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The Buy American Act: Two-Part Test

The rules for applying the Buy American Act can, at times, be confusing for contractors who sell to the US government. A recent decision by the Government Accountability Office, *City Chemical LLC,* B-296135.2, B-296230.2, June 17, 2005, 05-1 CPD ¶ 120, addresses the Act's applicability to manufactured products. The case highlights that there is a two-part test for determining whether a manufactured product is a domestic end product under the Act.

I. Overview of The Buy American Act

In general, the Buy American Act[1] requires that US government agencies acquire only end products that are manufactured in the United States substantially of materials mined, produced or manufactured in the United States. The Act does not apply if an agency determines that: (i) the cost is unreasonable; (ii) it is inconsistent with the public interest; (iii) domestic materials are unavailable; or (iv) any other exception to the Act applies.[2]

A. Cost Unreasonable

Under the Act's implementing regulations, end products are considered to be of foreign origin if the cost of foreign components used in such end products constitutes 50% or more of the cost of all of the components used in such products. A US agency is not precluded from acquiring a foreign end product if the price offered for any products of domestic origin is deemed to be unreasonable. The price is deemed unreasonable if the price for products of domestic origin exceeds the price of like products of foreign origin plus a differential of 6% (12% if the lowest domestic offer is from a small business concern) or 50% for Department of Defense procurements.[3]

B. Public Interest

A foreign product may also be acquired when in the public interest, such as when a US government agency has an agreement with a foreign government providing for a blanket exception to the Buy American Act. FAR 25.103(a). The

1. *The "Buy American Act" is the name generally given to the statutes codified at 41 U.S.C. §§ 10a-10d (2000 and Supp. 1 2001).* See also *41 U.S.C. § 10b-2(c).*

2. *A similar requirement of the Buy American Act provides that only unmanufactured articles, materials and supplies that have been mined or produced in the United States may be purchased, subject to the same exceptions. 41 U.S.C. § 10a. Different restrictions and exceptions apply for construction materials.* See *41 U.S.C. § 10b.*

3. See *Exec. Order No. 10582, 19 Fed. Reg. 8723 (Dec. 17, 1954),* as amended *in Exec. Order No. 12608, 52 Fed. Reg. 34617 (Sept. 9, 1987); Federal Acquisition Regulation (FAR) 25.105; Defense FAR Supplement (DFARS) 225.105.*

Department of Defense, for example, has made public interest exceptions for the acquisition of end products from certain countries as the result of memoranda of understanding and other international agreements. DFARS 225.872-1(a). When the Department of Defense acquires products from these countries, the Buy American Act does not apply. *Id.*

C. Nonavailability

Further, a foreign end product may be acquired if domestic materials are not available. Certain articles have been determined to be nonavailable because they are not mined, produced or manufactured in the United States in sufficient and reasonably available commercial quantities of satisfactory quality. Agencies also have the authority to determine other articles to be nonavailable. FAR 25.103(b); 25.104.

D. Other Exceptions

A major exception to the application of the Buy American Act exists for acquisitions covered by the World Trade Organization's Agreement on Government Procurement, and the Free Trade Agreements listed in FAR 25.400. For acquisitions covered by these agreements, the United States Trade Representative has waived the Buy American Act to products from designated countries.[4] Generally, these agreements apply to contracts over a certain dollar value. FAR 25.402(b).[5] Although the Buy American Act has been waived, when procuring products covered by these agreements, agencies can only acquire products mined, produced or manufactured, or substantially transformed in the United States or in the designated countries. FAR 25.403(c).[6]

The Buy American Act does not apply to services nor does it apply to products for use outside of the United States or to manufactured products when the contract value is less than the micro-purchase threshold in 41 U.S.C. § 428. *See* 41 U.S.C. §10a. Additionally, the Buy American Act does not apply to acquisitions of foreign information technology commercial items, by virtue of Section 517 of the Consolidated Appropriations Act, 2005. Public Law 108-447, Dec. 8, 2004, Division H, Title II.

II. Two-Part Test

If no exception applies and the procurement solicitation is subject to the Buy American Act, offerors are asked to certify whether their end product is a domestic or foreign one. FAR 52.225-2.[7] To help contracting officers make this determination, the regulations implementing the Buy American Act apply a two-part test to define when a manufactured end product is, in fact, a domestic end product. Under this two-part test, a manufactured end product will be considered domestic for purposes of the Act if: (i) the end product is manufactured in the United States and (ii) the cost of domestic components (i.e., components mined, produced or manufactured in the United States) exceeds 50% of the cost of all its components. FAR 25.003 and

4. This waiver was made pursuant to the Trade Agreements Act. 19 U.S.C. §§ 2501, et seq. See also *FAR 25.402(a)(1).*

5. Many acquisitions of products by the Department of Defense, however, are not covered by the trade agreements. See *FAR 25.401(a)(2) and DFARS 225.401-70.*

6. The Department of Defense has determined that it is not in the public interest to apply the Buy American Act under acquisitions covered by the Trade Agreements Act to products that are substantially transformed in the United States. DFARS 225.103(a)(i)(B).

7. In Department of Defense procurements, offerors must also list "qualifying country end products." DFARS 252.225-7000. A qualifying country end product includes an end product manufactured in a qualifying country—a country with whom the Department of Defense has entered a memorandum of understanding or international agreement waiving Buy American Act restrictions. DFARS 252.225-7001.

25.101(a).[8] A component is an article, material or supply incorporated directly into an end product. FAR 25.003.

The application of the two-part test can be confusing to offerors who must certify whether their end products are of domestic or foreign origin. As the GAO recently reiterated in *City Chemical*, to meet the two-part test, manufacturing must occur in the United States at both the component and end product states of production.

III. The GAO Decision

In *City Chemical,* the protesting company bid unsuccessfully in two Army procurements, one for green solvent dye, and the other for yellow solvent dye. Based on information that City Chemical provided the Army and an on-site visit, the contracting officer determined that City Chemical was offering foreign end products because the company used an imported material to make its dye. Accordingly, the contracting officer applied the 50% Department of Defense evaluation factor to City Chemical's offers and determined that a domestic offer was the lowest-priced technically acceptable offeror.

When notified that another offeror had been selected for the contract, City Chemical protested the Army's decision to the GAO. Although City Chemical imported a raw material, it nonetheless argued that this foreign material had been manufactured into a domestic component and that this component was ultimately transformed into the end product dye in the United States, thus satisfying both prongs of the Buy American Act's two-part test. In particular, City Chemical argued that it modified the imported material through a series of processes to yield a "processed mixture" and then in a second state, subjected the so-called "processed mixture" to a "sifting and selecting" process that yielded the end product dye. *City Chemical,* at 5-6.

The GAO rejected the Company's reasoning. According to the GAO, when an end product is derived from a single component or material, it will look to whether the component or material has "undergone substantial changes in physical character" to determine whether manufacturing has occurred. The GAO also indicated that in cases where the original material is of foreign origin, it will look for two distinct manufacturing processes, the first yielding a component distinguishable from the material and the second yielding an end product distinguishable from the component. When the original material is of foreign origin and there are not two distinct manufacturing processes, the GAO will find noncompliance with the two-part test for defining a domestic end product. *City Chemical,* at 6-7.

Without deciding whether the process used to transform the imported material into a "processed mixture" was sufficient to constitute manufacturing, the GAO determined that the "sifting and selecting" could not reasonably be considered manufacturing since it involved no change, let alone a substantial change, to the physical character of the dye. Accordingly, the GAO determined that there was no second manufacturing process and, therefore, that City Chemical did not meet the second part of the domestic end product test. *Id.*

City Chemical also argued that to the extent that its imported raw material may be viewed as a component, the cost of domestic components exceeded 50% of the cost of all components, when domestic labor was taken into account. The GAO, however, determined that any

8. In Department of Defense procurements, a domestic end product also means an end product manufactured in the United States, if the cost of qualifying country components and components mined produced or manufactured in the United States exceeds 50% of the cost of all its components. DFARS 252.225-7001.

labor associated with transforming the processed mixture into an end product could not be a component of the end product because labor is not an article, material or supply incorporated directly into an end product.[9] *City Chemical,* at 7.

IV. Some Observations

It is not always clear whether the Buy American Act will apply to a particular requirement. Such a determination will often depend on the type of product being acquired, the agency acquiring the product, and the dollar value of the procurement. As shown in *City Chemical*, when using a single component or material of foreign origin in the manufacturing process, offerors must also engage in two distinct manufacturing processes before that component or material will be considered to have become a "domestic" end product for purposes of the two-part test: the first to yield a component that is distinguishable from the original material; the second to yield an end product that is distinguishable from the component.

Notably, the US Congress is contemplating a codification of the two-part test. The House bill for the Fiscal Year 2006 Department of Defense Authorization Act contains a provision that would codify into law the two-part test now contained in the implementing regulations of the Buy American Act. H.R. 1815, 109th Congress, May 25, 2005, Section 818. The codification would also require the two-part test to be applied, notwithstanding any reciprocal defense procurement memorandum of understanding between the United States and a foreign country pursuant to which the Secretary of Defense has prospectively waived the Buy American Act for products of that country. The enactment of such a provision would significantly increase the number of defense-related procurements subject to the Buy American Act. Although this provision may not survive the conference with the Senate and may therefore not be included in the final Authorization Act, it is incumbent upon companies selling to the United States government to fully understand the requirements and ramifications of the Buy American Act and the two-part test in the implementing regulations when they do apply.

9. See also *FAR 25.003. ("Cost of components does not include any costs associated with the manufacture of the end product.").*

For more information regarding the Buy American Act, contact either of the attorneys below.

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