

Interpreting the Buy American Provision of the American Recovery and Reinvestment Act of 2009 For the Purchase of Water Meters and Meter Reading Systems

This paper will provide for guidance interpreting the “Buy American” requirements of the American Recovery and Reinvestment Act of 2009 (the “ARRA”), Pub. L. No. 111-5, § 1605(A).

The purpose of the ARRA is to provide federal capital funding for infrastructure projects that should stimulate both local and national economies. The ARRA’s “Buy American” provision requires that the federal money is spent, not just on projects in the United States, but also on United States manufactured or produced materials for the projects. The “Buy American” provision reads as follows:

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*.

ARRA, § 1605(A) (emphasis added).

The ARRA provides that the requirements of Section 1605 can be waived under three circumstances: (a) iron, steel, or relevant manufactured goods are not produced in the U.S. in sufficient and reasonably available quantities and of a satisfactory quality; (b) inclusion of iron, steel, or relevant manufactured goods are produced in the U.S. will increase the cost of the overall project by more than 25 percent; or (c) applying the domestic preference would be inconsistent with the public interest.

As the ARRA applies to water meters and meter reading systems, the Buy American provision raises several issues. In an attempt to assist you in your funding requests, this paper will address these questions.

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1. How can the municipality or utility (the “Funding Recipient”) determine if a supplier’s products are “produced in the United States?”

Some water meter companies manufacture all of their meter bases in the United States, but manufacture the meter register (the reading element) entirely in another country, like Mexico. They then import the completed register into the United States where it is “assembled” with the meter base in a simple process. In that situation, the completed “meter” is not “produced in the United States” for purposes of the Buy American provision of ARRA.

The ARRA requires that funds used for public building or public works projects can only be spent on iron, steel, and manufactured goods used in the project that are produced in the United States. Several federal agencies have issued interim rules or guidance concerning the implementation of the ARRA. *See, e.g.*, Department of Defense, et al, Amendments to Federal Acquisition Regulation 48 CFR Parts 1, 5, 25, and 52, 74 Fed. Reg. 14623 (Mar. 31, 2009) (“FAR Interim Rule”); Office of Management and Budget, Requirements for Implementing Sections 1512, 1605, and 1606 of the American Recovery and Reinvestment Act of 2009 for Financial Assistance Awards, 74 Fed. Reg. 18449 (Apr. 23, 2009) (“OMB Interim Final Guidance”); Environmental Protection Agency, Memorandum on Implementation of Buy American Provisions of P.L. 111-5 (Apr. 28, 2009) (“EPA Memorandum”).

Because the state and local governments and instrumentalities with water projects will be receiving funds under the ARRA provisions that allocate funds for EPA administration under the Clean Water State Revolving Loan Fund and the Drinking Water State Revolving Loan Fund, the EPA Memorandum and later EPA pronouncements directly will impact the analysis. Funding Recipients should expect that the EPA will look to rules and guidelines from other agencies as it continues to formulate its analysis. The EPA Memorandum refers to the OMB Interim Final Guidance, incorporates definitions from the OMB Interim Final Guidance, and states expressly that “the term and condition specified in the OMB Guidance at 176.140 (page 18454) will be incorporated as an award term of ARRA grants from EPA.” EPA Memorandum, at 2.

A. “Manufactured Good”

A key definition under all of the agency statements is the definition of “manufactured good.” The EPA’s guidance on the ARRA defines “manufactured good” as “a good brought to the construction site for incorporation into the building or work that has been (1) processed into a specific form or shape; or (2) combined with other raw material to create a material that has different properties than the properties of the individual raw materials.” EPA Memorandum, at 3; *accord* OMB Interim Final Guidance, 74 Fed. Reg. at 18454. The EPA Memorandum notes that “there is no requirement with regard to the origin of components or subcomponents in manufactured goods, as long as the manufacture of the goods occurs in the United States.” EPA Memorandum; *accord* OMB Interim Final Guidance, 74 Fed. Reg. at 18452 (“there is no requirement with respect to the origin of components or subcomponents in manufactured goods used in the project, as long as the manufacturing occurs in the United States”).

B. “Produced in the United States”

Neither the ARRA, the EPA Memorandum, the OMB Interim Final Guidance, nor the FAR Interim Rule define “produced in the United States.” Likewise, the legislative history also provides no guidance. However, other federal statutes that contain similar provisions help to define that term.

1. Guidance from Other Statutes

a. Buy American Act of 1933

The preexisting Buy American Act of 1933, 41 U.S.C. § 10a, contains a specific “Buy American” provision. That statute provides as follows: “only such manufactured articles, materials, and supplies as have been manufactured in the United States *substantially all from articles, materials, or supplies mined, produced, or manufactured, as the case may be, in the United States*, shall be acquired for public use.” *Id.* (emphasis added).

Because the Buy American provision of ARRA does not contain the domestic component requirements of the Buy American Act of 1933 (the “substantially all from articles . . . produced . . . in the United States” language), the Buy American provision of ARRA does not have those domestic component requirements. *See* FAR Interim Rule, 74 Fed. Reg. at 14624 (noting that Section 1605 “does not specify a requirement that significantly all the components of construction material must also be domestic”).

b. Trade Agreements Act of 1979

The Trade Agreements Act of 1979, 13 U.S.C. § 2501, *et seq.*, also addresses country of origin issues for government procurement purposes. The Trade Agreements Act states that an article “is a product of a country or instrumentality” if it is wholly the growth, product, or manufacture of that country or instrumentality, or “in the case of an article which consists in whole or in part of materials from another country or instrumentality, it has 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.” *Id.* at § 2518(4)(B) (emphasis added).

Determining whether a good has undergone a “substantial transformation” therefore is not based on the value or percentage of United States content under the Trade Agreements Act. Instead, it is based on whether the article has been given a different character or use as a result of the manufacturing processes occurring in the United States. *Compare* FAR 52.225-1(a), *with* FAR 52.225-5(a). “Substantial transformation” is determined on a case-by-case basis. The determinative issue in deciding substantial transformation is the extent of operations performed and whether the parts lose their identity and become an integral part of a new and different article. *Belcrest Linens v. United States*, 573 F. Supp. 1149 (Ct. Int’l Trade 1983), *aff’d*, 741 F.2d 1368 (Fed. Cir. 1984). “Assembly operations that are minimal or simple, as opposed to complex or meaningful, will generally not result in a substantial transformation.” Dept. of Homeland Security Customs and Border Protection, Notice of Issuance of Final Determination Concerning Ground Fault Circuit Interrupter, 73 Fed. Reg. 54420, 54421 (Sep. 19, 2008). If the manufacturing or combining process is a minor one that leaves the identity of the article intact, then a substantial transformation has not occurred. *Uniroyal, Inc. v. United States*, 542 F. Supp. 1026 (Ct. Int’l Trade 1982), *aff’d*, 702 F.2d 1022 (Fed. Cir. 1983) (no substantial transformation

where imported upper, the essence of the finished shoe, was combined with a domestically produced outsole to form a shoe).

C. Analysis of “Produced in the United States” With Respect to Water Meters.

Based on the definitions of “manufactured goods” in the OMB Interim Final Guidance, manufactured goods should be considered to be “produced” in the United States when the processing into the specific form or shape or the combining of raw materials into materials that contain different properties occurs in the United States. The “substantial transformation” standard under the Trade Agreements Act satisfies that standard. Lesser transformations may not and may expose the Funding Recipient to substantial liability.

Under the substantial transformation test, the law focuses on whether the article in question is substantially transformed into a new and different article of commerce with a “name, character, or use” different from the materials and parts used in its manufacture. *National Hand Tool v. United States*, 16 CIT 308, (1992) *aff’d* 989 F.2d 1201 (Fed. Cir. 1993).

A change in name requires a change in the commercial designation or commercial identity of the product. A ruling from the International Trade Commission on the tariff classification of a product is persuasive evidence of a change in name. Fortunately, there is a published ruling with respect to water meters and registers that provides substantial guidance.

In 2006, Badger Meter obtained a ruling from the International Trade Commission staff that its Absolute Digital Encoder Register manufactured in Mexico and imported into the United States would be classified in subheading 9028.90.00 HTSUS as *part of* a liquid supply meter *instead of* as an electric transducer under heading 8543 HTSUS. ITC, Classification of the Absolute Digital Encoder Register Used in Water Metering Systems, HQ 968089 (May 1, 2006).¹

Therefore, the “meter” is the meter base or casing, the register, and the measuring chamber. For purposes of the “name” part of the substantial transformation test, the register is part of the “meter.” This finding is important because a “substantial transformation” of an article of commerce into a “new and different article of commerce” does not occur where the component parts are already parts of the same article of commerce.

A change in character requires that the manufacturing or processing operation results in a change to the physical aspects or qualities of the product. While a subcomponent (for example, a magnet assembly) may be produced offshore, if the magnet assembly undergoes a substantial transformation into the register part of a meter in the United States, there is a change in character of the subcomponent by an alteration of its physical aspects or qualities.

Where the completed, hermetically-sealed register is imported to the United States, there is no change in the physical aspects or qualities of the register part of the meter that occurs in the United States.

A change in the use of the article is sufficient to constitute a substantial transformation when the change in use changes a product that has one use into a product that has a different use, changes

¹ The author notes that the ITC ruling concerning the Badger register occurred in 2006, and it is possible that Badger has changed its manufacturing processes.

a product with many potential uses into a product with one specific use, or narrows the range of possible uses of a multiple-use product. Using the same example, the use of a magnet assembly changes in the United States when it is incorporated into a register. But, the use of a completed register imported into the United States does not change in the United States merely by assembly with its meter maincase. It enters the United States as the register part of a water meter, and remains the register part of the water meter.

2. How does the source of subcomponents and components in the supplier's products fit into the definition of "produced in the United States?"

From the discussion above, Funding Recipients should be wary of supplier's reliance on the OMB Interim Final Rule statement concerning the Buy American provision that "with regard to the origin of components or subcomponents in manufactured goods used in the project, *as long as the manufacturing occurs in the United States.*" OMB Interim Final Rule, 2 CFR § 176.70(a)(2)(i).

It is correct that the ARRA Buy American provision disregards the country of origin of components and subcomponents. Therefore, the register part of a water meter may contain a circuit board from China, wire from the United States, and magnets from Mexico, and potentially still comply with the Buy American provision.

However, Funding Recipients can fail in their responsibilities if they do not keep the focus on whether the finished manufactured good is "produced in the United States." The manufactured goods used in the project must be produced in the United States, meaning that the manufactured good must be substantially transformed into its final form in the United States. While a component can be sourced offshore, the final manufacturing (which is more than mere assembly) has to occur in the United States.

3. Do international agreements like NAFTA and the WTO-GPA provide an exception for locally administered water projects?

Some manufacturers of iron, steel, and manufactured goods (not limited to water meter and water meter reading system manufacturers), as well as some potential Funding Recipients have made blanket statements that a product produced in a NAFTA country or another country with which the United States has a free-trade agreement automatically is exempted from the Buy American provisions of ARRA. **That blanket statement is very dangerous and incorrect.**

The ARRA Buy American provision states that "This section shall be applied in a manner consistent with United States obligations under international agreements." ARRA § 1605(d). However, that statement does not signal a blanket exemption for goods produced in one of the United States' NAFTA partners.

Equal treatment of goods under NAFTA applies *only* to federal government procuring agencies and "government entities" identified in the US NAFTA procurement annex. It does not apply to state and local procuring agencies.

ARRA contracts for goods and services at the state and local levels, even if funded by federal grants from the EPA under an SRF program, are not entitled to equal treatment under NAFTA. So, state, municipal, and other non-federal projects may not use iron, steel, and manufactured goods produced in Mexico or Canada, regardless of the NAFTA status of those countries.

In fact, the EPA's guidance on the ARRA Buy American provision specifically states that the provision requiring adherence to United States obligations under international agreements, "only applies to *direct procurement* by the entities listed in the appendix of OMB's Interim Final Guidance or the Federal government, *and does not apply to procurement initiated by local entities (SFR assistance recipients)*, unless they are listed in the appendix. We encourage you to review the appendix, available at 74 Fed. Reg. 18457. You will find the following: (1) only certain states are covered, (2) only certain state governmental branches (often only Executive Branch agencies) are covered, (3) construction services are excluded in some instances, and (4) only certain international agreements apply, which can include the World Trade Organization Agreement on Government Procurement (the "WTO GPA") and various Free Trade Agreements ("FTAs") with certain countries.

Therefore, beware of blanket statements to the effect that a supplier's manufactured goods are Buy American compliant based upon a blanket claim invoking NAFTA or another international trade agreement. For SRF funded programs, the claim is not likely to be accurate.

4. Can a Funding Recipient "Split Funding?"

The EPA already has noted that based on intended use plans submitted by States, many States intend to fund water projects with "split" funding, taking some from funds from ARRA grants and some funds from the base SRF program.

The EPA specifically prohibits the splitting of projects to manipulate the funding to avoid the Buy American requirements. The EPA has stated as follows: "EPA has concluded that any project that is funded *in whole or in part with ARRA funds*, must comply with the Buy American provisions." EPA Memorandum, at 8. The EPA specifically has warned that "This precluded the intentional splitting of ARRA projects into separate and smaller contracts or assistance agreements to avoid Buy American coverage on some portion of a large project, particularly where the activities are integrally and proximately related to the whole." *Id.*

Therefore, a Funding Recipient cannot split out the components of a project that do not satisfy the Buy American provision and only use the ARRA funding on elements that satisfy the Buy American provision. Consider the example of a project to replace water meters and upgrade to an AMR system. If the meters do not meet the Buy American provision but the AMR system does, the funding applicant is not allowed to apply for funding only on the AMR portion of the project.

5. What are the consequences of non-compliance?

Severe consequences attach to a Funding Recipient that fails to comply with the Buy American provisions. If a recipient of ARRA funds does not comply with the Buy American provisions,

the awarding official at the funding agency *must* review allegations of violations of the Buy American provision, and *even if fraud is not suspected* notify the Funding Recipient of the unauthorized use of foreign iron, steel, and/or manufactured goods and request a reply proposing corrective action. OMB Interim Final Rule, 2 CFR § 176.130(a) & (b).

If the award official determines that a Funding Recipient has used unauthorized foreign iron, steel, and/or manufactured goods, the award official *must* take appropriate action that can include requiring the removal and replacement of unauthorized foreign materials, or a reduction in the amount of the award of ARRA funds. *Id.* at § 176.130(c).

For serious violations, the award official at the agency also can withhold cash payments pending correction of the deficiency, suspend or terminate the award, and withhold further funds for the project. The award official also can forward a report to the agency recommending suspension or debarment from government contracting as a remedy. *Id.* at § 176.130(c)(4).

Finally, if the award official determines that the noncompliance appears to be fraudulent, the award official is authorized to refer to the matter to the officer responsible for criminal investigation. *Id.* Because reports made by Funding Recipients are essentially statements made to the Federal Government in support of a claim for payment, false statements of compliance with the Buy American provisions will likely be covered under the federal False Claims Act. Therefore, a false statement in a report could subject the maker of the statement to liability under the False Claims Act in a direct action by the government, or by a *qui tam* relator. As evidence of that intent, the ARRA also contains a “whistleblower protection” protection provision, ARRA § 1553. It prohibits reprisals against any employee of any non-federal employer receiving ARRA funds for disclosing information about alleged fraud, waste, and abuse related to ARRA funds.

Conclusion

The ARRA provides a significant funding opportunity for water projects and authorizes the use of federal capital funding for those projects. The new statute however contains a number of highly technical points that are potential pitfalls for Funding Recipients. A funding recipient should be aware of these issues and ensure that its procurement practices are in line with the intended definition of the Buy American provision.