uncertainties such as this, and because of the highly litigious nature of US procurement, the "Buy American" provision may trigger bid challenges, as competitors seek to displace awardees by arguing that the poorly defined "Buy American" requirements have not been met. Ironically, the deep recession—the genesis of the stimulus legislation—may only further encourage bid challenges, as competitors scramble to survive in a hostile market.
- **Compliance Obligations Will Increase:** Not all litigation will be bid challenges; there will almost certainly be fraud actions, as well. Under US federal procurement law (and under the laws of many states), "reckless" misstatements in administering a procurement can trigger fraud liability for contractors. Those fraud actions, typically for treble damages plus severe penalties, may be brought by "relators" (or "whistleblowers") on behalf of the government; the relators share in the government's recovery, and so are highly incentivized to root out possible fraud. To avoid this quagmire of potential liability, sophisticated contractors will likely institute very elaborate compliance systems to ensure that any "Buy American" requirements are met. As experiences with similar legal requirements (such as the Department of Defense's requirements for domestic specialty metals) have shown, these compliance systems are almost always expensive and cumbersome.
- **Strains on Trade Disputes Mechanisms:** Although the "Buy American" provision must, by its terms, be read to square with standing US trade agreements, how, exactly, the "Buy American" requirement should be implemented may yield trade disputes. That could put real stress on the dispute settlement mechanisms designed to accommodate disputes under trade agreements.
- **Implementing Regulations:** On February 18, 2009, the US Office of Management and Budget, which is part of the Executive Office of the President, issued initial implementing guidance for the Recovery Act. That guidance, at page 46, noted that the Federal Acquisition Regulation (FAR) will be amended to implement the Recovery Act's "Buy American" provisions.

The regulatory process to implement the Recovery Act's domestic preferences is likely to be closely watched and controversial. We will continue to monitor developments, and plan to issue further updates as that process unfolds.

We hope that you have found this client advisory useful. If you have additional questions, please contact your Arnold & Porter attorney or:

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