



October 19, 2009

'Buy American' and Renewable Energy Projects

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In February 2009, Congress passed the American Recovery and Reinvestment Act. The ARRA includes a large number of funding opportunities and tax incentives to support investment in clean energy at the local level. These incentives are designed to strengthen the economy and to promote clean and renewable energy.

The ARRA contains significant direct spending programs, tax incentives, loan guarantees and bond programs to support the development of renewable and clean energy technologies. Among the more controversial portions of the ARRA are the Buy American provisions.

Although the Obama administration has issued two sets of interim guidance for implementing the Buy American rules at the federal, state and local levels, many ambiguities remain that have the potential for delaying or scuttling renewable energy projects.

This article provides background on the Buy American rules of the ARRA and discusses some of the ambiguities for renewable energy projects.

Basics of Buy American Rules of ARRA

Section 1605 of the ARRA requires that all of the iron and steel and "manufactured goods" used in ARRA-funded projects for construction, alteration, maintenance or repair of "a public building or public work" be "produced in the United States."

Section 1605 also specifies that the provision shall be "applied in a manner consistent with United States obligations under international agreements." Exceptions are allowed where:

- the head of the federal agency concerned determines adherence would be "inconsistent with the public interest,"
- the iron/steel/manufactures are not produced in the U.S. in sufficient and available quantities, or
- the inclusion of U.S. products would increase overall project cost by 25 percent.

The Buy American rules of the ARRA generated a lot of controversy because governments around the world promised not to engage in protectionist measures in fighting the recession.

To foreign suppliers and their governments, the new Buy American rules are very protectionist. On the other hand, to many U.S. companies, use of federal funds means that the projects should be reserved for U.S. companies.

Similarity To Other Domestic Content Statutes

The ARRA's Buy American rules borrow provisions from two existing U.S. domestic content laws: the "Buy American Act" and the "Buy America" statute.

The former applies when the federal government directly buys products or itself builds public buildings or works via a procurement covered by the Federal Acquisition Regulations, while the latter applies principally to highway- and transit-related projects.

However, although similar, there are many aspects of the ARRA's Buy American provisions that are significantly different from either the Buy American Act or the Buy America statute.

The Obama Administration Interpretation Of The ARRA's Buy American Provision

Because the Buy American provisions of the ARRA contained very little guidance on how they should be applied, the Obama administration issued regulatory guidance. Unfortunately, three different sets of rules have been issued, depending on the type of contracting.

- On March 31, 2009, an interim rule amending the Federal Acquisition Regulation (FAR) was issued by the Civilian Agency and Defense Acquisition Councils (FAR Councils) imposing the ARRA's Buy American provision on federal construction contracts funded with ARRA appropriations.
- On April 3, 2009, the Office of Management and Budget (OMB) issued guidance to federal agencies as to how the Buy American provision is to be applied to ARRA grants and loans to states and municipalities.
- Finally, the Federal Transit Administration and Federal Highway Administration (FTA/FHA) have determined to apply the ARRA Buy American provision by simply imposing their existing Buy American regulations to ARRA grants.

Because the bulk of the renewable energy projects will be funded through ARRA funds for federal construction or state and municipal grants, this article focuses on the main provisions affecting renewable energy projects.

Iron and Steel Products

The U.S. steel industry was one of the major driving forces behind the Buy American provisions. As such, one of the main aspects of the Buy American provisions of the ARRA concerns iron and steel.

For iron and steel products procured by federal contractors for use as construction material in covered projects, all manufacturing processes must take place in the United States (except metallurgical processes related to refining steel additives).

Manufactured Goods A. FAR Rules

Manufactured goods used as construction materials also must be produced in the United States. Unfortunately, the interim rules fail to define precisely what is required for manufactured construction material to be considered "produced" or "manufactured" in the United States.

The standard espoused in the interim rules issued by the FAR Council states that a construction material will be considered “produced/manufactured” in the United States when it results from processing into a specific form and shape or combining of raw material into a property different from the individual raw materials, and that processing/combining occurs in the United States.

Although this would appear to be a low standard, it has left many companies in the dark about whether their U.S. manufacturing activities meet this amorphous standard.

Thus, unlike the criteria for steel in which all manufacturing processes must take place in the U.S., for manufactured goods, the use of components or subcomponents of foreign origin is allowed. Foreign components — including steel components — can be used to manufacture a product in the United States.

However, the components have to be incorporated into a further manufactured or assembled product away from the construction site (otherwise, they would be considered construction materials themselves and not components).

OMB Interim Guidance

OMB’s definition of “manufactured” differs slightly from the definition in the FAR. Under OMB’s guidance, a manufactured good that contains materials from another country must be “substantially transformed in the United States into a new and different manufactured good distinct from the materials from which it was transformed.”

The interim guidance adopts directly the “substantial transformation” test used to determine a product’s country of origin for trade purposes.

This is a test that the U.S. Customs & Border Protection (“customs”) has used for years to determine the country of origin of an imported product. The problem with this test, however, is that there are no clear and precise rules.

In response to this lack of clarity, the U.S. Environmental Protection Agency has provided some guidance on what it considers to be a substantial transformation. To help local utilities determine whether a good has been “substantially transformed” enough to pass the test, the federal agency provided a series of questions:

- Were all of the components of the manufactured good manufactured in the U.S., and were all of the components assembled into the final product in the U.S.? (If the answer is “yes,” then this is clearly manufactured in the U.S.)
- Was there a change in character or use of the good or the components in America? (These questions are asked about the finished good as a whole, not about each individual component.)
- Were the processes performed in the U.S. (including but not limited to assembly) complex and meaningful?

According to the EPA, an imported component that undergoes further processing in the United States would not satisfy the substantial transformation test by “having merely undergone ‘[a] simple combining or packaging operation.’”

Moreover, “assembly operations that are minimal or simple, as opposed to complex or meaningful, will generally not result in a substantial transformation.”

Although the EPA has issued guidance on how the substantial transformation test works, it is uncertain whether the EPA’s guidance will apply to renewable energy projects, where most funding comes from U.S. Department of Energy grants.

International Obligations

Pursuant to the ARRA, the Buy American provisions must be applied in a manner consistent with the WTO Agreement on Government Procurement (GPA) and U.S. free trade agreements.

Under these agreements, the Buy American requirement does not apply to iron, steel or manufactured goods produced in signatory countries and acquired for construction projects with a value of \$7.4 million or more.

Thus, procuring agencies must honor the federal government’s commitments to treat the foreign iron, steel or manufactured goods as the equivalent of domestic goods.

In determining whether a product is a product of the GPA or free trade agreement country, the rules specify that the “substantial transformation” test is to be used to determine country of origin when a manufactured good that contains materials from another country is processed in the GPA or FTA country.

Note that this exception to the Buy American provision of the ARRA does not always apply.

Although the exception applies to federal government procurements for construction projects, it only applies to states and municipalities who have signed on with respect to their agencies. Although 32 states have signed on to the GPA, the fact is that very few state or local agencies are covered.

Because most of the ARRA funds are disbursed through grants to states and municipalities, there is a significant likelihood that the Buy American provisions will apply to any state or local projects that use ARRA funds.

Violations of the Buy American Provisions

Both the FAR and OMB interim rules include provisions for dealing with violations of the Buy American rules.

A violation could result in contract termination for default, reduction in the contract price, suspension and debarment of the contractor and, potentially, even criminal liability.

Moreover, because each contractor must submit a certificate of compliance with the Buy American rules, a violation of the Buy American provisions could result in False Claims Act liability.

Specific Issues for Renewable Energy Project

When Do The Buy American Rules of the ARRA Apply?

There are several contexts where it is uncertain whether the Buy American rules of the ARRA apply.

Grants In Lieu of Tax Credits

Section 1603 of the ARRA allows taxpayers to claim, in lieu of claiming the investment tax credit or production tax credit, a grant when they place “specified energy property” in service. The grant reimburses the taxpayer for a portion of the expense of such property.

The Buy American provision applies to projects receiving “funds appropriated or otherwise made available by this Act.”

The law is divided into an introductory section, a Division A and a Division B. Section 4 of the introductory section states that references to “this Act” contained in any division of the legislation are to be treated as references only to the provisions of that division.

The Buy American provisions appear in Division A, while the tax provisions, including grants in lieu of tax credits, are in Division B. Thus, the Buy American provisions should not apply to the tax provisions, including grants in lieu of tax credits.

Unfortunately, however, no mention was made of this in either the interim guidance or rules. Nevertheless, a treasury official has stated that the grants in lieu of tax credits do not have to comply with the Buy American provisions of the ARRA. However, nothing official has been issued concerning whether the Buy American rules of the ARRA apply to grants in lieu of tax credits.

Loan Guarantees

On July 29, 2009, the Department of Energy issued \$30 billion in lending authority to support loan guarantees for renewable energy and transmission projects. Unlike the tax provisions, loan guarantees are in Division A of the ARRA. As such, recipients of ARRA funds conceptually must comply with the Buy American provisions.

Nevertheless, many of the projects receiving funds are private projects, typically through a Power Purchase Agreement (PPA). Under the terms of a PPA, the PPA provider (the electricity generator) typically assumes the risks and responsibilities of ownership when it purchases, operates and maintains the facility.

Because the Buy American provisions only apply to ARRA funds given for construction, repair, alteration and so on of a public works or public building, by definition the Buy American provisions of ARRA should not apply to loan guarantees for private projects.

Although the Buy American provisions should not apply to these types of private projects, the interim guidance has not addressed this issue squarely when it comes to renewable energy projects.

Moreover, there are a host of issues that could make a difference when it comes to PPAs. Would it make a difference if the host site operator itself is a governmental entity? Does it make a

difference if the host site operator is a governmental entity that has an option to buy the facility? These are just some of the issues that were not addressed in the interim guidance.

Substantial Transformation Test

As stated above, there are two amorphous standards that are espoused for determining when products that undergo further manufacturing can be considered a product of the United States (or a product of a free trade agreement country).

Despite guidance by the EPA, the fact is that these standards are not predictable. Without predictability, it makes it extremely difficult for renewable energy companies to know whether their projects are compliant with the Buy American rules.

Even customs has proposed eliminating altogether the substantial transformation test due to its unpredictability. Customs has stated the following:

“Despite its heritage and apparent straightforwardness, administration of the substantial transformation standard has not been without problems. These problems derive in large part from the inherently subjective nature of judgments made in case-by-case adjudications as to what constitutes a new and different article and whether processing has resulted in a new name, character and use.

“The substantial transformation standard has evolved over many years through numerous court decisions and CBP administrative rulings. Because the rule has been applied on a case-by-case basis to a wide range of scenarios and has frequently involved consideration of multiple criteria, the substantial transformation standard has been difficult for the courts and CBP to apply consistently and has often resulted in a lack of predictability and certainty for both CBP and the trade community.”

Instead, customs has proposed a change in tariff classification system (tariff shifts) for determining whether a change in origin has occurred.

Under this codified method, the substantial transformation that an imported good must undergo in order to be deemed a good of the country where the change occurred is usually expressed in terms of a specified tariff shift as a result of further processing.

This system currently is in place for making origin determinations for goods imported from Canada and Mexico pursuant to the North American Free Trade Agreement.

Due to its predictability, in any final guidance, the FAR Council and OMB should adopt the change in tariff classification system for determining origin for Buy American purposes.

Guidance

Another issue for the renewable energy industry is the lack of transparency with regard to procedures for having Buy American coverage issues resolved.

Although OMB and the FAR Council issued the guidance on the Buy American provisions, given the overarching issues, there is no central authority to uniformly decide Buy American issues. Rather, typically it is the contracting officer that in the first place makes decisions concerning the Buy American provisions.

The problem with this type of system is that many decisions are made without significant oversight and uniformity. There should be transparent and uniform rules concerning issues involving the Buy American rules that are issued by a lead agency like OMB. Unfortunately, however, no such hierarchy exists. This further stymies businesses because of the lack of predictability.

Conclusion

Given the ambiguities in the guidance and rules, coupled with the significant potential penalties for non-compliance, it is critical that renewable energy companies be aware of how the Buy American provisions apply and seek legal counsel to address those areas that it believes are unclear.

Addendum

In early summer, both the FAR Council and the OMB accepted comments on their interim guidance and rules. Many comments were received. Both the FAR Council and OMB intend to issue final rules in early fall. As of the submission of this article, the final guidance rules have not yet been released.

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This article first appeared in September 2009 in Hunton & Williams' Renewable Energy Quarterly.