

19 July 2019

*Practice Groups:*

*Public Policy & Law*

*Government  
Contracts*

## Buy American III: How Does The Latest “Buy American” Executive Order Affect Government Contractors And Their Supply Chains?

*By Steven A. McCain and Amy Conant Hoang*

On July 15, 2019, President Trump issued an Executive Order, “Maximizing Use of American-Made Goods, Products, and Materials.” The Executive Order builds on two prior “Buy American” Executive Orders and recommends two changes to current regulations implementing the Buy American Act of 1933. This alert summarizes the changes proposed in the Executive Order (known as “Buy American III”) and how they may affect a government contractor’s supply chain.

The Buy American Act does not apply to every procurement, but when it does apply, it mandates that federal agencies purchase domestic products. The Federal Acquisition Regulation (“FAR”) implements this mandate by requiring the use of “domestic end products” and defining what percentage of domestic content a domestic end item must contain. The Buy American Act contains a number of exceptions implemented in the FAR, including an exception when the cost of acquiring a domestic end product is unreasonable.

We predicted in an earlier publication that these two aspects of current Buy American Act regulations—the domestic content requirement and the determination of whether a domestic end product’s cost is “unreasonable”—were particularly susceptible to revision under President Trump’s “Buy American” agenda. [1] One year later, these are precisely the provisions the new Executive Order seeks to revise. Below, we provide key takeaways from the Executive Order, followed by an in-depth analysis of the Executive Order’s potential affect on current Buy American Act compliance requirements.

### I. Bottom Line Up Front: Key Takeaways From The New Executive Order

- a. For manufactured products other than steel or iron products, the Executive Order does not present a drastic change: it requires manufacturers to increase a product’s domestic content from 51% to 55% in order to qualify as a “domestic end product.”
- b. For steel and iron manufactured products, the Executive Order does propose a significant change, increasing domestic content from 51% to 95% in order to qualify as a “domestic end product.” It is unclear whether the Executive Order extends its proposed changes to “domestic construction materials.” If so, this change could be particularly significant for construction contractors on civilian agency construction sites.
- c. The Executive Order’s proposed change to domestic content requirements will not affect manufactured products that qualify as commercially available off-the-

shelf (“COTS”) items, as the FAR exempts COTS items from domestic content requirements.

- d. The Executive Order increases the “price penalty” against foreign end products from 6% to 20% (or from 12% to 30% for small business competition) which will reduce federal agency use of the “unreasonable cost” waiver and thereby increase procurement of domestic products.
- e. The change to the “unreasonable cost” exception does not affect DoD acquisitions, as DoD previously implemented a separate—and more severe—price penalty for foreign products.
- f. The proposed changes must be considered by the FAR Council within 180 days, but the Executive Order does not mandate subsequent rulemaking until (1) notice and comment, and (2) the FAR council determines that any proposed changes are appropriate and consistent with the law and the national security interests of the United States.

II. In-Depth Analysis: The Executive Order’s Proposed Changes To Current Buy American Compliance Requirements

a. The Buy American Act’s Domestic Content Requirement.

While some mistake the Buy American Act as a requirement for 100% domestic content, in reality, the regulations implementing the Buy American Act currently allow a manufactured product to contain up to 49% foreign components. As explained below, however, the language of the statute allows for interpretation and potential revisions to the percentage of domestic content required for an end product to be considered “domestic,” which the new Executive Order seeks to do.

The BAA, as implemented by the FAR, mandates a preference for “domestic end products.” Manufactured products meet a two-part test to be considered “domestic end products” for purposes of the Buy American Act:

1. Manufacturing must occur in the United States, and
2. The end product must consist of more than 50% U.S. component parts, by cost. [2]

Part Two of the test—the 51% domestic content requirement—derives from the implementing regulations rather than the statute itself. The statute employs a “substantially all” standard: “[O]nly 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, shall be acquired for public use.” [3] In 1954, President Eisenhower issued Executive Order 10582 declaring that “substantially all” should be interpreted as 50% or greater. [4] In response, the FAR Council implemented the 51% rule at FAR 25.003. The 51% rule has remained in place since its implementation. [5]

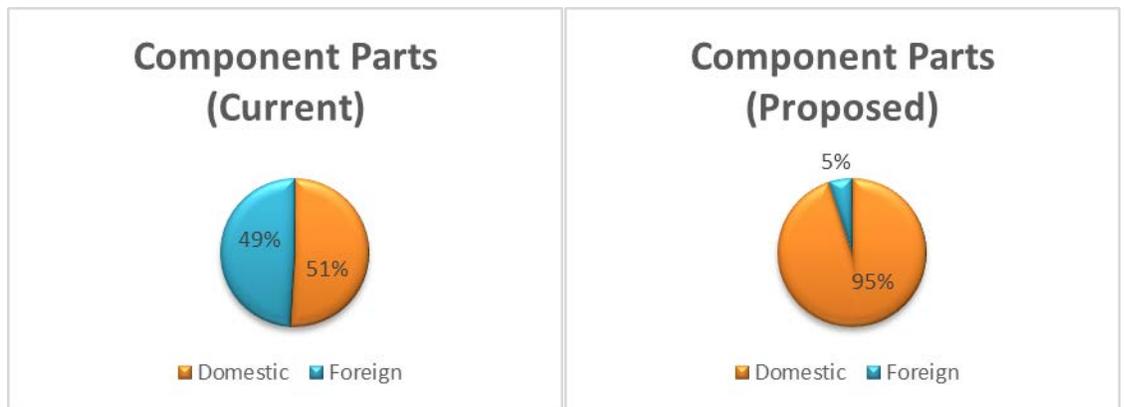
The new Executive Order seeks to revise the current 51% domestic content requirement. For iron and steel end products, the Executive Order advises defining a foreign end product as one in which “the cost of foreign iron and steel used in such iron and steel end products constitutes 5 percent or more of the cost of all the products used in such iron and steel end products.” Stated inversely, the Executive Order advises increasing the domestic content requirement from 51% to 95% for steel and iron manufactured products. For all other manufactured end products, the Executive Order presents a less drastic change: the Executive Order advises defining non-steel or iron foreign end products as those in which “the cost of the foreign products used in such end products constitutes 45 percent or more of the cost of all the products used in such end products.” Again stated

inversely, the Executive Order advises increasing the domestic content requirement from 51% to 55% for non-steel or iron manufactured products. [6]

**Non-steel or iron manufactured products: moderate change**



**Steel and iron manufactured products: significant change**



Notably, the proposed change to domestic content requirements will not affect end products that qualify as COTS items. The FAR currently waives the domestic content requirement for COTS items—COTS items qualify as domestic as long as they are manufactured in the United States, regardless of foreign content. [7] The Executive Order does not suggest revising this standard.

b. The Buy American Act’s “Unreasonable Cost” Exception

The Executive Order’s second proposed revision relates to the “unreasonable cost” exception contemplated in the Buy American Act statute. The Act mandates use of domestic materials “unless the head of the department or independent establishment concerned determines...*their cost to be unreasonable.*” [8] As discussed below, the statute does not define what constitutes an “unreasonable” cost; instead, the implementing regulations provide a calculation for agencies to use. The new executive order seeks to modify this calculation to reduce the use of the “unreasonable cost” exception.

The FAR implements the unreasonable cost exception by requiring agencies to apply a “price penalty” when evaluating offers of foreign end products. [9] An agency applies this “price penalty” by adding a percentage increase to the price of foreign products during evaluation. If, after application of the price penalty, the price of the foreign product is still

lower than the price of the domestic product (or, in the case of a negotiated procurement, determined to be the “best value”), then the unreasonable cost exception allows the agency to acquire the foreign product.

Currently, civilian agencies apply a price penalty of 6% to foreign offers, or a more severe 12% penalty to foreign offers if the next-in-line domestic offer is from a U.S. small business. [10] DoD agencies apply a price penalty of 50% to any foreign offer, regardless of small business competition. [11] The table below demonstrates application of the unreasonable cost exception’s price penalty:

Offeror	Proposed Price	Civilian Agency Price Penalty: Large Business (6%)	Civilian Agency Price Penalty: Small Business (12%)	DoD Agency Price Penalty (50%)
Domestic Widget	\$80,000	\$80,000	\$80,000	\$80,000
Foreign Widget	\$70,000	\$74,200	\$78,400	\$105,000
<b>Result</b>	--	<b>Foreign wins</b>	<b>Foreign wins</b>	<b>Domestic wins</b>

In the civilian agency competition (regardless of small or large business competition), even with the price penalty the foreign product is cheaper than the domestic product. As such, the unreasonable cost exception would allow the agency to acquire the foreign product. In the DoD competition, 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.

The new Executive Order seeks to increase the “price penalty” for civilian agency procurements. Specifically, the executive order suggests a 20% price penalty when a foreign offer is competing against a large business, and a 30% price penalty when a foreign offer is competing against a small business. Notably, this revision does not impact DoD procurements, as DoD’s price penalty already exceeds penalty increase proposed in the executive order.

Applying the new proposed price penalties to the example above illustrates the impact of this change could have on civilian agency procurement (and the lack thereof for DoD procurements):

Offeror	Proposed Price	Civilian Agency Price Penalty: Large Business (20%)	Civilian Agency Price Penalty: Small Business (30%)	DoD Agency Price Penalty (50%)
Domestic Widget	\$80,000	\$80,000	\$80,000	\$80,000
Foreign Widget	\$70,000	\$84,000	\$91,000	\$105,000
<b>Result</b>	--	<b>Domestic wins</b>	<b>Domestic wins</b>	<b>Domestic wins</b>

Under the revised, more severe price penalties, the domestic product's price is no longer considered an "unreasonable cost" under either of the civilian competition scenarios (and as noted previously, the DoD scenario does not change).

c. The New Executive Order's Impact On Government Contractors And Their Supply Chains

We will continue to monitor the impact of the new Executive Order, but its proposed changes are neither immediate nor definite. The executive order directs the FAR Council within 180 days to "*consider*" proposing these revisions for notice and public comment.

If the FAR Council does enact a final rule to implement the changes proposed in the new executive order, contractors should remember that these changes will only apply to the specific subset of procurements to which the Buy American Act applies. The Buy American Act applies to purchases (excluding service contracts) *over* the micropurchase threshold (currently \$10,000) [12] and *under* the Trade Agreements Act threshold (currently \$180,000 for supply contracts and \$6,932,000 for construction contracts). [13] The Buy American Act also applies to certain categories of acquisition regardless of whether the contract exceeds the Trade Agreements Act threshold, such as acquisitions set-aside for small businesses or indispensable to national security. [14] The Trade Agreements Act does not employ the Buy American Act's domestic content standards or price penalties and accordingly is not affected by this executive order. [15]

III. Conclusion

The Buy American III Executive Order could impact how government contractors and their supply chains comply with the Buy American Act. Of equal importance, the Executive Order demonstrates the Trump Administration's continued focus on "promot[ing] policies and incentives that return key national security industries to American shores." [16] The K&L Gates Public Policy and Law and Government Contracts teams are well positioned to assist interested parties to assess the impact on business interests at home and abroad, provide input to and engage with government officials, and ensure compliance with evolving domestic sourcing requirements.

---

[1] Nibley, Conant & Bakies, *Real Steps Toward Buy American Compliance Part IV: What Comes Next?*, The Government Contractor, 60 GC No. 22 ¶ 181 (June 13, 2018), reprinted with permission [here](#).

[2] FAR 25.003.

[3] 41 U.S.C.A. § 8302(a) (emphasis added).

[4] See Exec. Order No. 10582, § 2(a) (Dec. 17, 1954) ("For the purposes of this order materials shall be considered to be of foreign origin if the cost of the foreign products used in such materials constitutes fifty per centum or more of the cost of all the products used in such materials.").

[5] Various tribunals have upheld the 50% rule as a valid application of BAA requirements. See, e.g., *United States ex rel. Made in the USA Found. v. Billington*, 985 F. Supp. 604 (D. Md. 1997); *Allis-Chalmers Mfg. Co., Comp. Gen. Dec. B-147210*, 1961 CPD ¶ 69.

[6] The Executive Order also requires the FAR Council to report on the feasibility of incrementally raising the domestic content requirement from 55% to 75%.

[7] FAR 25.001(c)(1).

[8] 41 U.S.C.A. § 8302(a)(1) (emphasis added).

[9] See FAR 25.105

[10] *Id.*

[11] DFARS 225.101.

[12] 41 U.S.C.A. §1902(a)(1); 10 U.S.C.A. § 2338.

[13] FAR 25.100(b), 25.402(b)

[14] FAR 25.401(a).

[15] For a more in-depth analysis of the requirements and applicability of the Buy American Act and Trade Agreements Act, see Nibley, Conant & Bakies, *Real Steps Towards Buy American Compliance Part II: Demystifying BAA and TAA Requirements, The Government Contractor*, 60 GC No. 12 ¶ 97 (March 28, 2018), reprinted with permission [here](#).

[16] Donald J. Trump, National Security Strategy, at 30 (Dec. 18, 2017).

---

## K&L GATES

K&L Gates is a fully integrated global law firm with lawyers located across five continents. The firm represents leading multinational corporations, growth and middle-market companies, capital markets participants and entrepreneurs in every major industry group as well as public sector entities, educational institutions, philanthropic organizations and individuals. For more information about K&L Gates or its locations, practices and registrations, visit [www.klgates.com](http://www.klgates.com).

This publication is for informational purposes and does not contain or convey legal advice. The information herein should not be used or relied upon in regard to any particular facts or circumstances without first consulting a lawyer.

©2019 K&L Gates LLP. All Rights Reserved.