ATTACHMENTS

1) Section 1605 of the American Recovery and Reinvestment Act
2) OMB Guidance on the Buy American Requirement of ARRA 2 CFR Part 176.60 *et. seq.*
3) FAR ARRA Buy American provisions 75 FR 53153 (August 30, 2010)
4) Recovery Board Web-site screen; purposes of ARRA
5) OIG Site Visit Report No. 11-R-0700, September 23, 2011
   Appendix A: City of Ottawa Response to Draft Report
   Appendix B: EPA Response to Draft Report
   Appendix C: Illinois EPA Response to Draft Report
   Appendix D: Distribution
6) OW Guidance, "Determining Whether 'Substantial Transformation' of Components Into a 'Manufactured Good' Has Occurred in the U.S.: Analysis, Roles, and Responsibilities," October 22, 2009
7) Region 5 Proposed Management Decision, January 27, 2012
8) OIG Response to Management Decision, March 15, 2012
9) OGC Memo on EPA's Guidance on the Buy American Provision of ARRA, August 7, 2012
10) OW Response to OIG, August 15, 2012
11) OIG Response to OW's August 15, 2012 Memo, September 28, 2012
12) OIG Memo to Barbara Bennett, October 17, 2012
13) Agency's Proposed Resolution to the Ottawa IG Report, December 15, 2012
14) OIG Memo to Barbara Bennett, January 17, 2013
15) Joint Submission---Audit Resolution Form, January 29, 2013
16) Submission of OIG to Robert Perciasepe, March 21, 2013 (Exhibits Omitted)
17) Submission of OW to Robert Persciasepe
18) Region 5 and OW/OIG Audit Dispute Resolution Request: Briefing for the Acting Administrator, April 1, 2013
19) Internal Agency Audit Dispute Resolution Process, excerpt from EPA Manual 2750

LIMIT ON FUNDS

SEC. 1604. None of the funds appropriated or otherwise made available in this Act may be used by any State or local government, or any private entity, for any casino or other gambling establishment, aquarium, zoo, golf course, or swimming pool.

BUY AMERICAN

SEC. 1605. USE OF AMERICAN IRON, STEEL, AND MANUFACTURED GOODS. (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.

(b) Subsection (a) shall not apply in any case or category of cases in which the head of the Federal department or agency involved finds that—

(1) applying subsection (a) would be inconsistent with the public interest;

(2) iron, steel, and the relevant manufactured goods are not produced in the United States in sufficient and reasonably available quantities and of a satisfactory quality; or

(3) inclusion of iron, steel, and manufactured goods produced in the United States will increase the cost of the overall project by more than 25 percent.

(c) If the head of a Federal department or agency determines that it is necessary to waive the application of subsection (a) based on a finding under subsection (b), the head of the department or agency shall publish in the Federal Register a detailed written justification as to why the provision is being waived.

(d) This section shall be applied in a manner consistent with United States obligations under international agreements.

WAGE RATE REQUIREMENTS

SEC. 1606. Notwithstanding any other provision of law and in a manner consistent with other provisions in this Act, all laborers and mechanics employed by contractors and subcontractors on projects funded directly by or assisted in whole or in part by and through the Federal Government pursuant to this Act shall be paid wages at rates not less than those prevailing on projects of a character similar in the locality as determined by the Secretary of Labor in accordance with subchapter IV of chapter 31 of title 40, United States Code. With respect to the labor standards specified in this section, the Secretary of Labor shall have the authority and functions set forth in Reorganization Plan Numbered 14 of 1950 (64 Stat. 1267; 5 U.S.C. App.) and section 3145 of title 40, United States Code.

ADDITIONAL FUNDING DISTRIBUTION AND ASSURANCE OF APPROPRIATE USE OF FUNDS

SEC. 1607. (a) CERTIFICATION BY GOVERNOR.—Not later than 45 days after the date of enactment of this Act, for funds provided to any State or agency thereof, the Governor of the State shall certify that: (1) the State will request and use funds provided by this Act; and (2) the funds will be used to create jobs and promote economic growth.

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ntrastate district;
Council of governments, whether
incorporated as a nonprofit cor-
ɔn under State law; and
Any other instrumentality of a
overnment.
rivate entity. (1) This term means
ıtity other than a State, local
ment, Indian tribe, or foreign
entity.
his term includes:
nonprofit organization, includ-
y nonprofit institution of higher
ion, hospital, or tribal organiza-
her than one included in the def-
of Indian tribe in paragraph (b)
section.
for-profit organization.
tate, consistent with the defini-
n section 103 of the TVPA, as
ed (22 U.S.C. 7102), means:
ny State of the United States;
he District of Columbia;
ny agency or instrumentality of
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ɔation;
The Commonwealths of Puerto
and the Northern Mariana Is-
and
he United States Virgin Islands,
American Samoa, and a terri-
possession of the United States.

176—AWARD TERMS FOR AS-ANCE AGREEMENTS THAT IN-DE FUNDS UNDER THE AMER-N RECOVERY AND REINVEST-NT ACT OF 2009, PUBLIC LAW -5

AUTHORITY: American Recovery and Reinvestment Act of 2009, Public Law 111–5; Federal Funding Accountability and Transparency Act of 2006, (Pub. L. 109–282), as amended.

SOURCE: 74 FR 18450, Apr. 23, 2009, unless otherwise noted.

§ 176.10 Purpose of this part.

This part establishes Federal Governmentwide award terms for financial assistance awards, namely, grants, cooperative agreements, and loans, to implement the cross-cutting requirements of the American Recovery and Reinvestment Act of 2009, Public Law 111–5 (Recovery Act). These requirements are cross-cutting in that they apply to more than one agency's awards.

§ 176.20 Agency responsibilities (general).

(a) In any assistance award funded in whole or in part by the Recovery Act, the award official shall indicate that the award is being made under the Recovery Act, and indicate what projects and/or activities are being funded under the Recovery Act. This requirement applies whenever Recovery Act funds are used, regardless of the assistance type.

(b) To maximize transparency of Recovery Act funds required for reporting by the assistance recipient, the award official shall consider structuring assistance awards to allow for separately tracking Recovery Act funds.

(c) Award officials shall ensure that recipients comply with the Recovery Act requirements of Subpart A. If the recipient fails to comply with the reporting requirements or other award terms, the award official or other authorized agency action official shall take the appropriate enforcement or termination action in accordance with 2 CFR 215.62 or the agency's implementation of the OMB Circular A–102 grants management common rule. OMB Circular A–102 is available at *http://www.whitehouse.gov/omb/circulars/a102/a102.html*.

(d) The award official shall make the recipient's failure to comply with the reporting requirements a part of the recipient's performance record.

§ 176.30 Definitions.

As used in this part—

Award means any grant, cooperative agreement or loan made with Recovery Act funds. Award official means a person with the authority to enter into, administer, and/or terminate financial assistance awards and make related determinations and findings.

Classified or *"classified information"* means any knowledge that can be communicated or any documentary material, regardless of its physical form or characteristics, that—

(1)(i) Is owned by, is produced by or for, or is under the control of the United States Government; or

(ii) Has been classified by the Department of Energy as privately generated restricted data following the procedures in 10 CFR 1045.21; and

(2) Must be protected against unauthorized disclosure according to Executive Order 12958, Classified National Security Information, April 17, 1995, or classified in accordance with the Atomic Energy Act of 1954.

Recipient means any entity other than an individual that receives Recovery Act funds in the form of a grant, cooperative agreement or loan directly from the Federal Government.

Recovery funds or *Recovery Act funds* are funds made available through the appropriations of the American Recovery and Reinvestment Act of 2009, Public Law 111–5.

Subaward means—

(1) A legal instrument to provide support for the performance of any portion of the substantive project or program for which the recipient received this award and that the recipient awards to an eligible subrecipient;

(2) The term does not include the recipient's procurement of property and services needed to carry out the project or program (for further explanation, see §___.210 of the attachment to OMB Circular A–133, "Audits of States,

Local Governments, and Non-Profit Organizations''). OMB Circular A–133 is available at *http://www.whitehouse.gov/omb/circulars/a133/a133.html.*

(3) A subaward may be provided through any legal agreement, including an agreement that the recipient or a subrecipient considers a contract.

Subcontract means a legal instrument used by a recipient for procurement of property and services needed to carry out the project or program.

Subrecipient or *Subawardee* means a non-Federal entity that expends Federal awards received from a pass-through entity to carry out a Federal program, but does not include an individual that is a beneficiary of such a program. A subrecipient may also be a recipient of other Federal awards directly from a Federal awarding agency. Guidance on distinguishing between a subrecipient and a vendor is provided in §____.210 of OMB Circular A–133.

Subpart A—Reporting and Registration Requirements Under Section 1512 of the American Recovery and Reinvestment Act of 2009

§ 176.40 Procedure.

The award official shall insert the standard award term in this subpart in all awards funded in whole or in part with Recovery Act funds, except for those that are classified, awarded to individuals, or awarded under mandatory and entitlement programs, except as specifically required by OMB, or expressly exempted from the reporting requirement in the Recovery Act.

§ 176.50 Award term—Reporting and registration requirements under section 1512 of the Recovery Act.

Agencies are responsible for ensuring that their recipients report information required under the Recovery Act in a timely manner. The following award term shall be used by agencies to implement the recipient reporting and registration requirements in section 1512:

(a) This award requires the recipient to complete projects or activities which are funded under the American Recovery and Reinvestment Act of 2009 (Recovery Act) and to report on use of Recovery Act funds provided through this award. Information from these reports will be made available to the public.

(b) The reports are due no later than ten calendar days after each calendar quarter in which the recipient receives the assistance award funded in whole or in part by the Recovery Act.

(c) Recipients and their first-tier recipients must maintain current registrations in the Central Contractor Registration (*http://www.ccr.gov*) at all times during which they have active federal awards funded with Recovery Act funds. A Dun and Bradstreet Data Universal Numbering System (DUNS) Number (*http://www.dnb.com*) is one of the requirements for registration in the Central Contractor Registration.

(d) The recipient shall report the information described in section 1512(c) of the Recovery Act using the reporting instructions and data elements that will be provided online at *http://www.FederalReporting.gov* and ensure that any information that is pre-filled is corrected or updated as needed.

Subpart B—Buy American Requirement Under Section 1605 of the American Recovery and Reinvestment Act of 2009

§ 176.60 Statutory requirement.

Section 1605 of the Recovery Act prohibits use of recovery funds 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 law requires that this prohibition be applied in a manner consistent with U.S. obligations under international agreements, and it provides for waiver under three circumstances:

(a) Iron, steel, or relevant manufactured goods are not produced in the United States in sufficient and reasonably available quantities and of a satisfactory quality;

(b) Inclusion of iron, steel, or manufactured goods produced in the United States 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.

§ 176.70 Policy.

Except as provided in §176.80 or §176.90—

(a) None of the funds appropriated or otherwise made available by the Recovery Act may be used for a project for the construction, alteration, maintenance, or repair of a public building or public work (see definitions at §§176.140 and 176.160) unless—

(1) The public building or public work is located in the United States; and

(2) All of the iron, steel, and manufactured goods used in the project are produced or manufactured in the United States.

(i) Production in the United States of the iron or steel used in the project requires that all manufacturing processes must take place in the United States, except metallurgical processes involving refinement of steel additives. These requirements do not apply to iron or steel used as components or subcomponents of manufactured goods used in the project.

(ii) There is no requirement 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.

(b) Paragraph (a) of this section shall not apply where the Recovery Act requires the application of alternative Buy American requirements for iron, steel, and manufactured goods.

§ 176.80 Exceptions.

(a) When one of the following exceptions applies in a case or category of cases, the award official may allow the recipient to use foreign iron, steel and/or manufactured goods in the project without regard to the restrictions of section 1605 of the Recovery Act:

(1) *Nonavailability.* The head of the Federal department or agency may determine that the iron, steel or relevant manufactured good is not produced or manufactured in the United States in sufficient and reasonably available commercial quantities of a satisfactory quality. The determinations of non-availability of the articles listed at 48 CFR 25.104(a) and the procedures at 48 CFR 25.103(b)(1) also apply if any of those articles are manufactured goods needed in the project.

(2) *Unreasonable cost.* The head of the Federal department or agency may determine that the cost of domestic iron, steel, or relevant manufactured goods will increase the cost of the overall project by more than 25 percent in accordance with §176.110.

(3) *Inconsistent with public interest.* The head of the Federal department or agency may determine that application of the restrictions of section 1605 of the Recovery Act would be inconsistent with the public interest.

(b) When a determination is made for any of the reasons stated in this section that certain foreign iron, steel, and/or manufactured goods may be used—

(1) The award official shall list the excepted materials in the award; and

(2) The head of the Federal department or agency shall publish a notice in the FEDERAL REGISTER within two weeks after the determination is made, unless the item has already been determined to be domestically nonavailable. A list of items that are not domestically available is at 48 CFR 25.104(a). The FEDERAL REGISTER notice or information from the notice may be posted by OMB to Recovery.gov. The notice shall include—

(i) The title ''Buy American Exception under the American Recovery and Reinvestment Act of 2009'';

(ii) The dollar value and brief description of the project; and

(iii) A detailed written justification as to why the restriction is being waived.

§ 176.90 Acquisitions covered under international agreements.

Section 1605(d) of the Recovery Act provides that the Buy American requirement in section 1605 shall be applied in a manner consistent with U.S. obligations under international agreements.

(a) The Buy American requirement set out in §176.70 shall not be applied where the iron, steel, or manufactured goods used in the project are from a Party to an international agreement,

listed in paragraph (b) of this section, and the recipient is required under an international agreement, described in the appendix to this subpart, to treat the goods and services of that Party the same as domestic goods and services. As of January 1, 2010, this obligation shall only apply to projects with an estimated value of $7,804,000 or more and projects that are not specifically excluded from the application of those agreements.

(b) The international agreements that obligate recipients that are covered under an international agreement to treat the goods and services of a Party the same as domestic goods and services and the respective Parties to the agreements are:

(1) The World Trade Organization Government Procurement Agreement (Aruba, Austria, Belgium, Bulgaria, Canada, Chinese Taipei (Taiwan), Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hong Kong, Hungary, Iceland, Ireland, Israel, Italy, Japan, Korea (Republic of), Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, Netherlands, Norway, Poland, Portugal, Romania, Singapore, Slovak Republic, Slovenia, Spain, Sweden, Switzerland, and United Kingdom);

(2) The following Free Trade Agreements:

(i) Dominican Republic-Central America-United States Free Trade Agreement (Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, Nicaragua);

(ii) North American Free Trade Agreement (NAFTA) (Canada and Mexico);

(iii) United States-Australia Free Trade Agreement;

(iv) United States-Bahrain Free Trade Agreement;

(v) United States-Chile Free Trade Agreement;

(vi) United States-Israel Free Trade Agreement;

(vii) United States-Morocco Free Trade Agreement;

(viii) United States-Oman Free Trade Agreement;

(ix) United States-Peru Trade Promotion Agreement; and

(x) United States-Singapore Free Trade Agreement.

(3) United States-European Communities Exchange of Letters (May 15, 1995): Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovak Republic, Slovenia, Spain, Sweden, and United Kingdom; and

(4) Agreement between the Government of Canada and the Government of the United States of America on Government Procurement.

[74 FR 18450, Apr. 23, 2009, as amended at 75 FR 14323, Mar. 25, 2010]

§ 176.100 Timely determination concerning the inapplicability of section 1605 of the Recovery Act.

(a) The head of the Federal department or agency involved may make a determination regarding inapplicability of section 1605 to a particular case or to a category of cases.

(b) Before Recovery Act funds are awarded by the Federal agency or obligated by the recipient for a project for the construction, alteration, maintenance, or repair of a public building or public work, an applicant or recipient may request from the award official a determination concerning the inapplicability of section 1605 of the Recovery Act for specifically identified items.

(c) The time for submitting the request and the information and supporting data that must be included in the request are to be specified in the agency's and recipient's request for applications and/or proposals, and as appropriate, in other written communications. The content of those communications should be consistent with the notice in § 176.150 or § 176.170, whichever applies.

(d) The award official must evaluate all requests based on the information provided and may supplement this information with other readily available information.

(e) In making a determination based on the increased cost to the project of using domestic iron, steel, and/or manufactured goods, the award official must compare the total estimated cost of the project using foreign iron, steel and/or relevant manufactured goods to the estimated cost if all domestic iron, steel, and/or relevant manufactured goods were used. If use of domestic iron, steel, and/or relevant manufactured goods would increase the cost of the overall project by more than 25 percent, then the award official shall determine that the cost of the domestic iron, steel, and/or relevant manufactured goods is unreasonable.

§ 176.110 Evaluating proposals of foreign iron, steel, and/or manufactured goods.

(a) If the award official receives a request for an exception based on the cost of certain domestic iron, steel, and/or manufactured goods being unreasonable, in accordance with § 176.80, then the award official shall apply evaluation factors to the proposal to use such foreign iron, steel, and/or manufactured goods as follows:

(1) Use an evaluation factor of 25 percent, applied to the total estimated cost of the project, if the foreign iron, steel, and/or manufactured goods are to be used in the project based on an exception for unreasonable cost requested by the applicant.

(2) Total evaluated cost = project cost estimate + (.25 × project cost estimate, if paragraph (a)(1) of this section applies).

(b) Applicants or recipients also may submit alternate proposals based on use of equivalent domestic iron, steel, and/or manufactured goods to avoid possible denial of Recovery Act funding for the proposal if the Federal Government determines that an exception permitting use of the foreign item(s) does not apply.

(c) If the award official makes an award to an applicant that proposed foreign iron, steel, and/or manufactured goods not listed in the applicable notice in the request for applications or proposals, then the award official must add the excepted materials to the list in the award term.

§ 176.120 Determinations on late requests.

(a) If a recipient requests a determination regarding the inapplicability of section 1605 of the Recovery Act after obligating Recovery Act funds for a project for construction, alteration, maintenance, or repair (late request), the recipient must explain why it could not request the determination before making the obligation or why the need for such determination otherwise was not reasonably foreseeable. If the award official concludes that the recipient should have made the request before making the obligation, the award official may deny the request.

(b) The award official must base evaluation of any late request for a determination regarding the inapplicability of section 1605 of the Recovery Act on information required by § 176.150(c) and (d) or § 176.170(c) and (d) and/or other readily available information.

(c) If a determination, under § 176.80 is made after Recovery Act funds were obligated for a project for construction, alteration, maintenance, or repair that an exception to section 1605 of the Recovery Act applies, the award official must amend the award to allow use of the foreign iron, steel, and/or relevant manufactured goods. When the basis of the exception is nonavailability or public interest, the amended award shall reflect adjustment of the award amount, redistribution of budgeted funds, and/or other appropriate actions taken to cover costs associated with acquiring or using the foreign iron, steel, and/or manufactured goods. When the basis for the exception is the unreasonable cost of domestic iron, steel, and/or manufactured goods the award official shall adjust the award amount or the budget, as appropriate, by at least the differential established in § 176.110(a).

§ 176.130 Noncompliance.

The award official must—

(a) Review allegations of violations of section 1605 of the Recovery Act;

(b) Unless fraud is suspected, notify the recipient of the apparent unauthorized use of foreign iron, steel, and/or manufactured goods and request a reply, to include proposed corrective action; and

(c) If the review reveals that a recipient or subrecipient has used foreign iron, steel, and/or manufactured goods without authorization, take appropriate action, including one or more of the following:

(1) Process a determination concerning the inapplicability of section

1605 of the Recovery Act in accordance with § 176.120.

(2) Consider requiring the removal and replacement of the unauthorized foreign iron, steel, and/or manufactured goods.

(3) If removal and replacement of foreign iron, steel, and/or manufactured goods used in a public building or a public work would be impracticable, cause undue delay, or otherwise be detrimental to the interests of the Federal Government, the award official may determine in writing that the foreign iron, steel, and/or manufactured goods need not be removed and replaced. A determination to retain foreign iron, steel, and/or manufactured goods does not constitute a determination that an exception to section 1605 of the Recovery Act applies, and this should be stated in the determination. Further, a determination to retain foreign iron, steel, and/or manufactured goods does not affect the Federal Government's right to reduce the amount of the award by the cost of the steel, iron, or manufactured goods that are used in the project or to take enforcement or termination action in accordance with the agency's grants management regulations.

(4) If the noncompliance is sufficiently serious, consider exercising appropriate remedies, such as withholding cash payments pending correction of the deficiency, suspending or terminating the award, and withholding further awards for the project. Also consider preparing and forwarding a report to the agency suspending or debarring official in accordance with the agency's debarment rule implementing 2 CFR part 180. If the noncompliance appears to be fraudulent, refer the matter to other appropriate agency officials, such as the officer responsible for criminal investigation.

§ 176.140 Award term—Required Use of American Iron, Steel, and Manufactured Goods—Section 1605 of the American Recovery and Reinvestment Act of 2009.

When awarding Recovery Act funds for construction, alteration, maintenance, or repair of a public building or public work that does not involve iron, steel, and/or manufactured goods covered under international agreements, the agency shall use the award term described in the following paragraphs:

(a) *Definitions.* As used in this award term and condition—

(1) *Manufactured good* means a good brought to the construction site for incorporation into the building or work that has been—

(i) Processed into a specific form and shape; or

(ii) Combined with other raw material to create a material that has different properties than the properties of the individual raw materials.

(2) *Public building and public work* means a public building of, and a public work of, a governmental entity (the United States; the District of Columbia; commonwealths, territories, and minor outlying islands of the United States; State and local governments; and multi-State, regional, or interstate entities which have governmental functions). These buildings and works may include, without limitation, bridges, dams, plants, highways, parkways, streets, subways, tunnels, sewers, mains, power lines, pumping stations, heavy generators, railways, airports, terminals, docks, piers, wharves, ways, lighthouses, buoys, jetties, breakwaters, levees, and canals, and the construction, alteration, maintenance, or repair of such buildings and works.

(3) *Steel* means an alloy that includes at least 50 percent iron, between .02 and 2 percent carbon, and may include other elements.

(b) *Domestic preference.* (1) This award term and condition implements Section 1605 of the American Recovery and Reinvestment Act of 2009 (Recovery Act) (Pub. L. 111–5), by requiring that all iron, steel, and manufactured goods used in the project are produced in the United States except as provided in paragraph (b)(3) and (b)(4) of this section and condition.

(2) This requirement does not apply to the material listed by the Federal Government as follows:

[*Award official to list applicable excepted materials or indicate "none"*]

(3) The award official may add other iron, steel, and/or manufactured goods to the list in paragraph (b)(2) of this section and condition if the Federal Government determines that—

(i) The cost of the domestic iron, steel, and/or manufactured goods would be unreasonable. The cost of domestic iron, steel, or manufactured goods used in the project is unreasonable when the cumulative cost of such material will increase the cost of the overall project by more than 25 percent;

(ii) The iron, steel, and/or manufactured good is not produced, or manufactured in the United States in sufficient and reasonably available quantities and of a satisfactory quality; or

(iii) The application of the restriction of section 1605 of the Recovery Act would be inconsistent with the public interest.

(c) *Request for determination of inapplicability of Section 1605 of the Recovery Act.* (1)(i) Any recipient request to use foreign iron, steel, and/or manufactured goods in accordance with paragraph (b)(3) of this section shall include adequate information for Federal Government evaluation of the request, including—

(A) A description of the foreign and domestic iron, steel, and/or manufactured goods;

(B) Unit of measure;

(C) Quantity;

(D) Cost;

(E) Time of delivery or availability;

(F) Location of the project;

(G) Name and address of the proposed supplier; and

(H) A detailed justification of the reason for use of foreign iron, steel, and/or manufactured goods cited in accordance with paragraph (b)(3) of this section.

(ii) A request based on unreasonable cost shall include a reasonable survey of the market and a completed cost comparison table in the format in paragraph (d) of this section.

(iii) The cost of iron, steel, and/or manufactured goods material shall include all delivery costs to the construction site and any applicable duty.

(iv) Any recipient request for a determination submitted after Recovery Act funds have been obligated for a project for construction, alteration, maintenance, or repair shall explain why the recipient could not reasonably foresee the need for such determination and could not have requested the determination before the funds were obligated. If the recipient does not submit a satisfactory explanation, the award official need not make a determination.

(2) If the Federal Government determines after funds have been obligated for a project for construction, alteration, maintenance, or repair that an exception to section 1605 of the Recovery Act applies, the award official will amend the award to allow use of the foreign iron, steel, and/or relevant manufactured goods. When the basis for the exception is nonavailability or public interest, the amended award shall reflect adjustment of the award amount, redistribution of budgeted funds, and/or other actions taken to cover costs associated with acquiring or using the foreign iron, steel, and/or relevant manufactured goods. When the basis for the exception is the unreasonable cost of the domestic iron, steel, or manufactured goods, the award official shall adjust the award amount or redistribute budgeted funds by at least the differential established in 2 CFR 176.110(a).

(3) Unless the Federal Government determines that an exception to section 1605 of the Recovery Act applies, use of foreign iron, steel, and/or manufactured goods is noncompliant with section 1605 of the American Recovery and Reinvestment Act.

(d) *Data.* To permit evaluation of requests under paragraph (b) of this section based on unreasonable cost, the Recipient shall include the following information and any applicable supporting data based on the survey of suppliers:

FOREIGN AND DOMESTIC ITEMS COST COMPARISON

Description	Unit of measure	Quantity	Cost (dollars)*
Item 1:			
Foreign steel, iron, or manufactured good			
Domestic steel, iron, or manufactured good			

FOREIGN AND DOMESTIC ITEMS COST COMPARISON—Continued

Description	Unit of measure	Quantity	Cost (dollars)*
Item 2:			
Foreign steel, iron, or manufactured good			
Domestic steel, iron, or manufactured good			

[List name, address, telephone number, email address, and contact for suppliers surveyed. Attach copy of response; if oral, attach summary.]
[Include other applicable supporting information.]
*[*Include all delivery costs to the construction site.]*

§ 176.150 Notice of Required Use of American Iron, Steel, and Manufactured Goods—Section 1605 of the American Recovery and Reinvestment Act of 2009.

When requesting applications or proposals for Recovery Act programs or activities that may involve construction, alteration, maintenance, or repair of a public building or public work, and do not involve iron, steel, and/or manufactured goods covered under international agreements, the agency shall use the notice described in the following paragraphs in their solicitations:

(a) *Definitions.* Manufactured good, public building and public work, and steel, as used in this notice, are defined in the 2 CFR 176.140.

(b) *Requests for determinations of inapplicability.* A prospective applicant requesting a determination regarding the inapplicability of section 1605 of the American Recovery and Reinvestment Act of 2009 (Pub. L. 111–5) (Recovery Act) should submit the request to the award official in time to allow a determination before submission of applications or proposals. The prospective applicant shall include the information and applicable supporting data required by paragraphs at 2 CFR 176.140(c) and (d) in the request. If an applicant has not requested a determination regarding the inapplicability of 1605 of the Recovery Act before submitting its application or proposal, or has not received a response to a previous request, the applicant shall include the information and supporting data in the application or proposal.

(c) *Evaluation of project proposals.* If the Federal Government determines that an exception based on unreasonable cost of domestic iron, steel, and/or manufactured goods applies, the Federal Government will evaluate a project requesting exception to the requirements of section 1605 of the Recovery Act by adding to the estimated total cost of the project 25 percent of the project cost, if foreign iron, steel, or manufactured goods are used in the project based on unreasonable cost of comparable manufactured domestic iron, steel, and/or manufactured goods.

(d) *Alternate project proposals.* (1) When a project proposal includes foreign iron, steel, and/or manufactured goods not listed by the Federal Government at 2 CFR 176.140(b)(2), the applicant also may submit an alternate proposal based on use of equivalent domestic iron, steel, and/or manufactured goods.

(2) If an alternate proposal is submitted, the applicant shall submit a separate cost comparison table prepared in accordance with 2 CFR 176.140(c) and (d) for the proposal that is based on the use of any foreign iron, steel, and/or manufactured goods for which the Federal Government has not yet determined an exception applies.

(3) If the Federal Government determines that a particular exception requested in accordance with 2 CFR 176.140(b) does not apply, the Federal Government will evaluate only those proposals based on use of the equivalent domestic iron, steel, and/or manufactured goods, and the applicant shall be required to furnish such domestic items.

§ 176.160 Award term—Required Use of American Iron, Steel, and Manufactured Goods (covered under International Agreements)—Section 1605 of the American Recovery and Reinvestment Act of 2009.

When awarding Recovery Act funds for construction, alteration, maintenance, or repair of a public building or public work that involves iron, steel,

and/or manufactured goods materials covered under international agreements, the agency shall use the award term described in the following paragraphs:

(a) *Definitions.* As used in this award term and condition—

Designated country—(1) A World Trade Organization Government Procurement Agreement country (Aruba, Austria, Belgium, Bulgaria, Canada, Chinese Taipei (Taiwan), Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hong Kong, Hungary, Iceland, Ireland, Israel, Italy, Japan, Korea (Republic of), Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, Netherlands, Norway, Poland, Portugal, Romania, Singapore, Slovak Republic, Slovenia, Spain, Sweden, Switzerland, and United Kingdom;

(2) A Free Trade Agreement (FTA) country (Australia, Bahrain, Canada, Chile, Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, Israel, Mexico, Morocco, Nicaragua, Oman, Peru, or Singapore);

(3) A United States-European Communities Exchange of Letters (May 15, 1995) country: Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovak Republic, Slovenia, Spain, Sweden, and United Kingdom; or

(4) An Agreement between Canada and the United States of America on Government Procurement country (Canada).

Designated country iron, steel, and/or manufactured goods—(1) Is wholly the growth, product, or manufacture of a designated country; or

(2) In the case of a manufactured good that consist in whole or in part of materials from another country, has been substantially transformed in a designated country into a new and different manufactured good distinct from the materials from which it was transformed.

Domestic iron, steel, and/or manufactured good—(1) Is wholly the growth, product, or manufacture of the United States; or

(2) In the case of a manufactured good that consists in whole or in part of materials from another country, has been substantially transformed in the United States into a new and different manufactured good distinct from the materials from which it was transformed. There is no requirement with regard to the origin of components or subcomponents in manufactured goods or products, as long as the manufacture of the goods occurs in the United States.

Foreign iron, steel, and/or manufactured good means iron, steel and/or manufactured good that is not domestic or designated country iron, steel, and/or manufactured good.

Manufactured good means a good brought to the construction site for incorporation into the building or work that has been—

(1) Processed into a specific form and shape; or

(2) Combined with other raw material to create a material that has different properties than the properties of the individual raw materials.

Public building and *public work* means a public building of, and a public work of, a governmental entity (the United States; the District of Columbia; commonwealths, territories, and minor outlying islands of the United States; State and local governments; and multi-State, regional, or interstate entities which have governmental functions). These buildings and works may include, without limitation, bridges, dams, plants, highways, parkways, streets, subways, tunnels, sewers, mains, power lines, pumping stations, heavy generators, railways, airports, terminals, docks, piers, wharves, ways, lighthouses, buoys, jetties, breakwaters, levees, and canals, and the construction, alteration, maintenance, or repair of such buildings and works.

Steel means an alloy that includes at least 50 percent iron, between .02 and 2 percent carbon, and may include other elements.

(b) *Iron, steel, and manufactured goods.* (1) The award term and condition described in this section implements—

(i) Section 1605(a) of the American Recovery and Reinvestment Act of 2009 (Pub. L. 111–5) (Recovery Act), by requiring that all iron, steel, and manufactured goods used in the project are produced in the United States; and

(ii) Section 1605(d), which requires application of the Buy American requirement in a manner consistent with U.S. obligations under international agreements. The restrictions of section 1605 of the Recovery Act do not apply to designated country iron, steel, and/or manufactured goods. The Buy American requirement in section 1605 shall not be applied where the iron, steel or manufactured goods used in the project are from a Party to an international agreement that obligates the recipient to treat the goods and services of that Party the same as domestic goods and services. As of January 1, 2010, this obligation shall only apply to projects with an estimated value of $7,804,000 or more.

(2) The recipient shall use only domestic or designated country iron, steel, and manufactured goods in performing the work funded in whole or part with this award, except as provided in paragraphs (b)(3) and (b)(4) of this section.

(3) The requirement in paragraph (b)(2) of this section does not apply to the iron, steel, and manufactured goods listed by the Federal Government as follows:

[*Award official to list applicable excepted materials or indicate "none"*]

(4) The award official may add other iron, steel, and manufactured goods to the list in paragraph (b)(3) of this section if the Federal Government determines that—

(i) The cost of domestic iron, steel, and/or manufactured goods would be unreasonable. The cost of domestic iron, steel, and/or manufactured goods used in the project is unreasonable when the cumulative cost of such material will increase the overall cost of the project by more than 25 percent;

(ii) The iron, steel, and/or manufactured good is not produced, or manufactured in the United States in sufficient and reasonably available commercial quantities of a satisfactory quality; or

(iii) The application of the restriction of section 1605 of the Recovery Act would be inconsistent with the public interest.

(c) *Request for determination of inapplicability of section 1605 of the Recovery Act or the Buy American Act.* (1)(i) Any recipient request to use foreign iron, steel, and/or manufactured goods in accordance with paragraph (b)(4) of this section shall include adequate information for Federal Government evaluation of the request, including—

(A) A description of the foreign and domestic iron, steel, and/or manufactured goods;

(B) Unit of measure;

(C) Quantity;

(D) Cost;

(E) Time of delivery or availability;

(F) Location of the project;

(G) Name and address of the proposed supplier; and

(H) A detailed justification of the reason for use of foreign iron, steel, and/or manufactured goods cited in accordance with paragraph (b)(4) of this section.

(ii) A request based on unreasonable cost shall include a reasonable survey of the market and a completed cost comparison table in the format in paragraph (d) of this section.

(iii) The cost of iron, steel, or manufactured goods shall include all delivery costs to the construction site and any applicable duty.

(iv) Any recipient request for a determination submitted after Recovery Act funds have been obligated for a project for construction, alteration, maintenance, or repair shall explain why the recipient could not reasonably foresee the need for such determination and could not have requested the determination before the funds were obligated. If the recipient does not submit a satisfactory explanation, the award official need not make a determination.

(2) If the Federal Government determines after funds have been obligated for a project for construction, alteration, maintenance, or repair that an exception to section 1605 of the Recovery Act applies, the award official will amend the award to allow use of the foreign iron, steel, and/or relevant manufactured goods. When the basis for the exception is nonavailability or public interest, the amended award shall reflect adjustment of the award amount, redistribution of budgeted

funds, and/or other appropriate actions taken to cover costs associated with acquiring or using the foreign iron, steel, and/or relevant manufactured goods. When the basis for the exception is the unreasonable cost of the domestic iron, steel, or manufactured goods, the award official shall adjust the award amount or redistribute budgeted funds, as appropriate, by at least the differential established in 2 CFR 176.110(a).

(3) Unless the Federal Government determines that an exception to section 1605 of the Recovery Act applies, use of foreign iron, steel, and/or manufactured goods other than designated country iron, steel, and/or manufactured goods is noncompliant with the applicable Act.

(d) *Data.* To permit evaluation of requests under paragraph (b) of this section based on unreasonable cost, the applicant shall include the following information and any applicable supporting data based on the survey of suppliers:

FOREIGN AND DOMESTIC ITEMS COST COMPARISON

Description	Unit of measure	Quantity	Cost (dollars)*
Item 1:			
Foreign steel, iron, or manufactured good			
Domestic steel, iron, or manufactured good			
Item 2:			
Foreign steel, iron, or manufactured good			
Domestic steel, iron, or manufactured good			

[List name, address, telephone number, email address, and contact for suppliers surveyed. Attach copy of response; if oral, attach summary.]
[Include other applicable supporting information.]
*[*Include all delivery costs to the construction site.]*

[74 FR 18450, Apr. 23, 2009, as amended at 75 FR 14323, Mar. 25, 2010]

§ 176.170 Notice of Required Use of American Iron, Steel, and Manufactured Goods (covered under International Agreements)—Section 1605 of the American Recovery and Reinvestment Act of 2009.

When requesting applications or proposals for Recovery Act programs or activities that may involve construction, alteration, maintenance, or repair of a public building or public work, and involve iron, steel, and/or manufactured goods covered under international agreements, the agency shall use the notice described in the following paragraphs in the solicitation:

(a) *Definitions. Designated country iron, steel, and/or manufactured goods, foreign iron, steel, and/or manufactured good, manufactured good, public building* and *public work*, and *steel*, as used in this provision, are defined in 2 CFR 176.160(a).

(b) *Requests for determinations of inapplicability.* A prospective applicant requesting a determination regarding the inapplicability of section 1605 of the American Recovery and Reinvestment Act of 2009 (Pub. L. 111–5) (Recovery Act) should submit the request to the award official in time to allow a determination before submission of applications or proposals. The prospective applicant shall include the information and applicable supporting data required by 2 CFR 176.160 (c) and (d) in the request. If an applicant has not requested a determination regarding the inapplicability of section 1605 of the Recovery Act before submitting its application or proposal, or has not received a response to a previous request, the applicant shall include the information and supporting data in the application or proposal.

(c) *Evaluation of project proposals.* If the Federal Government determines that an exception based on unreasonable cost of domestic iron, steel, and/or manufactured goods applies, the Federal Government will evaluate a project requesting exception to the requirements of section 1605 of the Recovery Act by adding to the estimated total cost of the project 25 percent of the project cost if foreign iron, steel, or manufactured goods are used based on

unreasonable cost of comparable domestic iron, steel, or manufactured goods.

(d) *Alternate project proposals.* (1) When a project proposal includes foreign iron, steel, and/or manufactured goods, other than designated country iron, steel, and/or manufactured goods, that are not listed by the Federal Government in this Buy American notice in the request for applications or proposals, the applicant may submit an alternate proposal based on use of equivalent domestic or designated country iron, steel, and/or manufactured goods.

(2) If an alternate proposal is submitted, the applicant shall submit a separate cost comparison table prepared in accordance with paragraphs 2 CFR 176.160(c) and (d) for the proposal that is based on the use of any foreign iron, steel, and/or manufactured goods for which the Federal Government has not yet determined an exception applies.

(3) If the Federal Government determines that a particular exception requested in accordance with 2 CFR 176.160(b) does not apply, the Federal Government will evaluate only those proposals based on use of the equivalent domestic or designated country iron, steel, and/or manufactured goods, and the applicant shall be required to furnish such domestic or designated country items.

APPENDIX TO SUBPART B OF 2 CFR PART 176—U.S. STATES, OTHER SUB-FEDERAL ENTITIES, AND OTHER ENTITIES SUBJECT TO U.S. OBLIGATIONS UNDER INTERNATIONAL AGREEMENTS (AS OF FEBRUARY 16, 2010)

States	Entities covered	Exclusions	Relevant international agreements
Arizona	Executive branch agencies		—WTO GPA. —U.S.-Chile FTA. —U.S.-Singapore FTA.
Arkansas	Executive branch agencies, including universities but excluding the Office of Fish and Game.	Construction services	—WTO GPA. —DR-CAFTA. —U.S.-Australia FTA. —U.S.-Chile FTA. —U.S.-Morocco FTA. —U.S.-Peru TPA. —U.S.-Singapore FTA.
California	Executive branch agencies		—WTO GPA. —U.S.-Australia FTA. —U.S.-Chile FTA. —U.S.-Singapore FTA.
Colorado	Executive branch agencies		—WTO GPA. —DR-CAFTA. —U.S.-Australia FTA. —U.S.-Chile FTA. —U.S.-Morocco FTA. —U.S.-Peru TPA. —U.S.-Singapore FTA.
Connecticut	—Department of Administrative Services —Department of Transportation.. —Department of Public Works.. —Constituent Units of Higher Education.		—WTO GPA. —DR-CAFTA. —U.S.-Australia FTA. —U.S.-Chile FTA. —U.S.-Morocco FTA. —U.S.-Singapore FTA.
Delaware	—Administrative Services (Central Procurement Agency). —State Universities. —State Colleges.	Construction-grade steel (including requirements on subcontracts); motor vehicles; coal.	—WTO GPA. —DR-CAFTA (except Honduras). —U.S.-Australia FTA. —U.S.-Chile FTA. —U.S.-Morocco FTA. —U.S.-Singapore FTA.
Florida	Executive branch agencies	Construction-grade steel (including requirements on subcontracts); motor vehicles; coal.	—WTO GPA. —DR-CAFTA. —U.S.-Australia FTA. —U.S.-Chile FTA. —U.S.-Morocco FTA. —U.S.-Peru TPA. —U.S.-Singapore FTA.

States	Entities covered	Exclusions	Relevant international agreements
Georgia	—Department of Administrative Services. —Georgia Technology Authority.	Beef; compost; mulch	—U.S.-Australia FTA.
Hawaii	Department of Accounting and General Services.	Software developed in the State; construction.	—WTO GPA. —DR-CAFTA (except Honduras). —U.S.-Australia FTA. —U.S.-Chile FTA. —U.S.-Morocco FTA. —U.S.-Singapore FTA.
Idaho	Central Procurement Agency (including all colleges and universities subject to central purchasing oversight).		—WTO GPA. —DR-CAFTA (except Honduras). —U.S.-Australia FTA. —U.S.-Chile FTA. —U.S.-Morocco FTA. —U.S.-Singapore FTA.
Illinois	—Department of Central Management Services.	Construction-grade steel (including requirements on subcontracts); motor vehicles; coal.	—WTO GPA. —U.S.-Australia FTA. —U.S.-Chile FTA. —U.S.-Peru TPA. —U.S.-Singapore FTA. —U.S.-EC. Exchange of Letters (applies to EC Member States for procurement not covered by WTO GPA and only where the State considers out-of-State suppliers).
Iowa	—Department of General Services —Department of Transportation. —Board of Regents' Institutions (universities).	Construction-grade steel (including requirements on subcontracts); motor vehicles; coal.	—WTO GPA. —U.S.-Chile FTA. —U.S.-Singapore FTA.
Kansas	Executive branch agencies	Construction services; automobiles; aircraft.	—WTO GPA. —U.S.-Australia FTA. —U.S.-Chile FTA. —U.S.-Morocco FTA. —U.S.-Singapore FTA.
Kentucky	Division of Purchases, Finance and Administration Cabinet.	Construction projects	—WTO GPA. —DR-CAFTA. —U.S.-Australia FTA. —U.S.-Chile FTA. —U.S.-Morocco FTA. —U.S.-Singapore FTA.
Louisiana	Executive branch agencies		—WTO GPA. —DR-CAFTA. —U.S.-Australia FTA. —U.S.-Chile FTA. —U.S.-Morocco FTA. —U.S.-Singapore FTA.
Maine	—Department of Administrative and Financial Services —Bureau of General Services (covering State government agencies and school construction). — Department of Transportation..	Construction-grade steel (including requirements on subcontracts); motor vehicles; coal.	—WTO GPA. —U.S.-Australia FTA. —U.S.-Chile FTA. —U.S.-Singapore FTA.

■ a. Revising the date of the clause to read "(Oct 2010)";
■ b. Removing from paragraph (e)(1)(v) "accurate cost" and adding "accurate certified cost" in its place;
■ c. Removing from paragraph (e)(1)(vii)(C) "reason cost" and adding "reason certified cost" in its place; and
■ d. Removing from paragraphs (e)(1)(vii)(D) and (e)(1)(vii)(E) "subcontractor's cost" and adding "subcontractor's certified cost" in its place.

[FR Doc. 2010–21026 Filed 8–27–10; 8:45 am]
BILLING CODE 6820–EP–P

DEPARTMENT OF DEFENSE

GENERAL SERVICES ADMINISTRATION

NATIONAL AERONAUTICS AND SPACE ADMINISTRATION

48 CFR Parts 2, 5, 25, and 52

[FAC 2005–45; FAR Case 2009–008; Item III; Docket 2009–0008, Sequence 1]

RIN 9000–AL22

Federal Acquisition Regulation; American Recovery and Reinvestment Act of 2009 (the Recovery Act)—Buy American Requirements for Construction Material

AGENCIES: Department of Defense (DoD), General Services Administration (GSA), and National Aeronautics and Space Administration (NASA).

ACTION: Final rule.

SUMMARY: The Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council (the Councils) have adopted as final, with changes, an interim rule amending the Federal Acquisition Regulation (FAR) to implement the American Recovery and Reinvestment Act of 2009 (Recovery Act) with respect to the "Buy American—Recovery Act" provision, section 1605 in Division A.

DATES: *Effective Date:* October 1, 2010.

Applicability Date: The rule applies to solicitations issued and contracts awarded on or after the effective date of this rule. Contracting officers shall modify, on a bilateral basis, in accordance with FAR 1.108(d)(3), existing contracts to include the appropriate FAR clause for future work, if Recovery Act funds will be used. In the event that a contractor refuses to accept such a modification, the contractor will not be eligible for award of any work that uses Recovery Act funds.

FOR FURTHER INFORMATION CONTACT: For clarification of content, contact Ms. Cecelia L. Davis, Procurement Analyst, at (202) 219–0202. For information pertaining to status or publication schedules, contact the Regulatory Secretariat at (202) 501–4755. Please cite FAC 2005–45, FAR case 2009–008.

SUPPLEMENTARY INFORMATION:

A. Background

This final rule implements the unique "Buy American—Recovery Act" provision, section 1605 of the Recovery Act, by revising FAR subpart 25.6, and related provisions and clauses at FAR part 52, with conforming changes to FAR subparts 2.1, 5.2, 25.0, and 25.11. An interim rule was published in the **Federal Register** at 74 FR 14623, March 31, 2009. The public comment period ended June 1, 2009.

As required by section 1605, the final rule makes it clear that there will be full compliance with U.S. obligations under all international trade agreements when undertaking construction covered by such agreements with Recovery Act funds. The new required provisions and clauses implement U.S. obligations under our trade agreements in the same way as they are currently implemented in non-Recovery Act construction contracts. The Caribbean Basin countries are excluded from the definition of "Recovery Act designated country," because the treatment provided to them is not as a result of a U.S. international obligation.

B. Discussion and Analysis

The Regulatory Secretariat received 35 responses, but 2 responses lacked attached comments and 1 response appeared unrelated to the case. The responses included multiple comments on a wide range of issues addressed in the interim rule. Each issue is discussed by topic in the following sections.

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1. Comments on Section 1605 of the Recovery Act

Comments: Although the respondents expressed general support for the goals of the Recovery Act to stimulate the U.S. economy, many were concerned about the Recovery Act Buy American restrictions of section 1605. For example:

Several entities representing other countries objected to the potential restrictions on trade. They alleged that the Recovery Act Buy American requirement in section 1605 is not in conformity with the U.S. pledge to refrain from raising new barriers in the framework of the Summit on Financial Markets and the World Economy, November 2008, and the G20 pledge, April 2009. They alleged that it will have a negative impact on the world trade and economy. One respondent stated that it is not rational for the U.S. to take trade protection actions such as the "Buy American—Recovery Act" provision, because it will not be useful for the American and global economy in promoting recovery from the current downturn. Another respondent stated that, to the extent 1605 imposes more restrictive requirements than previously existed, it represents a new barrier to trade in goods between the United States and Canada. One respondent found several aspects of section 1605 problematic because of their "inherent lack of clarity."

Some United States industry associations also had concerns about section 1605. One objected that the real-life burdens of complying with these country-of-origin requirements cannot be overstated. This respondent concluded that, where the U.S. Government places a premium on

promoting its important socio-economic goals, this requires companies interested in selling in the Federal marketplace to segregate their inventories based on country of origin and implement costly compliance regimes. Another respondent noted a risk that the Recovery Act Buy American provisions may have numerous unintended consequences on the United States and harm American workers and companies and the global economy. A third respondent commented that "Congress' well-meaning intentions, like all protectionist measures, could inadvertently hurt the downstream U.S. users."

Response: Comments on the merits of section 1605 of the Recovery Act are outside the scope of this case, because the Councils cannot change the law.

This final rule is focused on the optimal implementation of section 1605 in the FAR, *i.e.,* the Councils have attempted to find the balance between domestic-sourcing requirements and simplicity and clarity of implementation, so that the rule does not become so onerous that it does more harm than good to U.S. industry.

2. Applicability of Section 1605 of the Recovery Act

a. Relation to the Buy American Act

There are two main issues raised by respondents with regard to the applicability of the Buy American Act in contracts funded with Recovery Act funds.

i. Does the Buy American Act apply to manufactured construction material used in Recovery Act projects?

Comments: A few respondents contended that the Buy American Act still applies to goods covered by section 1605 of the Recovery Act—that both standards must be met. These respondents objected that the interim rule deviated from existing law and regulations that should still govern the purchase of goods covered by the Recovery Act. According to these respondents, any final rule must, at a minimum, preserve the basic requirements of assembly in the United States and the 51 percent domestic component rule, because the Buy American Act still applies. Another respondent claimed that this rule cannot waive the Buy American Act's component test without additional authority.

Response: The Recovery Act sets out specific domestic source restrictions for iron, steel, and manufactured goods incorporated into Recovery Act construction projects. In many ways, these restrictions mirror the Buy American Act, but there are specific differences (no component test, different standards for unreasonable cost, no exception for impracticable, etc.). The Councils and OMB determined that it was reasonable to interpret section 1605 as including all of the "Buy American—Recovery Act" restrictions that Congress intended to apply to iron, steel, and manufactured goods covered by the Recovery Act, *i.e.,* these goods are not also covered by the Buy American Act. Since Congress was clearly aware of the Buy American Act when creating the Recovery Act domestic source restrictions and exceptions, if Congress had wanted the component test or other aspects of the Buy American Act to apply, they would have included them. Congress incorporated those aspects of the Buy American Act that they wanted to apply, and excluded or modified those aspects that they did not want to apply. The Councils have determined that section 1605 of the Recovery Act supersedes the Buy American Act with regard to the acquisition of manufactured construction materials used on a project funded with Recovery Act funds. Therefore, the component test does not apply to construction material used in projects funded by the Recovery Act.

ii. Does the Buy American Act apply to unmanufactured construction material used in Recovery Act projects?

Comments: Several non-U.S. respondents objected that the interim rule applies the Buy American Act to unmanufactured construction material. One of them stated that the interim rule has expanded the scope of the Recovery Act by way of arbitrary interpretation and constitutes an unjustified limitation of the use of foreign unmanufactured construction materials, given that the use of foreign unmanufactured construction materials is not prohibited by the Recovery Act. A respondent believed that "statutory authority does not exist to extend the provisions required by section 1605 to unmanufactured goods" and asked that this be struck from the final rule. Another objected that the additional 6 percent evaluation factor applied to unmanufactured construction material is only stipulated in the FAR, and should not be permitted under the spirit of the "G20 Statement."

Response: Section 1605 did not address unmanufactured construction material. The interim rule coverage of unmanufactured construction material is not based on extending the coverage of section 1605, but on continuing to apply the Buy American Act to that material not covered by the Recovery Act.

b. Applicability to Construction Projects/Contracts

i. How To Identify a "Construction" Contract

Comments: A respondent wanted to know whether the contracting agency will be required to affirmatively stipulate whether a contract is considered a "construction" contract and require that this language be flowed down to subcontractors.

Response: Construction contracts are easily identifiable by the presence of construction provisions and clauses in the solicitation and contract, such as the clauses prescribed in FAR subpart 36.5 as well as the Buy American Act provisions and clauses for construction contracts in FAR clauses 52.225–9 through 52.225–12 or now the Recovery Act Buy American, FAR provisions at 52.225–21 through 52.225–24. It is the responsibility of the prime contractor to comply with contract clauses and impose on subcontractors whatever conditions are necessary to enable the prime contractor to meet the contract requirements.

ii. Use of terms "contract" and "project"

Comments: Two respondents contended that the interim rule is unclear in several places regarding the scope of coverage because the terms "projects" and "contracts" appear to be used interchangeably.

- FAR 25.602(a) states that "None of the funds appropriated or otherwise made available by the Recovery Act may be used for a project for the construction, alteration, maintenance or repair of a public building or public work * * *"
- FAR 25.603(c), implementing the Trade Agreements Act, states that "For construction contracts with an estimated acquisition value * * *"
- FAR 52.225–21(b)(2) states, "The contractor shall use only domestic construction material in performing this contract * * *."

Response: Construction "project" is often a more inclusive term than construction "contract." Large construction projects may involve more than one construction contract. The term "project" may also be used to denote a segment of a contract, if the funds are clearly segregated. To clarify this meaning, the Councils have added a statement in the policy section at FAR 25.602 and also clarified in the provision and clause prescriptions at FAR 25.1102(e)(2) that the contract must indicate if the Recovery Act provision

and clause only apply to certain line items in the contract.

The scope of this rule is established, in accordance with section 1605(a) of the Recovery Act, as applying restrictions to "a project for the construction, alteration, maintenance, or repair of a public building or public work." The final rule has clarified at FAR 25.602 that the agency determines the scope of the project and conveys this to the contractor through the specified applicability of the Recovery Act provision and clause in the contract.

However, the statute can only be implemented through clauses that go into a specific construction contract. Each contract can only impose requirements applicable to that particular contract. Therefore, the term "contract" is used when the interim rule is addressing a requirement that is specific to a contractor or contract, particularly as used in the provisions and clauses.

c. Applicability to Construction Materials or Supplies

i. Equating "Manufactured Goods Used in the Project" to "Construction Material"

Comments: There were many concerns about the interpretation in the interim rule of the applicability of section 1605 to manufactured goods, namely that the rule equates manufactured goods used in the project to construction material.

A respondent contended that the narrow interpretation of manufactured goods "ignores common sense and well-established precedent." According to the respondent, the rule equates manufactured goods to construction material and limits the applicability to construction materials that are incorporated into a public building or work.

Another respondent stated that the rule should apply to all manufactured goods—not just construction materials, contending that manufactured goods "used in the project" means "all hazmat suits, tool belts, masks, tarps, covers, safety straps, construction clothing, gloves, *etc.* purchased by the contractor as part of doing the work."

A respondent stated that regulations for public works projects must require that all manufactured goods, including textile products, must be manufactured in the United States, as intended by the Recovery Act.

On the other hand, a respondent expressed concern that the perceived requirement that all manufactured products on the construction site are covered is proving disastrous for American equipment manufacturers. This respondent stated that construction equipment manufacturers provide the machines that improve operations and reduce costs of any infrastructure project. The process to verify and prove 100 percent U.S. content of each piece of equipment is onerous.

Some respondents expressed support for the Councils' approach in FAR subpart 25.6 of treating iron, steel, and manufactured goods as another way of describing "construction material: As that term has been understood and applied with respect to 41 U.S.C. 10a–10d in FAR subpart 25.2 and its associated clauses."

Response: One of the goals in implementation of the Recovery Act was to make the definitions and procedures as close to existing FAR definitions and procedures as possible, except where differences are required by the Recovery Act.

Therefore, when applied to a construction contract, FAR subpart 25.6 and the associated construction clauses use the standard definition of "construction material" at FAR 25.003 that is familiar to contractors and contracting officers. There is a long series of Government Accountability Office (GAO) decisions and case law that then can be applied without completely starting over. For use in a construction contract, the Councils interpreted "manufactured goods used in the project" to be comparable to the long-standing definition of "construction material" as an "article, material, or supply brought to the construction site by the contractor or a subcontractor for incorporation into the building or work." Review of the existing case law clarifies the many possible nuances relating to construction material and its delivery to the site. Rather than "ignoring well established precedent," the Councils relied on well-established precedent. The FAR has never applied domestic source restrictions to such items as hazmat suits, tool belts, masks, tarps, covers, safety straps, construction clothing, and gloves, which are used in a construction project by the contractor but are not incorporated into the construction project. Further, the interim rule did not apply the Recovery Act Buy American requirement of section 1605 to equipment used at the construction site, because it is not incorporated into the construction project. These items are not deliverables to the Government, but remain the property of the contractor. The contractor may already have purchased these items before commencement of the contract, and may continue to use them on subsequent contracts. Therefore, their purchase is not generally subject to restrictions in the terms of the contract.

ii. Applicability to Supplies Purchased by the Government

Comment: One respondent expressed concern that the interim rule, in the definition of construction material, stated that manufactured goods that are purchased by the Government are supplies and, therefore, excluded from the definition of manufactured goods, as used in section 1605.

Response: The statement that items purchased by the Government are supplies, not construction material, has been a standard part of the definition of construction material for many years. It is a true statement that items purchased by the Government are not "construction material" as it is defined in the FAR. However, section 1605 does require that all manufactured goods incorporated into the project must be produced in the United States, whether purchased by the contractor as construction material or purchased by the Government as an item of supply. If the Government directly purchases manufactured goods and delivers them to the site for incorporation into the project, such material must comply with the "Buy American—Recovery Act" restriction of section 1605, even though it is not construction material as defined in the FAR. The final rule clarifies this in the policy section. Furthermore, for added clarity, the final rule deletes from the definition of "construction material" in FAR clauses 52.225–21 and 52.225–23 the phrase about items purchased by the Government not being construction material, because it appears to cause confusion and because the information about actions the Government may take is not pertinent to the contractor for performance of the construction contract.

iii. Contractor-Purchased Supplies for Delivery to the Government

Comments: A respondent requested that the final rule clarify that, to the extent purchases of supplies made with Recovery Act funds are not covered as construction material, they are subject to normal Buy American Act/Trade Agreements Act requirements.

Response: Contractor-purchased supplies that are for delivery to the Government, not for incorporation into the project, continue to be covered by the pre-existing FAR regulations on the Buy American Act and trade agreements, as applicable. This rule only applies to construction contracts funded with Recovery Act funds or

supplies purchased by the Government for incorporation into the project.

d. Manufacture vs. Substantial Transformation or Tariff Shift

There were many comments on the issue of manufacture and substantial transformation.

i. Buy American Act and Substantial Transformation

Comments: Several respondents believed that the Buy American Act includes a requirement for substantial transformation. One respondent stated that the rule should use the "long-standing definition" of a domestic manufactured good, *i.e.*, final substantial transformation must occur in the United States. Another respondent stated that the Buy American Act of 1933 includes a substantial transformation test. A respondent also stated that the Buy American Act requires substantial transformation in the United States. The respondent was concerned that the interim rule only requires assembly in the United States.

Response: Whether or not the Buy American Act requires "manufacture" or "substantial transformation" is not directly relevant to this rule, but only might be used as a matter of comparison for interpretation of section 1605. The Councils have determined that the Buy American Act does not apply to manufactured construction material. Many of the respondents, whether contending that the Buy American Act still applies or using the Buy American Act for purposes of comparison and interpretation, have misinterpreted the Buy American Act. The Buy American Act includes the requirement for domestic manufactured goods to be "manufactured" in the United States. This term has been used consistently in the FAR as the first prong of the test for domestic manufactured end products and construction material. There is no substantial transformation test included in the Buy American Act. The term "substantial transformation" only comes into the FAR to implement trade agreements. The rule of origin for designated country end products and designated country construction material requires products to be wholly the product of, or be "substantially transformed" in the designated country. Even under trade agreements, there is no requirement for substantial transformation of products produced in the United States, because U.S.-made end products are not designated country products. Actually, the definition of "U.S.-made end product" allows either "substantial transformation" or "manufacture" in the United States to qualify as a U.S.-made end product, because the Buy American Act has been waived for U.S.-made end products when the World Trade Organization Government Procurement Agreement applies. However, this is not the case for domestic construction material. Even when trade agreements apply, domestic construction material must meet the Buy American requirements of domestic manufacture, not substantial transformation. Therefore, those respondents who argue that the Buy American Act requires substantial transformation are simply wrong.

ii. Should "manufacture" in this rule include the standard of substantial transformation?

Comment: Further elaborating on substantial transformation, two respondents recommended that the Councils should adopt a clear rule defining the concept of domestic manufacture consistent with the "well-established standard" of substantial transformation as the first part of the two-pronged test for domestic construction material. The respondent stated that the rule should not confer domestic status simply as a result of minor processing or mere assembly in the United States. According to these respondents, by not adopting substantial transformation, the interim rule has created ambiguity. These respondents pointed out a clear administrative process in the Federal Government for making substantial transformation determinations. They also stated that U.S. Customs and Border Protection (Customs) considers the totality of the circumstances and makes determinations on a case-by-case basis. The respondents questioned why the interim rule omitted any reference to substantial transformation.

Three respondents recommended allowing either manufacture (perhaps combined with the component test) or substantial transformation. According to one of the respondents, allowing both models to determine when a product has been manufactured in the United States ensures greatest flexibility. This respondent believed that this is only relevant below the Trade Agreements Act threshold, *i.e.*, above the threshold, the requirements defined under those pre-existing regulations would apply.

Response: Section 1605 of the Recovery Act does not require substantial transformation. It requires that manufactured goods be "produced" in the United States. The Councils have interpreted the law to equate "production" of manufactured goods to "manufacture." To the extent that the Recovery Act domestic source restriction is worded consistently with the Buy American Act, it is reasonable to implement in a similar fashion. "Substantial transformation" has never been applied in the FAR to domestic construction material, just to designated country construction material that is subject to trade agreements.

Therefore, the final rule continues to utilize the FAR language that parallels the pre-existing construction contract definition of domestic construction material, requiring manufacture in the United States.

iii. Definition of Manufacture

Comments: Other respondents were concerned about the definition of "manufacture." A respondent stated that the interim rule does not provide a clear definition of what constitutes manufacture, *i.e.*, how to determine whether sufficient activity has taken place in the United States for a material to be considered produced in the United States. Likewise, two respondents noted the various interpretations of "manufacture," *i.e.*, some believe it is similar or identical in concept to substantial transformation under Customs' rules, while others believe it is closer to the Buy American Act—Construction clause test for manufacture. One of these respondents asked that the final rule clarify the definition. Yet another respondent stated that, although the rule does not define "manufacture," the regulations suggest that the test will be similar to the requirement of U.S. manufacture applied under the Buy American Act. This may in some cases be less demanding than the substantial transformation test, which examines whether an article is transformed into a new and different article of commerce, having a new name, character, and use.

Response: The Councils have considered in the past including a definition of "manufacture" in the FAR but did not do so because of the case-specific nature of its application. The definition may be different for canned beans than for an aircraft. However, for those who find the word "manufacture" confusing and cite the long-standing tradition of interpretation of "substantial transformation," there is also a longstanding record of interpretation of "manufacture" under the Buy American Act. (See for example B–175633 of November 3, 1975, which addressed the issue of whether a radio had been manufactured in the United States. The GAO did not find against the Army position that, if the final manufacturing process takes place in the United States, the end product is "manufactured in the United States.")

iv. Tariff Shift

Comments: A respondent proposed that the rules of origin under 19 CFR part 102, currently used for NAFTA country-of-origin determinations, be applied to decisions regarding whether construction materials are considered domestic. According to the respondent, Customs is currently proposing that the CFR part 102 rules (also known as "tariff shift" rules) be applied for all country-of-origin determinations (See **Federal Register** at 73 FR 43385, July 25, 2008). Tariff shift rules consider the Harmonized Tariff Schedule of the United States classification of the article before and after manufacturing. If the classification shifts, then the article takes on a new country of origin.

Response: Companies that contract with the Government are accustomed to the well-established meaning of the term "manufacture" as applied under the Buy American Act and now the Recovery Act.

e. Iron and Steel

i. Similarity to Federal Transportation Laws

Comments: Three respondents pointed out that the section 1605 restrictions on iron and steel are similar to the Recovery Act Buy American requirements within the statutory and regulatory framework of Federal transportation laws (U.S. Department of Transportation highways and transit program), which mandate that 100 percent of the iron and steel used in a project be domestically manufactured and also impose comparable standards of unreasonable cost.

Response: The drafters of the FAR interim rule recognized the similarity to the restrictions applicable to the Federal Transit Administration, and modeled the FAR interim rule restriction on iron and steel after 49 CFR part 661, "Buy America Requirements."

ii. 51 Percent Component Test

Comments: One respondent wanted the FAR to go back to the 51 percent component test of the Buy American Act for what constitutes iron and steel products manufactured in the United States in order to ensure compliance with our international agreements, assist in getting projects started, limit delays, and ensure competition.

Response: Reverting to the 51 percent component test of the Buy American Act to determine what constitutes iron or steel products manufactured in the United States would not fully implement section 1605 of the Recovery Act. Section 1605 singled out iron and steel. In addition to requiring that manufactured construction material be manufactured in the United States, the law requires that the iron and steel also be produced in the United States. If the 51 percent component test of the Buy American Act were sufficient, then it would have been unnecessary to impose section 1605 at all. The Recovery Act could have continued to apply the Buy American Act without revision.

iii. Iron or Steel as a Component of Construction Material That Consists Wholly or Predominantly of Iron or Steel

Comments: One respondent also requested clarification that construction materials (such as welded steel pipe) that are produced in the United States using steel that was rolled in the United States from foreign slab are "produced in the United States" within the meaning of the Recovery Act.

A respondent stated that the FAR rule should allow contractors to utilize imported steel slab as raw material feed stock—and substantially transform that slab in the United States into flat rolled steel (hot rolled, cold rolled, galvanized, *etc.*) products, which in turn are used by other manufacturers to produce a wide variety of construction materials. Absent such an approach, construction material using these steel products could be deemed foreign construction materials, simply because the steel slab from which it was made was imported. According to the respondent, this will result in U.S. buyers shying away from these U.S. manufactured construction materials, thus eliminating U.S. jobs.

Another respondent, a carbon steel finishing mill, was concerned that steel can be either the construction material itself or a component of some other manufactured product (such as welded steel pipe). The respondent noted that a manufactured good may consist of only one component.

One respondent approved of the distinction between "steel used as a construction material" and "steel used in a construction material" but requested clarification of the boundaries of these two categories in the final rule. The respondent proposed that the boundary should be between—

- Steel goods delivered to the construction site directly from a steel mill (or its warehouse distributor) (*e.g.*, structural steel items (H-beams, I-beams, *etc.*), reinforcing rod, and plate); and
- Steel goods that have been further processed from intermediate, non-construction material products produced by a steel mill, into manufactured goods delivered to the construction site.

Alternatively, the respondent offered another definition of "steel used in a construction material"—"all steel goods except steel goods delivered to the construction site directly from a steel mill (or its warehouse/distributor) for use as a construction material."

Response: The Councils agree that a clearer distinction is required for circumstances when the Recovery Act Buy American restriction of section 1605 applies to iron or steel components. The intent of the interim rule was not to draw a line between iron or steel used as a construction material, and iron or steel used in a construction material, as suggested by one respondent, but between construction material that consisted wholly or predominantly of iron or steel and construction material in which iron or steel are minor components. The suggestion that manufactured steel goods not delivered to the construction site directly from the mill should be exempt would not be fulfilling the intent of the law. On the other hand, the requirement that every piece of iron and steel, no matter how miniscule, must be melted and rolled in the United States, would be quite unworkable, and would be counterproductive to the overall intent of the law.

The interim rule separated manufactured construction material into two main categories: Iron or steel used as a construction material and "other" manufactured construction material. The interim rule made clear that manufactured construction material that consisted wholly of iron or steel must be produced in the United States, including all stages of production except metallurgical processes involving refinement of steel additives. It also stated that "other" manufactured construction material would require manufacture in the United States, but imposed no requirement on the components or subcomponents in this category of "other" manufactured construction material.

The interim rule is not clear, however, with regard to treatment of construction material that consists predominantly, but not wholly, of iron or steel. Some respondents assumed that all construction material would fall in the "other" category unless it was wholly of iron or steel. Others interpreted, as was intended, that the "other" category was to cover material which did not consist wholly or predominantly of iron or steel.

The Councils re-examined the requirement of the statute and how best to convey these requirements in the regulations. Because iron and steel are singled out for specific mention in the

statute, the Councils conclude that a primary objective of the Act is to promote the use of domestic iron and steel. The Councils have determined that a clearer way to express the requirements of the law would be to interpret the requirement for iron or steel to be produced in the United States as being in addition to (rather than a subset of) the requirement for all manufactured construction material to be manufactured in the United States. The statute did not include the word "other." All manufactured construction material must be manufactured in the United States. This interpretation supports the requirement that iron or steel, whether or not it has reached the stage of being manufactured construction material, must be produced at all stages in the United States. This is similar to some other domestic source restrictions on particular materials or components such as the restrictions on domestic melting or production of specialty metals at 10 U.S.C. 2533b. The intent of the Councils was to balance full implementation of the law with feasibility of compliance. Therefore, the final rule applies this restriction on domestic production of iron and steel only when the iron or steel is a component of construction material that consists wholly or predominantly of iron or steel. (The respondent was correct that there may be just one component in a construction material).

In view of this policy clarification, the proposal to treat foreign slab as a "component" of other manufactured goods, not requiring production in the United States, is not acceptable, because the resultant construction material consists wholly or predominantly of iron or steel, and allowing foreign slab would not meet the objectives of the law.

The Councils have made changes to the policy at FAR 25.602 to clarify the restriction on the production of iron and steel and have revised the definitions of "domestic construction material" in FAR 25.601 and paragraph (a) of the FAR clauses at 52.225–21 and 52.225–23, specifying that all of the iron or steel in manufactured construction material that consists wholly or predominantly of iron or steel shall be produced in the United States, but the origin of the raw materials of the iron or steel is not restricted.

iv. Iron or Steel as Components of Manufactured Construction Material That Does Not Consist Wholly or Predominantly of Iron or Steel

Comments: Some respondents objected to the provision in the interim rule that the Recovery Act Buy American restriction does not apply to iron or steel used as components of other manufactured goods. One respondent stated that the Recovery Act Buy American requirements of section 1605 must apply to all iron and steel, including all iron and steel components and subcomponents used in manufactured construction material. One respondent believed that this provision of the interim rule creates a loophole, in that the use of foreign steel reinforcing bar (rebar) used in concrete slab would be allowed, because the steel rebar would be considered a component of a manufactured product (the concrete slab).

On the other hand, a different respondent believed that the fact that the regulations permit foreign steel or iron used as components or subcomponents of other manufactured construction material to be considered domestic construction materials as long as the manufacturing is done in the United States is a sound and practical decision. This respondent commented that the rule allows U.S. companies flexibility to prudently source from both American and foreign vendors to manage costs, while promoting U.S. manufacture.

Response: The interim rule would not allow foreign steel rebar (as a component of concrete slab) because the rule applies to construction material brought to the construction site. The steel rebar is brought separately to the construction site and is therefore itself construction material, not a component of the concrete slab, which is poured and formed on the construction site.

As stated in the prior section, iron and steel components are only exempt from the restriction of section 1605 if the construction material does not consist wholly or predominantly of iron or steel.

f. Components

Comments: Three respondents agreed with the interim rule approach of not including a requirement relating to the origin of components. They argue that an expansive and practical definition of manufactured goods is needed to allow the contractor leeway in getting the project done on time and within budget.

Many other respondents strongly argued for inclusion of a "component test," often citing the Buy American Act as a precedent.

- One respondent stated that the costs of all the domestic components in the final product must exceed 50 percent of the cost of all the components.
- A respondent stated that Congress' deliberate inclusion of the term "manufactured goods" was plainly intended to be under the precedent established under the Buy American Act. Yet another respondent stated that the interim rule does not meet the requirements of section 1605 because domestic content requirements for components and subcomponents parts have been omitted. This respondent also objected that the interim rule has ignored a long history of applying a domestic content rule in determining if a good is produced in the United States for purposes of enforcing domestic source restrictions. According to the respondent, OMB acknowledges that the two-part test relied upon is from the Buy American Act, then simply waives the domestic content part of the 1933 Act's text. Desiring an expeditious flow of funding cannot trump the statutory requirement to procure domestically produced goods. Longstanding interpretation of domestic manufactured goods under the Buy American Act also comports with Congressional intent to save and create manufacturing jobs.
- A respondent was disturbed that the interim rule explicitly rejected the use of a component test, one of the minimal Buy American Act standards for rule of origin. The respondent contended that allowing for the use of non-domestic component parts will have a significant impact on the job-creation ability of the stimulus.
- Two respondents stated that the Councils should adopt a clear rule defining the concept of domestic manufacture consistent with the well-established standard of substantial transformation and a 50 percent component content standard (by cost). The FAR should not confer domestic status simply as a result of minor processing or mere assembly in the United States.

Response: The Councils in the interim rule did not, as respondents claim, acknowledge dependence on the two-prong Buy American Act test and then waive the component test. The Councils relied on the difference in wording between section 1605 and the Buy American Act. The preamble to the interim rule specifically stated: "Because section 1605 does not specify a requirement that significantly all the components of construction material must also be domestic, as does the Buy American Act, the definition of domestic construction material under this interim rule does not include a requirement relating to the origin of the components of domestic manufactured construction material" (see **Federal Register** at 74 FR 14624, March 31, 2009). The Buy American Act requires manufacture in the United States "substantially all from articles,

materials, or supplies mined, produced, or manufactured * * * in the United States" (41 U.S.C. 10b). On the other hand, section 1605 only requires the manufactured goods to be "produced" in the United States. If Congress intended the component test to apply, it could have easily so stated in section 1605.

Comments: In fact, a few respondents even suggested carrying the component test further than the Buy American Act interpretation of the 50 percent domestic component test. A respondent stated that statutory language could be interpreted to mean a 100 percent domestic content requirement. Another respondent stated that, if OMB wanted to be aggressive, it could write a rule with an even more stringent component test (*see* Berry Amendment), especially with respect to textile and apparel products.

Response: Even if section 1605 were not silent on the issue of a 100 percent domestic component requirement, it would be almost impossible to comply with such a requirement in this current global economy. It would cause immense difficulty to American manufacturers, and section 1605 does not require it.

Comments: One respondent was confused about the waiver by the Administrator of OFPP of the component test for COTS items because of the technical correction made to FAR 25.001 by the interim rule. The respondent noted that the interim rule amends FAR 25.001(c)(1) by waiving the component test for commercially available off-the-shelf items for all procurements, regardless of whether the procurement is funded with Recovery Act funds.

Response: The interim rule did not introduce the component test waiver for COTS items at FAR 25.001(c)(1). The final rule for that change was published in the **Federal Register** at 74 FR 2713, January 15, 2009, and became effective February 17, 2009. However, the rationale for that waiver may provide support for the decision that the component test is not appropriate for implementation of the Recovery Act. The Administrator of OFPP waived the component test of the Buy American Act for COTS items because "a waiver of the component test would allow a COTS item to be treated as a domestic end product if it is manufactured in the United States, without tracking the origin of its components. Waiving only the component test of the Buy American Act for COTS items, and still requiring the end product to be manufactured in the United States, reduces significantly the administrative burden on contractors and the associated cost to the Government." The FAR procedures for evaluation of foreign offers in acquisitions of supplies covered by trade agreements is predicated on agencies treating offers of U.S.-made end products (*i.e.,* offers that may not be domestic end products that meet the component test of the Buy American Act) more like the agencies treat eligible products (the trade agreements do not apply any component test to eligible products from designated countries). Today's markets are globally integrated with foreign components often indistinguishable from domestic components. The difficulty in tracking the country of origin of components is a disincentive for firms to contract with the Government.

Comments: A number of respondents that agreed with not including the component test for domestic products still requested a definition of "component" in the rule.

Response: There are two basic definitions of "component" in the FAR, at 2.101 and 25.003, and associated Buy American Act clauses. In the final rule, there is no separate definition of component in FAR subpart 25.6, so the definition at FAR 25.003 applies to FAR subpart 25.6. However, for increased clarity, the appropriate definition of "component" has been included in the FAR clauses at 52.225–21 and 52.225–23.

g. Summary Matrix of Requirements for Domestic Construction Material

The following matrix summarizes the requirements for domestic construction material in projects that use Recovery Act funds.

REQUIREMENTS FOR DOMESTIC CONSTRUCTION MATERIAL IN PROJECTS THAT USE RECOVERY ACT FUNDS

Type of construction material	Applicable statute	Production of construction material	Production of iron/steel	Production of other components
Manufactured—wholly or predominantly iron or steel.	Section 1605 of Recovery Act.	Manufacture in U.S.	All processes in U.S. (except steel additives).	No requirement.
Manufactured—not wholly or predominantly iron or steel.	Section 1605 of Recovery Act.	Manufacture in U.S.	No requirement	No requirement.
Unmanufactured	Buy American Act	Mined or produced in U.S.	XXX	XXX.

3. Applicability of International Agreements

a. Trade Agreements

Comments: As provided by section 1605(d), the Recovery Act Buy American provisions must be applied in a manner consistent with United States obligations under international agreements. One respondent requested that the final regulations should ensure compliance with existing international obligations, but did not specify any shortcomings in the interim rule in this regard. Another respondent considered that the interim rule is creating great consternation with our international trading partners and could lead them to retaliate with their own protectionist measures. A third respondent claimed that the interim rule did not ensure consistency with international obligations.

Response: As required by section 1605, the FAR rule provides for full compliance with U.S. obligations under all international trade agreements when undertaking construction covered by such agreements with Recovery Act funds. The new required provisions and clauses implement U.S. obligations under our trade agreements in much the same way as they are currently implemented in non-Recovery Act construction contracts, with one exception. The Caribbean Basin countries are excluded from the definition of "Recovery Act designated country," because the treatment provided to them is not as a result of any U.S. international obligation but is the result of a United States initiative. The new cost evaluation standards do not apply to manufactured construction material from Recovery Act designated countries.

Comments: One respondent stated that, as drafted, the interim rule implied that all construction material from Recovery Act designated countries is exempt from the Recovery Act Buy

American requirements set forth in section 1605 and the Buy American Act. This implication is inconsistent with the law because, according to the respondent, not all Recovery Act designated country construction material is exempt. FAR subpart 25.4 limits the foreign products eligible for equal consideration with domestic offers. Even if end products for resale or set asides for small business are produced in Recovery Act designated countries, for example, they would not be deemed eligible products per FAR subpart 25.4. Likewise, one respondent pointed out that FAR subpart 25.4 does not apply to procurements set aside for small businesses and requested clarification in the final rule on continuation of this policy.

Response: The FAR subpart 25.4 exception for resale of end products is inapplicable to construction contracts.

FAR subpart 25.4 states that it does not apply to acquisitions set aside for small businesses. FAR 25.603(c) has a cross reference to FAR subpart 25.4.

Comments: Two respondents considered that the situation created by the interim rule with regard to sources of iron and steel is unfair. Namely, designated countries have unrestricted ability to provide iron and steel from anywhere, whereas domestic sources must provide iron and steel melted in the United States. According to these respondents, this would incentivize designated country steel firms to stop shipping slabs to the U.S. and to substitute finished construction materials. The result would be a loss of U.S. jobs in both the steel-finishing and construction-material manufacturing sectors.

Response: In its trade agreements, the United States commits to apply to products from designated countries the rule of origin that is used in the normal course of trade between these countries, *i.e.*, "wholly the product of" or "substantially transformed" in the designated country. In projects funded by the Recovery Act, we cannot add new restrictions on the products of our trading partners that are not applied to other procurements covered by our agreements.

Comments: A respondent recommended that the final FAR rule should provide for the use of an inventory accounting methodology to determine the origin of fungible goods that are commingled American and foreign inventories. This respondent noted that NAFTA permits this methodology to avoid unfairly disqualifying companies that produce eligible products but commingle such products in inventories with foreign products.

Response: The Recovery Act does not permit such methodology.

b. G20 Summit Pledge

Comments: The countries of the G20 stated at the summit that they would refrain from raising new trade barriers to trade in goods and services. According to various respondents, the new law and the interim rule, by adding the restrictions on the production of iron and steel and increasing the test for unreasonable costs, raise new barriers to trade, even though the Recovery Act Buy American requirement must be applied consistent with U.S. international obligations. A respondent stated that overly restrictive implementation of the Recovery Act will undermine the ability of the U.S. companies with global supply chains to participate in the Recovery Act. According to a respondent, it will lead to closed markets overseas to the detriment of American exports, products, and jobs.

A respondent stated that ambiguities in the interim rule were open to interpretation by Government agencies on multiple levels. In the absence of examples of permissible procurement from foreign sources, the business community must await test cases to determine whether, for example, the letter of the law in terms of the WTO GPA signatory exceptions to the exclusionary principles will truly apply. The respondent believed that this ambiguity serves as a de facto obstacle to foreign suppliers engaging in commerce or any form of business alliance with American bidders.

A non-U.S. respondent stated that access to the U.S. procurement market has been further limited in areas not covered by the WTO GPA. Their preference would be non-application of the new requirements to European Union member countries.

Two foreign respondents also wanted to emphasize that the United States should uphold the G20 statement in implementing the Recovery Act Buy American provisions. One stated that, for acquisitions below the WTO GPA threshold of $7,443,000 for construction, the new discriminatory procurement requirements would apply in relation to goods from Recovery Act designated countries.

Response: These concerns essentially go back to the requirements of section 1605 of the Recovery Act. The FAR rule must implement the law. Section 1605 provides for application consistent with United States obligations under international agreements. Pledges at the G20 Summit do not constitute international agreements, as contemplated by section 1605. The FAR rule cannot create new exemptions.

4. Other Definitions

a. Construction Material

Comments: Three respondents stated that, in some circumstances, if foreign pieces are delivered to the jobsite and assembled there instead of being delivered as part of an assembled construction material, those pieces would presumably be in violation. The respondents believe that this rule will encourage or force some assemblies to be done offsite in order to maintain compliance. They recommend allowing the contracting officer some level of discretion.

Response: The definition of construction material in the rule as an article, material, or supply brought to the construction site by the contractor or subcontractor for incorporation into the building or work is unchanged from the first sentence of the current FAR 25.003. That is how Government construction subject to the FAR has worked for many years.

Comments: One respondent further objected that the new FAR clause 52.225–23 included a definition of construction material that singles out "emergency life safety systems" as discrete and complete, allowing them to be evaluated as a single and distinct construction material, regardless of how and when the parts or components are delivered to the construction site. The respondent stated that there are numerous other types of systems, such as environmental control communications systems, that are integrated into the building in such a fashion that warrant being treated in a similar manner that the FAR should consider.

Response: This is the current FAR definition of construction material (see, for example, FAR 52.225–9(a)).

b. Public Building or Public Work

Comment: A respondent stated that there is no definition or cross reference for "public building" or "public work."

Response: The interim rule at FAR 25.602 referenced the definition of "public building or public work" at FAR 22.401. For the definition in the final rule, please see FAR 25.601.

c. Manufactured Construction Material/ Unmanufactured Construction Material

Comment: One respondent expressed concern that the definitions of manufactured and unmanufactured create no clear standard for determining

when a good is a domestic construction material.

Response: The standard for determining whether a good is a domestic construction material is not found in the definitions of "manufactured construction material" and "unmanufactured construction material." It is found in the definition of "domestic construction material" at FAR 25.601 and in the policy at FAR 25.602. In the final rule, the Councils have expanded the definition of "domestic construction material" at FAR 25.601 to include the more detailed standards relating to iron and steel that were included in the policy statement.

5. Exceptions

a. Class Exceptions

Comment: One respondent posited that blanket waivers or broad temporary waivers would be appropriate and should be broadly defined in the FAR. Another respondent noted that the statute was changed during conference to include, at paragraph (b), the phrase "category of cases" for which section 1605 would not apply and wondered why the FAR doesn't mention or take advantage of this language.

Response: The Councils note that neither the statute nor the FAR precludes the use of class waivers in appropriate circumstances.

Comments: Four respondents stated that the FAR should include a *de minimis* waiver in order to limit detrimental impacts of a very small-value item preventing a company from providing an entire system on a project. One respondent suggested a waiver for any construction material that costs less than 10 percent of the entire project cost. Another respondent believed that such minimal use should not trigger the 25 percent evaluation factor because such *de minimis* usage will not threaten the commercial viability of relevant U.S. industry. Two respondents used the example of piping where specific gaskets and fittings must be added on site and are not always manufactured domestically.

Response: Because construction material is defined as the article, material, or supply delivered to the construction site, and there is no component test (except for iron or steel), it is not possible for the delivery of an entire system to be considered non-domestic because of a very small value foreign component of the system, as long as the component is not delivered separately to the construction site.

Further, the clarification of "produced in the United States" (FAR 25.602(a)(1)) makes clear that iron and steel components will only be tracked if the construction material is a manufactured construction material that consists wholly or predominantly of iron or steel.

b. Public Interest

Comments: One respondent wanted a nationwide public interest waiver issued to enable Recovery Act funds to be deployed now, when most needed, rather than await publication of "Buy American regulations." The respondent stated that "(t)he U.S. Environmental Protection Agency (EPA) has taken the prudent approach of using the 'public interest' exception to issue a nationwide waiver of the Recovery Act Buy American requirement for State Revolving Loan Fund projects for which debt was incurred between October 1, 2008 and February 17, 2009."

Two respondents noted that the "public interest" exception does not specify criteria for the agency head to use. One of these respondents asked if there are special procedures that should be included in the FAR.

Response: The Councils believe that the first comment is moot, given that the Recovery Act regulations were published in the **Federal Register** at 74 FR 14623, March 31, 2009. Further, the EPA class exception referred to by the respondent was for State Revolving Loan Fund projects, an area that is covered by the OMB guidance, not the FAR.

With regard to the second comment, the Councils note that the language for this exception is modeled on the public interest exception currently in use for the Buy American Act at FAR 25.103(a). The public interest exception may only be authorized by the agency head (with power of redelegation) and is used infrequently. The FAR includes no special procedures so that agency heads retain appropriate flexibility.

Comment: Another respondent wanted to know whether each State uses the same criteria or procedures.

Response: The FAR is not used by State or local governments; it is used by Federal agencies to contract with appropriated funds. Each agency has a unique mission, and it would not be appropriate to require them all to use the same criteria.

Comment: A respondent suggested that the public interest exception be interpreted flexibly, considering economic efficiency and overall quality of goods so that, "even if non-American iron, steel, and manufactured goods may not satisfy the 25 percent rule, they can still be accepted under the public interest exception."

Response: The public interest exception is designed to be used flexibly and only as a last resort when the nonavailability or unreasonable cost exceptions do not fit. However, it is not designed to circumvent the new statutory standards for determination of unreasonable cost of domestic construction material.

c. Nonavailability

Comments: Four respondents queried the nonavailability waiver at FAR 25.603. One of these respondents believed that the nonavailability exception should be modified to require consideration of the geographical scope of the market in which production takes place so that foreign products are not unfairly discriminated against.

Response: The Councils disagree. The statute contained no such provision, and to add one now would contradict the intention of the U.S. Congress in enacting the Recovery Act. The statute provides an exception for nonavailability of domestic manufactured construction material. This does not result in any discrimination against foreign construction material, but actually allows the purchase of foreign construction material when domestic manufactured construction material is unavailable.

Comment: Another respondent recommended that the final rule provide for a time-limited, streamlined process for issuing nonavailability waivers.

Response: The reason for issuing a nonavailability exception is that the items in question are truly not available "in the United States in sufficient and reasonably available commercial quantities of a satisfactory quality." (FAR 25.603(a)(1)). The Councils believe that contracting officers should not unfairly rush the process of determining whether these conditions apply to an item.

Comment: Another point of view expressed by a respondent was that the final rule should require an offeror proposing a nonavailability waiver to provide, in addition to the items already listed, the following: (1) Supplier information or pricing information from a reasonable number of domestic suppliers indicating availability/delivery date for construction materials, (2) information documenting efforts to find available domestic sources, (3) a project schedule, and (4) relevant excerpts from project plans, specifications, and permits indicating the required quantity and quality of construction materials.

This respondent also requested that the contract list all foreign material

used, including construction material from designated countries.

Response: The Councils' intention was to use the same requirements for this exception as have been used for Buy American Act non-availability determinations for some 15 years. It would be an unnecessary burden to list designated country construction material, because section 1605 requires compliance with trade agreements, and there is no restriction on the use of designated country construction material when trade agreements apply.

Comment: A respondent noted that it seems inconsistent, if designated country materials are not considered foreign construction items, not to consider them when making the determinations in FAR 25.603(a) and (b).

Response: Designated country material is considered to be foreign.

d. Unreasonable Cost

Comment: One respondent stated that "it is quite apparent that a preference for offers excluding foreign construction material lacks the necessary legal justification and constitutes an obvious prejudice against foreign construction material."

Response: The Councils disagree. The paragraphs in the solicitation provisions on evaluation of offers (FAR clauses 52.225–22(c) and 52.225–24(c)) clearly state that the preference is for an offer that does not include foreign construction material excepted at the request of the offeror on the basis of unreasonable cost. This does not constitute a prejudice against all foreign construction material. Inclusion of Recovery Act designated country construction material will not cause the Government to discriminate against an offer. This is in accordance with the law, as promulgated by the U.S. Congress and applied consistent with U.S. international obligations.

Comments: Two respondents stated that the evaluation of foreign construction materials, and the authority provided to submit alternate offers with equivalent domestic material, constitutes a prejudice against foreign construction material.

Response: The Councils disagree and note that the FAR is implementing U.S. law. Further, the implementation scheme is fully compliant with U.S. international agreements.

Comments: Two respondents commented that the 25 percent evaluation factor likely renders the unreasonable cost exception moot because it is so high that it will be impossible to meet.

Response: The Councils had no discretion about the requirement to add 25 percent to the contract cost when foreign iron, steel, or manufactured goods are proposed to be used in a construction project or public work. The factor is specifically required by the language of section 1605(b)(3) of Public Law 111–5.

Comment: Another respondent suggested that the table at FAR 52.225–23(d) should include another category entitled "Recovery Act designated country material."

Response: The respondent gave no reason for this suggestion, and the Councils cannot accept the recommendation. The statute provides an exception for unreasonable cost of domestic material, not for unreasonable cost of designated country construction material. The statute requires a comparison of the price differential between domestic manufactured construction material (including iron and steel) and foreign manufactured construction material (other than designated country manufactured construction material). In an acquisition subject to trade agreements, the material that is obtained from designated countries is not part of the evaluation because it is not domestic construction material.

6. Determinations That an Exception Applies

a. Process and Publication

Comments: Two respondents stated that the use of waivers should be encouraged and simplified.

Response: The Councils have made the exception process as streamlined as is possible within the terms of the statute. Agencies already have authority to use class exceptions.

Comments: Two respondents believed that the specific two-week timeframe for publication of a waiver in the **Federal Register** should be replaced with language requiring publication in the fastest practicable manner. In addition, the Office of Federal Procurement Policy (OFPP) requested that a copy of the nonavailability determination be provided to the OFPP Administrator.

Response: The statute specifically called for publication in the **Federal Register** (Pub. L. 111–5, section 1605(c)). However, the law does not set a time frame for such publication. The Councils agree with the respondents that timely publication is desirable, but the **Federal Register** often must accommodate workload priorities that are out of the control of contracting officers. Therefore, FAR 25.603(b)(2) is revised to require the agency head to provide the notice to the **Federal Register** within 3 business days after the determination is made. Except in unusual workload circumstances, this change should result in publication in the **Federal Register** in less than 2 weeks.

The final rule includes, at FAR 25.603(b), a requirement to provide to the Administrator for Federal Procurement Policy and to the Recovery Accountability and Transparency Board a copy of a determination made in accordance with FAR 25.603(a) concurrent with its provision to the **Federal Register**.

Comments: Six respondents demanded that OMB provide full transparency in the process of obtaining waivers of section 1605's application by requiring that all waiver requests be posted publicly on line. Several of these respondents wanted the waiver request to be posted promptly and publicly on line (the internet or *Recovery.gov*); one wanted the waiver request to be posted within 3 days of its receipt; and one respondent wanted waiver requests to be e-mailed to any trade associations and domestic manufacturers desiring to be on an alert list.

Response: While section 1605 does require publication of exceptions made to the requirement to use U.S.-produced iron, steel, and manufactured goods used in the project, there is no requirement in the statute to publish requests for an exception. Therefore, no change is being made to the FAR to introduce such a requirement.

Comment: One respondent considered that FAR 25.604(a) confuses inapplicability with exceptions and appears to refer to one of the exceptions as a rationale for that "inapplicability" determination. The respondent believed that the concept of the Buy American clause not being applicable is distinct from a situation where the Buy American clause may apply, but an exception has been granted.

Response: The FAR language for this case uses the exact wording from the current FAR Buy American Act coverage. Contracting officers are not waiving section 1605 of the Recovery Act or the Buy American Act, but determining whether an exception applies, and then, if an exception does apply, determining that section 1605 of the Recovery Act or the Buy American Act is inapplicable.

b. Requests for Specific Exceptions

Comments: Three respondents stated that the recent addition of commercial off-the-shelf (COTS) items to exceptions from the Buy American Act for construction materials (FAR 25.225–9

and –11) and the exception at FAR 25.103(e) for commercial information technology (IT) should be available for Recovery Act-funded construction projects.

Response: The Councils do not agree. The COTS item exception only exempts COTS items from the component test of the Buy American Act. This rule does not apply a component test to any of the manufactured construction material subject to section 1605 of the Recovery Act except iron and steel. By definition, unmanufactured construction material does not have components.

With regard to the commercial IT exception, it applies only to the Buy American Act. The Recovery Act exceptions are explicitly stated in section 1605 and are not identical to the Buy American Act exceptions.

Comments: Two respondents requested that commercial items, as a category, be exempt from coverage under section 1605.

Response: The Councils decline to make this change, as the Congress did not exempt commercial items from section 1605 applicability.

Comment: One of these respondents also asked that other typically non-construction materials not primarily made of iron or steel be excluded from coverage.

Response: The Councils do not understand the respondent's use of the term "other typically non-construction materials." The Councils have used the standard FAR definition of "construction material" without change. Under this definition, if it is incorporated into a public building or public work, then the material is construction material.

Comment: One respondent recommended that the FAR waive application of section 1605 for all manufactured goods not made primarily of iron and steel.

Response: The Councils decline for the reason that the Congress specifically included manufactured goods in the coverage of section 1605.

Comment: A respondent wanted the Councils to issue a class waiver from the Buy American Act requirements for electronic fluorescent lighting ballasts.

Response: The FAR includes, at FAR 25.104(a), a list of items that have been determined nonavailable in accordance with FAR 25.103(b)(1)(i). A class determination made in accordance with the above reference does not necessarily mean that there is no domestic source for the listed items, but that domestic sources can only meet 50 percent or less of total U.S. Government and nongovernment demand. The respondent is free to make a request for a class determination. In addition, the offeror may request, and the contracting officer may grant, an exception on an individual contract in accordance with FAR 25.603.

7. Exemption for Acquisitions Below the Simplified Acquisition Threshold

Comments: Two respondents requested that the final rule exempt purchases under the simplified acquisition threshold (SAT) from the Recovery Act.

Response: The determination was made under the interim rule that section 1605 of the Recovery Act would apply to all contracts, including those below the SAT (see Interim Rule, Supplementary Information, Section C (see **Federal Register** at 74 FR 14625, March 31, 2009)). The Councils remain committed to this position in order to fully implement the goals of the Recovery Act. Therefore, any project, of whatever dollar value, financed with Recovery Act funds is subject to these limitations.

8. Remedies for Noncompliance

Comments: One respondent requested that the final rule include a safe-harbor provision protecting companies receiving Recovery Act funds without proper notice from the Government or the purchasing company.

Response: The Councils believe that this is unnecessary, given the protections already built into the use of Recovery Act funds. First, any appropriation of Recovery Act funds receives a special designation that identifies it as Recovery Act money. In addition, FAR 4.1501, 5.704, and 5.705, along with the contract checklist issued by the Recovery Accountability and Transparency Board, require contracting officers to indicate, in the solicitation or award, which products or services are funded under the Recovery Act.

Comment: One respondent stated that the regulations must provide adequate remedies, such as debarment, for non-compliance with section 1605. It claimed that only such meaningful remedies can serve to deter misbehavior.

Response: All of the usual remedies available through the FAR or Federal law are equally available as remedies for noncompliance with section 1605 regulations. No additional remedies are needed.

Comment: One respondent recommended replacing the requirement, at FAR 25.607(c)(4), to refer apparent fraudulent noncompliance to "the agency's Inspector General" rather than to "other appropriate agency officials."

Response: This recommendation has been partially accepted. While the agency Inspector General is available for referral of suspected fraud, it is not the only option in this situation. FAR 25.607(c)(4) is revised to include both the agency's Inspector General and other possible officials.

9. Funding Mechanisms

a. Modifications to Existing Contracts

Comments: Three respondents strongly recommended that the Recovery Act limitations should not be applied to task orders issued under Governmentwide Acquisition Contracts (GWACs) or Multiple Award Contracts (MACs).

Response: The Councils cannot make the change requested by these respondents because the Recovery Act restrictions follow the appropriations. Any construction project or public work funded with Recovery Act money must comply with the restrictions in section 1605, whether the contracting vehicle for the project is a contract or task order.

b. Treatment of Mixed Funding

Comments: Seven respondents were concerned that the interim rule failed to provide any clarity about how projects with mixed funding (some Recovery Act funds and other Federal appropriations) would be treated. Several respondents expressed a strong preference for treating mixed-funded projects as not covered by the Recovery Act limitations.

Response: Given that the statute was designed so that the section 1605 limitations are tied to the source of funding, the Councils do not have the option of complying with respondents' preference. Any Federal construction or public works contract effort that is funded by any funds, however miniscule, appropriated by the Recovery Act must, by law, comply with the section 1605 requirements. However, the regulations do provide that a contract may be funded with Recovery Act funds and non-Recovery Act funds if the funds are properly segregated by line item or sub-line item. In addition, contracting officers are required to indicate, in the solicitation or award, which products or services are funded under the Recovery Act. However, if the contracting officer does not properly segregate Recovery Act and non-Recovery funds, then the law requires the mixed-funded line items or contracts to be treated as if they were entirely Recovery-Act funded. (See discussion of "project" at 2.b. above and in the FAR text at 25.602–1(c).)

10. Interim Rule Improper

Comment: One respondent believed it was inappropriate to publish an interim rule, as it deprived interested parties of the right to comment. The need to have rules available as soon as the Recovery Act funds were made available to Federal agencies for obligation, according to the respondent, was not a sufficient justification for the absence of prior public comment.

Response: The Administration directed the Councils to publish an interim rule in order to provide contracting agencies with the necessary direction quickly. In any case, respondents were given an opportunity to comment fully on the interim rule, and each comment has been thoroughly considered by the Councils.

11. Inconsistencies Between This Rule and Pre-Existing FAR Rule and the OMB Grants Guidance

a. Inconsistency With Pre-Existing FAR

Comments: One respondent objected that this rule will require well-intentioned and compliant companies to establish yet more processes and systems (many of which will be largely duplicative of existing Buy American Act/Trade Agreements Act compliance requirements) to comply with the Recovery Act. The respondent claimed that this creates significant cost burdens and delays in construction projects. Another respondent stated that any change in current supply chains made in order to comply with this rule will limit competition, cause delays, and increase costs. A respondent objected to the creation of yet another list of designated countries.

Response: The Councils used pre-existing FAR language and processes to the extent that it was possible to do so and still meet the requirements of the Recovery Act. The Recovery Act also specified the new requirements for iron and steel and the 25 percent contract evaluation factor.

Recovery Act-designated countries were identified from the language of the statute, the Committee report, and consultation with the United States Trade Representative. Caribbean Basin countries were not included as Recovery Act-designated countries because they are not covered by an international agreement.

b. Inconsistency With the OMB Grants Guidance

Comments: Four respondents expressed a strong preference that the final rule should have the closest possible alignment with the OMB guidance governing grants under the Recovery Act.

One respondent noted that the OMB grants guidance includes examples of "public building." The respondent would like to know whether a public building in the FAR is the same as a public building in the OMB guidance.

Response: The Councils agree and note that the final rule was developed in close coordination with OMB grant officials. The Councils point out, however, that grants, financial assistance, and loans are not subject to the Buy American Act. Therefore, the coverage cannot be the same in these two regulations regarding unmanufactured construction material. Further, the OMB guidance applies to all assistance recipients, including States. Trade agreements do not apply uniformly at the State level.

The final revised FAR provisions include the definition from FAR 22.401 and add examples of public buildings and public works from the OMB grants guidance.

It is our understanding that the OMB grants coverage will be conformed to the FAR terminology to use "manufacture" in lieu of "substantially transformed." The Councils and OMB are not aware of any other areas where the OMB guidance and this FAR rule are not aligned.

Comment: One respondent requested that the Councils consider requesting EPA, Federal Transit/Highways Administration, and other agencies that have issued their own guidance to withdraw it.

Response: The Councils decline. There is no reason to request any agency to withdraw contracting guidance that is in compliance with the FAR.

Language in the Recovery Act exempted the Federal Highway Administration (FHA) from section 1605. It is appropriate that FHA maintain separate regulations.

12. Need for Additional Guidance

Comments: Two respondents stated that there is confusion about the scope of applicability of this rule and requested that the FAR more clearly spell out that contracting authorities are obliged to comply with international commitments and request relevant and user-friendly guidance.

Response: The Councils note that changes in the final rule have differentiated projects that are subject to the Recovery Act rules from projects that are subject to existing Buy American Act and trade agreements requirements. The Councils have made it abundantly clear in the final rule and this preamble that Federal agencies must comply with international agreements when conducting procurements for Recovery Act projects that are covered by such agreements.

Further, contracting authorities that do not comply with the FAR, and thereby with international commitments, should be reported and are subject to sanctions.

Comment: One of those respondents thought that the FAR does not explain what regime must be followed in cases where an entity covered by the World Trade Organization Government Procurement Agreement (WTO GPA) conducts procurement jointly with an entity that is not covered by the WTO GPA.

Response: If one entity in a joint procurement is covered by the GPA or another international agreement, but another entity that is also involved in the same procurement is not covered by the GPA or another international agreement, the procurement will be conducted in a manner that ensures that U.S. obligations under international agreements are honored. That means that in such a case, products from Recovery Act designated countries will not be subject to the restrictions of section 1605 of the Recovery Act.

C. Applicability to Contracts at or Below the Simplified Acquisition Threshold

Section 4101 of Public Law 103–355, the Federal Acquisition Streamlining Act (FASA) (41 U.S.C. 429), governs the applicability of laws to contracts or subcontracts in amounts not greater than the simplified acquisition threshold. It is intended to limit the applicability of laws to them. FASA provides that if a provision of law contains criminal or civil penalties, or if the Federal Acquisition Regulatory Council makes a written determination that it is not in the best interest of the Federal Government to exempt contracts or subcontracts at or below the simplified acquisition threshold, the law will apply to them.

The FAR Council determined, for the interim rule, that it should apply to contracts or subcontracts at or below the simplified acquisition threshold, as defined at FAR 2.101. The public comments received did not cause the FAR Council to modify this position for the final rule.

This is a significant regulatory action and, therefore, was subject to review under Section 6(b) of Executive Order 12866, Regulatory Planning and Review, dated September 30, 1993. This rule is not a major rule under 5 U.S.C. 804.

D. Regulatory Flexibility Act

The Department of Defense, the General Services Administration, and the National Aeronautics and Space Administration certify that this final rule will not have a significant economic impact on a substantial number of small entities within the meaning of the Regulatory Flexibility Act, 5 U.S.C. 601, *et seq.*, because it will only impact an offeror that wants to use non-U.S. iron, steel, and manufactured goods in a construction project in the United States. The Councils stated in the interim rule their belief that there are adequate domestic sources for these materials, and the Office of Management and Budget (OMB) guidance M–09–10 issued February 18, 2009, entitled "Initial Implementing Guidance for the American Recovery and Reinvestment Act of 2009," provides a strong preference for using small businesses for Recovery Act projects wherever possible. No comments to the contrary were received from small entities in response to the interim rule.

E. Paperwork Reduction Act

The Paperwork Reduction Act does apply; however, the information collection requirements imposed by the FAR provisions 52.225–22 and 52.225–24 are currently covered by the approved information collection requirements for FAR provisions 52.225–9 and 52.225–11 (OMB Control number 9000–0141, entitled Buy America Act—Construction—FAR Sections Affected: Subpart 25.2; 52.225–9; and 52.225–11). No public comments were received regarding the data elements, the burden, or any other part of the collection.

List of Subjects in 48 CFR Parts 2, 5, 25, and 52

Government procurement.

Dated: August 18, 2010.

Edward Loeb,

Director, Acquisition Policy Division.

■ Therefore, DoD, GSA, and NASA amend 48 CFR parts 2, 5, 25, and 52 as set forth below:

■ 1. The authority citation for 48 CFR parts 2, 5, 25, and 52 continues to read as follows:

Authority: 40 U.S.C. 121(c); 10 U.S.C. chapter 137; and 42 U.S.C. 2473(c).

PART 2—DEFINITIONS OF WORDS AND TERMS

■ 2. Amend section 2.101 in paragraph (b)(2), in the definition "Component", by revising paragraphs (2) and (3); and adding paragraph (4) to read as follows:

2.101 Definitons.

* * * * *

(b) * * *

(2) * * *

Component * * *

(2) 52.225–1 and 52.225–3, see the definition in 52.225–1(a) and 52.225–3(a);

(3) 52.225–9 and 52.225–11, see the definition in 52.225–9(a) and 52.225–11(a); and

(4) 52.225–21 and 52.225–23, see the definition in 52.225–21(a) and 52.225–23(a).

* * * * *

PART 5—PUBLICIZING CONTRACT ACTIONS

5.207 [Amended]

■ 3. Amend section 5.207 by removing from paragraph (c)(13)(iii) the word "Other".

PART 25—FOREIGN ACQUISITION

■ 4. Amend section 25.001 by adding a new sentence to the end of paragraph (c)(4) to read as follows:

25.001 General.

* * * * *

(c) * * *

(4) * * * If the construction material consists wholly or predominantly of iron or steel, the iron or steel must be produced in the United States.

■ 5. Amend section 25.003 by revising the definition "Domestic construction material" to read as follows:

25.003 Definitions.

* * * * *

Domestic construction material means—

(1)(i) An unmanufactured construction material mined or produced in the United States;

(ii) A construction material manufactured in the United States, if—

(A) The cost of the components mined, produced, or manufactured in the United States exceeds 50 percent of the cost of all its components. Components of foreign origin of the same class or kind for which nonavailability determinations have been made are treated as domestic; or

(B) The construction material is a COTS item;

(2) Except that for use in subpart 25.6, see the definition in 25.601.

* * * * *

■ 6. Revise section 25.600 to read as follows:

25.600 Scope of subpart.

This subpart implements section 1605 in Division A of the American Recovery and Reinvestment Act of 2009 (Pub. L. 111–5) (Recovery Act) with regard to manufactured construction material and the Buy American Act with regard to unmanufactured construction material. It applies to construction projects that use funds appropriated or otherwise provided by the Recovery Act.

■ 7. Amend section 25.601 by revising the definition "Domestic construction material"; and adding, in alphabetical order, the definition "Public building or public work".

The revised and added text reads as follows:

25.601 Definitions.

* * * * *

Domestic construction material means the following:

(1) An unmanufactured construction material mined or produced in the United States. (The Buy American Act applies.)

(2) A manufactured construction material that is manufactured in the United States and, if the construction material consists wholly or predominantly of iron or steel, the iron or steel was produced in the United States. (Section 1605 of the Recovery Act applies.)

* * * * *

Public building or public work means a building or work, the construction, prosecution, completion, or repair of which is carried on directly or indirectly by authority of, or with funds of, a Federal agency to serve the interest of the general public regardless of whether title thereof is in a Federal agency (see 22.401). These buildings and works may include, without limitation, bridges, dams, plants, highways, parkways, streets, subways, tunnels, sewers, mains, power lines, pumping stations, heavy generators, railways, airports, terminals, docks, piers, wharves, ways, lighthouses, buoys, jetties, breakwaters, levees, and canals, and the construction, alteration, maintenance, or repair of such buildings and works.

* * * * *

■ 8. Revise section 25.602 to read as follows:

25.602 Policy.

25.602–1 Section 1605 of the Recovery Act.

Except as provided in 25.603—

(a) None of the funds appropriated or otherwise made available by the Recovery Act may be used for a project for the construction, alteration, maintenance, or repair of a public building or public work unless the

public building or public work is located in the United States and—

(1) All of the iron, steel, and manufactured goods used as construction material in the project are produced or manufactured in the United States.

(i) All manufactured construction material must be manufactured in the United States.

(ii) *Iron or steel components.* (A) Iron or steel components of construction material consisting wholly or predominantly of iron or steel must be produced in the United States. This does not restrict the origin of the elements of the iron or steel, but requires that all manufacturing processes of the iron or steel must take place in the United States, except metallurgical processes involving refinement of steel additives.

(B) The requirement in paragraph (a)(1)(ii)(A) of this section does not apply to iron or steel components or subcomponents in construction material that does not consist wholly or predominantly of iron or steel.

(iii) *All other components.* There is no restriction on the origin or place of production or manufacture of components or subcomponents that do not consist of iron or steel.

(iv) *Examples.* (A) If a steel guardrail consists predominantly of steel, even though coated with aluminum, then the steel would be subject to the section 1605 restriction requiring that all stages of production of the steel occur in the United States, in addition to the requirement to manufacture the guardrail in the United States. There would be no restrictions on the other components of the guardrail.

(B) If a wooden window frame is delivered to the site as a single construction material, there is no restriction on any of the components, including the steel lock on the window frame; or

(2) If trade agreements apply, the manufactured construction material shall either comply with the requirements of paragraph (a)(1) of this subsection, or be wholly the product of or be substantially transformed in a Recovery Act designated country;

(b) Manufactured materials purchased directly by the Government and delivered to the site for incorporation into the project shall meet the same domestic source requirements as specified for manufactured construction material in paragraphs (a)(1) and (a)(2) of this section; and

(c) A project may include several contracts, a single contract, or one or more line items on a contract.

25.602–2 Buy American Act.

Except as provided in 25.603, use only unmanufactured construction material mined or produced in the United States, as required by the Buy American Act or, if trade agreements apply, unmanufactured construction material mined or produced in a designated country may also be used.

■ 9. Revise section 25.603 to read as follows:

25.603 Exceptions.

(a)(1) When one of the following exceptions applies, the contracting officer may allow the contractor to incorporate foreign manufactured construction materials without regard to the restrictions of section 1605 of the Recovery Act or foreign unmanufactured construction material without regard to the restrictions of the Buy American Act:

(i) *Nonavailability.* The head of the contracting activity may determine that a particular construction material is not mined, produced, or manufactured in the United States in sufficient and reasonably available commercial quantities of a satisfactory quality. The determinations of nonavailability of the articles listed at 25.104(a) and the procedures at 25.103(b)(1) also apply if any of those articles are acquired as construction materials.

(ii) *Unreasonable cost.* The contracting officer concludes that the cost of domestic construction material is unreasonable in accordance with 25.605.

(iii) *Inconsistent with public interest.* The head of the agency may determine that application of the restrictions of section 1605 of the Recovery Act to a particular manufactured construction material, or the restrictions of the Buy American Act to a particular unmanufactured construction material would be inconsistent with the public interest.

(2) In addition, the head of the agency may determine that application of the Buy American Act to a particular unmanufactured construction material would be impracticable.

(b) *Determinations.* When a determination is made, for any of the reasons stated in this section, that certain foreign construction materials may be used—

(1) The contracting officer shall list the excepted materials in the contract; and

(2) For determinations with regard to the inapplicability of section 1605 of the Recovery Act, unless the construction material has already been determined to be domestically nonavailable (*see* list at 25.104), the head of the agency shall provide a notice to the **Federal Register** within three business days after the determination is made, with a copy to the Administrator for Federal Procurement Policy and to the Recovery Accountability and Transparency Board. The notice shall include—

(i) The title "Buy American Exception under the American Recovery and Reinvestment Act of 2009";

(ii) The dollar value and brief description of the project; and

(iii) A detailed justification as to why the restriction is being waived.

(c) *Acquisitions under trade agreements.* (1) For construction contracts with an estimated acquisition value of $7,804,000 or more, also see subpart 25.4. Offers proposing the use of construction material from a designated country shall receive equal consideration with offers proposing the use of domestic construction material.

(2) For purposes of applying section 1605 of the Recovery Act to evaluation of manufactured construction material, designated countries do not include the Caribbean Basin Countries.

■ 10. Amend section 25.604 by revising paragraph (c)(1), and by removing from paragraph (c)(2) "the unmanufactured" and adding "the domestic unmanufactured" in its place.

The revised text reads as follows:

25.604 Preaward determination concerning the inapplicability of section 1605 of the Recovery Act or the Buy American Act.

* * * * *

(c) * * *

(1) *Manufactured construction material.* The contracting officer must compare the offered price of the contract using foreign manufactured construction material (*i.e.*, any construction material not manufactured in the United States, or construction material consisting predominantly of iron or steel and the iron or steel is not produced in the United States) to the estimated price if all domestic manufactured construction material were used. If use of domestic manufactured construction material would increase the overall offered price of the contract by more than 25 percent, then the contracting officer shall determine that the cost of the domestic manufactured construction material is unreasonable.

* * * * *

■ 11. Amend section 25.605 by—

■ a. Revising paragraphs (a)(1) and (a)(2);

■ b. Redesignating paragraphs (b) through (d) as paragraphs (c) through (e);

■ c. Adding a new paragraph (b); and

■ d. Removing from the newly designated paragraph (c) "If two" and adding "Unless paragraph (b) applies, if two" in its place.

The revised and added text reads as follows:

25.605 Evaluating offers of foreign construction material.

(a) * * *

(1) Use an evaluation factor of 25 percent, applied to the total offered price of the contract, if foreign manufactured construction material is incorporated in the offer based on an exception for unreasonable cost of comparable domestic construction material requested by the offeror.

(2) In addition, use an evaluation factor of 6 percent applied to the cost of foreign unmanufactured construction material incorporated in the offer based on an exception for unreasonable cost of comparable domestic unmanufactured construction material requested by the offeror.

(b) If the solicitation specifies award on the basis of factors in addition to cost or price, apply the evaluation factors as specified in paragraph (a) of this section and use the evaluated price in determining the offer that represents the best value to the Government.

* * * * *

■ 12. Amend section 25.607 by revising paragraph (c)(4) to read as follows:

25.607 Noncompliance.

* * * * *

(c) * * *

(4) If the noncompliance is sufficiently serious, consider exercising appropriate contractual remedies, such as terminating the contract for default. Also consider preparing and forwarding a report to the agency suspending or debarring official in accordance with subpart 9.4. If the noncompliance appears to be fraudulent, refer the matter to other appropriate agency officials, such as the agency's inspector general or the officer responsible for criminal investigation.

■ 13. Amend section 25.1102 by redesignating paragraph (e)(2) as paragraph (e)(3); adding a new paragraph (e)(2); and revising the newly designated paragraph (e)(3) to read as follows:

25.1102 Acquisition of construction.

* * * * *

(e) * * *

(2) If these Recovery Act provisions and clauses are only applicable to a project consisting of certain line items in the contract, identify in the schedule the line items to which the provisions and clauses apply.

(3) When using clause 52.225–23, list foreign construction material in paragraph (b)(3) of the clause as follows:

(i) *Basic clause.* List all foreign construction materials excepted from the Buy American Act or section 1605 of the Recovery Act, other than manufactured construction material from a Recovery Act designated country or unmanufactured construction material from a designated country.

(ii) *Alternate I.* List in paragraph (b)(3) of the clause all foreign construction material excepted from the Buy American Act or section 1605 of the Recovery Act, other than—

(A) Manufactured construction material from a Recovery Act designated country other than Bahrain, Mexico, or Oman; or

(B) Unmanufactured construction material from a designated country other than Bahrain, Mexico, or Oman.

PART 52—SOLICITATION PROVISIONS AND CONTRACT CLAUSES

■ 14. Amend section 52.225–21 by—

■ a. Revising the section heading;

■ b. Revising the heading and the date of the clause;

■ c. In paragraph (a) by—

■ 1. Adding, in alphabetical order, the definition "Component";

■ 2. Removing the last sentence from the definition "Construction material"; and

■ 3. Revising the definition "Domestic construction material"; and

■ d. Revising paragraphs (b)(1)(i), (b)(1)(ii), and (b)(4).

The revised and added text reads as follows:

52.225–21 Required Use of American Iron, Steel, and Manufactured Goods—Buy American Act—Construction Materials.

* * * * *

Required Use of American Iron, Steel, and Manufactured Goods—Buy American Act—Construction Materials (Oct 2010)

(a) * * *

Component means an article, material, or supply incorporated directly into a construction material.

* * * * *

Domestic construction material means the following—

(1) An unmanufactured construction material mined or produced in the United States. (The Buy American Act applies.)

(2) A manufactured construction material that is manufactured in the United States and, if the construction material consists wholly or predominantly of iron or steel, the iron or steel was produced in the United States. (Section 1605 of the Recovery Act applies.)

* * * * *

(b) * * *

(1) * * *

(i) Section 1605 of the American Recovery and Reinvestment Act of 2009 (Recovery Act) (Pub. L. 111–5), by requiring, unless an exception applies, that all manufactured construction material in the project is manufactured in the United States and, if the construction material consists wholly or predominantly of iron or steel, the iron or steel was produced in the United States (produced in the United States means that all manufacturing processes of the iron or steel must take place in the United States, except metallurgical processes involving refinement of steel additives); and

(ii) The Buy American Act (41 U.S.C. 10a–10d) by providing a preference for unmanufactured construction material mined or produced in the United States over unmanufactured construction material mined or produced in a foreign country.

* * * * *

(4) The Contracting Officer may add other foreign construction material to the list in paragraph (b)(3) of this clause if the Government determines that—

(i) The cost of domestic construction material would be unreasonable;

(A) The cost of domestic manufactured construction material, when compared to the cost of comparable foreign manufactured construction material, is unreasonable when the cumulative cost of such material will increase the cost of the contract by more than 25 percent;

(B) The cost of domestic unmanufactured construction material is unreasonable when the cost of such material exceeds the cost of comparable foreign unmanufactured construction material by more than 6 percent;

(ii) The construction material is not mined, produced, or manufactured in the United States in sufficient and reasonably available quantities and of a satisfactory quality;

(iii) The application of the restriction of section 1605 of the Recovery Act to a particular manufactured construction material would be inconsistent with the public interest or the application of the Buy American Act to a particular unmanufactured construction material would be impracticable or inconsistent with the public interest.

* * * * *

■ 15. Amend section 52.225–22 by—

■ a. Revising the section heading;

■ b. Revising the heading and the date of the provision;

■ c. Removing from paragraph (a) the word "Other";

■ d. In paragraph (c) by—

■ 1. Adding in paragraph (c)(1) introductory text "in accordance with FAR 25.604" after the word "applies";

■ 2. Revising paragraph (c)(1)(i);

■ 3. Adding in paragraph (c)(1)(ii) "an exception for the" after the words "based on"; and

■ 4. Redesignating paragraph (c)(2) as paragraph (c)(3); adding a new paragraph (c)(2); and revising the newly designated paragraph (c)(3); and

■ e. Removing from paragraph (d)(1) "paragraph (b)(2)" and adding "paragraph (b)(3)" in its place.

The revised and added text reads as follows:

52.225–22 Notice of Required Use of American Iron, Steel, and Manufactured Goods—Buy American Act—Construction Materials.

* * * * *

Notice of Required Use of American Iron, Steel, and Manufactured Goods—Buy American Act—Construction Materials (Oct 2010)

* * * * *

(c) * * *

(1) * * *

(i) 25 percent of the offered price of the contract, if foreign manufactured construction material is incorporated in the offer based on an exception for unreasonable cost of comparable manufactured domestic construction material; and

* * * * *

(2) If the solicitation specifies award on the basis of factors in addition to cost or price, the Contracting Officer will apply the evaluation factors as specified in paragraph (c)(1) of this provision and use the evaluated price in determining the offer that represents the best value to the Government.

(3) Unless paragraph (c)(2) of this provision applies, if two or more offers are equal in price, the Contracting Officer will give preference to an offer that does not include foreign construction material excepted at the request of the offeror on the basis of unreasonable cost of comparable domestic construction material.

* * * * *

■ 16. Amend section 52.225–23 by—

■ a. Revising the section heading;

■ b. Revising the heading and the date of the clause;

■ c. In paragraph (a) by—

■ 1. Adding, in alphabetical order, the definitions "Component", "Designated country", "Designated country construction material", and "Nondesignated country";

■ 2. Removing the last sentence from the definition "Construction material";

■ 3. Revising the definition "Domestic construction material"; and

■ 4. Removing from the definition "Recovery Act designated country" paragraph (2) the word "Israel,";

■ d. Revising paragraph (b);

■ e. Revising paragraph (c)(3);

■ f. Removing from the table heading in paragraph (d) "Foreign and" and adding "Foreign (Nondesignated Country) and" in its place; and

■ g. In Alternate I by—

■ i. Revising the date of the alternate; and

■ ii. Revising paragraph (b).

The revised and added text reads as follows:

52.225–23 Required Use of American Iron, Steel, and Manufactured Goods—Buy American Act—Construction Materials Under Trade Agreements.

* * * * *

Required Use of American Iron, Steel, and Manufactured Goods—Buy American Act—Construction Materials Under Trade Agreements (Oct 2010)

(a) * * *

Component means an article, material, or supply incorporated directly into a construction material.

* * * * *

Designated country means any of the following countries:

(1) A World Trade Organization Government Procurement Agreement (WTO GPA) country (Aruba, Austria, Belgium, Bulgaria, Canada, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hong Kong, Hungary, Iceland, Ireland, Israel, Italy, Japan, Korea (Republic of), Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, Netherlands, Norway, Poland, Portugal, Romania, Singapore, Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Taiwan, or United Kingdom);

(2) A Free Trade Agreement (FTA) country (Australia, Bahrain, Canada, Chile, Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, Mexico, Morocco, Nicaragua, Oman, Peru, or Singapore);

(3) A least developed country (Afghanistan, Angola, Bangladesh, Benin, Bhutan, Burkina Faso, Burundi, Cambodia, Central African Republic, Chad, Comoros, Democratic Republic of Congo, Djibouti, East Timor, Equatorial Guinea, Eritrea, Ethiopia, Gambia, Guinea, Guinea-Bissau, Haiti, Kiribati, Laos, Lesotho, Liberia, Madagascar, Malawi, Maldives, Mali, Mauritania, Mozambique, Nepal, Niger, Rwanda, Samoa, Sao Tome and Principe, Senegal, Sierra Leone, Solomon Islands, Somalia, Tanzania, Togo, Tuvalu, Uganda, Vanuatu, Yemen, or Zambia); or

(4) A Caribbean Basin country (Antigua and Barbuda, Aruba, Bahamas, Barbados, Belize, British Virgin Islands, Dominica, Grenada, Guyana, Haiti, Jamaica, Montserrat, Netherlands Antilles, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, or Trinidad and Tobago).

Designated country construction material means a construction material that is a WTO GPA country construction material, an FTA country construction material, a least developed country construction material, or a Caribbean Basin country construction material.

Domestic construction material means the following:

(1) An unmanufactured construction material mined or produced in the United States. (The Buy American Act applies.)

(2) A manufactured construction material that is manufactured in the United States and, if the construction material consists wholly or predominantly of iron or steel, the iron or steel was produced in the United States. (Section 1605 of the Recovery Act applies.)

* * * * *

Nondesignated country means a country other than the United States or a designated country.

* * * * *

(b) *Construction materials.* (1) The restrictions of section 1605 of the American Recovery and Reinvestment Act of 2009 (Pub. L. 111–5) (Recovery Act) do not apply to Recovery Act designated country manufactured construction material. The restrictions of the Buy American Act do not apply to designated country unmanufactured construction material. Consistent with U.S. obligations under international agreements, this clause implements—

(i) Section 1605 of the Recovery Act by requiring, unless an exception applies, that all manufactured construction material in the project is manufactured in the United States and, if the construction material consists wholly or predominantly of iron or steel, the iron or steel was produced in the United States (produced in the United States means that all manufacturing processes of the iron or steel must take place in the United States, except metallurgical processes involving refinement of steel additives); and

(ii) The Buy American Act by providing a preference for unmanufactured construction material mined or produced in the United States over unmanufactured construction material mined or produced in a nondesignated country.

(2) The Contractor shall use only domestic construction material, Recovery Act designated country manufactured construction material, or designated country unmanufactured construction material in performing this contract, except as provided in paragraphs (b)(3) and (b)(4) of this clause.

(3) The requirement in paragraph (b)(2) of this clause does not apply to the construction materials or components listed by the Government as follows:

[*Contracting Officer to list applicable excepted materials or indicate "none"*.]

(4) The Contracting Officer may add other construction material to the list in paragraph (b)(3) of this clause if the Government determines that—

(i) The cost of domestic construction material would be unreasonable;

(A) The cost of domestic manufactured construction material is unreasonable when the cumulative cost of such material, when compared to the cost of comparable foreign manufactured construction material, other than Recovery Act designated country construction material, will increase the overall cost of the contract by more than 25 percent;

(B) The cost of domestic unmanufactured construction material is unreasonable when the cost of such material exceeds the cost of comparable foreign unmanufactured construction material, other than designated country construction material, by more than 6 percent;

(ii) The construction material is not mined, produced, or manufactured in the United States in sufficient and reasonably available commercial quantities of a satisfactory quality; or

(iii) The application of the restriction of section 1605 of the Recovery Act to a particular manufactured construction

material would be inconsistent with the public interest or the application of the Buy American Act to a particular unmanufactured construction material would be impracticable or inconsistent with the public interest.

(c) * * *

(3) Unless the Government determines that an exception to section 1605 of the Recovery Act or the Buy American Act applies, use of foreign construction material other than manufactured construction material from a Recovery Act designated country or unmanufactured construction material from a designated country is noncompliant with the applicable Act.

* * * * *

Alternate I (Oct 2010). * * *

(b) *Construction materials.* (1) The restrictions of section 1605 of the American Recovery and Reinvestment Act of 2009 (Pub. L. 111–5) (Recovery Act) do not apply to Recovery Act designated country manufactured construction material. The restrictions of the Buy American Act do not apply to designated country unmanufactured construction material. Consistent with U.S. obligations under international agreements, this clause implements—

(i) Section 1605 of the Recovery Act, by requiring, unless an exception applies, that all manufactured construction material in the project is manufactured in the United States and, if the construction material consists wholly or predominantly of iron or steel, the iron or steel was produced in the United States (produced in the United States means that all manufacturing processes of the iron or steel must take place in the United States, except metallurgical processes involving refinement of steel additives); and

(ii) The Buy American Act by providing a preference for unmanufactured construction material mined or produced in the United States over unmanufactured construction material mined or produced in a nondesignated country.

(2) The Contractor shall use only domestic construction material, Recovery Act designated country manufactured construction material, or designated country unmanufactured construction material, other than Bahrainian, Mexican, or Omani construction material, in performing this contract, except as provided in paragraphs (b)(3) and (b)(4) of this clause.

■ 17. Amend section 52.225–24 by—

■ a. Revising the section heading;

■ b. Revising the heading and the date of the provision;

■ c. Removing from paragraph (a) the word "Other"; and

■ d. Revising paragraph (c).

The revised text reads as follows:

52.225–24 Notice of Required Use of American Iron, Steel, and Manufactured Goods—Buy American Act—Construction Materials Under Trade Agreements.

* * * * *

Notice of Required Use of American Iron, Steel, and Manufactured Goods—Buy American Act—Construction Materials Under Trade Agreements (Oct 2010)

* * * * *

(c) *Evaluation of offers.* (1) If the Government determines that an exception based on unreasonable cost of domestic construction material applies in accordance with FAR 25.604, the Government will evaluate an offer requesting exception to the requirements of section 1605 of the Recovery Act or the Buy American Act by adding to the offered price of the contract—

(i) 25 percent of the offered price of the contract, if foreign manufactured construction material is included in the offer based on an exception for the unreasonable cost of comparable manufactured domestic construction material; and

(ii) 6 percent of the cost of foreign unmanufactured construction material included in the offer based on an exception for the unreasonable cost of comparable domestic unmanufactured construction material.

(2) If the solicitation specifies award on the basis of factors in addition to cost or price, the Contracting Officer will apply the evaluation factors as specified in paragraph (c)(1) of this provision and use the evaluated cost or price in determining the offer that represents the best value to the Government.

(3) Unless paragraph (c)(2) of this provision applies, if two or more offers are equal in price, the Contracting Officer will give preference to an offer that does not include foreign construction material excepted at the request of the offeror on the basis of unreasonable cost.

* * * * *

[FR Doc. 2010–21027 Filed 8–27–10; 8:45 am]

BILLING CODE 6820–EP–P

DEPARTMENT OF DEFENSE

GENERAL SERVICES ADMINISTRATION

NATIONAL AERONAUTICS AND SPACE ADMINISTRATION

48 CFR Chapter 1

[Docket FAR 2010–0077, Sequence 7]

Federal Acquisition Regulation; Federal Acquisition Circular 2005–45; Small Entity Compliance Guide

AGENCIES: Department of Defense (DoD), General Services Administration (GSA), and National Aeronautics and Space Administration (NASA).

ACTION: Small Entity Compliance Guide.

SUMMARY: This document is issued under the joint authority of the Secretary of Defense, the Administrator of General Services and the Administrator of the National Aeronautics and Space Administration. This *Small Entity Compliance Guide* has been prepared in accordance with section 212 of the Small Business Regulatory Enforcement Fairness Act of 1996. It consists of a summary of rules appearing in Federal Acquisition Circular (FAC) 2005–45 which amend the FAR. Interested parties may obtain further information regarding these rules by referring to FAC 2005–45, which precedes this document. These documents are also available via the Internet at *http://www.regulations.gov.*

DATES: For effective dates see separate documents, which follow.

FOR FURTHER INFORMATION CONTACT: The analyst whose name appears in the table below. Please cite FAC 2005–45 and the specific FAR case number. For information pertaining to status or publication schedules, contact the Regulatory Secretariat at (202) 501–4755.

LIST OF RULES IN FAC 2005–45

Item	Subject	FAR case	Analyst
I	Inflation Adjustment of Acquisition-Related Thresholds	2008–024	Jackson.
II	Definition of Cost or Pricing Data	2005–036	Chambers.
III	American Recovery and Reinvestment Act of 2009 (the Recovery Act)—Buy American Requirements for Construction Materials.	2009–008	Davis.

SUPPLEMENTARY INFORMATION:

Summaries for each FAR rule follow. For the actual revisions and/or amendments made by these FAR cases, refer to the specific item number and subject set forth in the documents following these item summaries.

FAC 2005–45 amends the FAR as specified below:

Item I—Inflation Adjustment of Acquisition-Related Thresholds (FAR Case 2008–024)

This final rule amends the FAR to implement section 807 of the Ronald W.

THE RECOVERY ACT

On February 13, 2009, in direct response to the economic crisis and at the urging of Pı Obama, Congress passed the American Recovery and Reinvestment Act of 2009 -- cc referred to as the "stimulus" or the "stimulus package." Four days later, the President Recovery Act into law. The three immediate goals of the Recovery Act are:

- Create new jobs and save existing ones
- Spur economic activity and invest in long-term growth
- Foster unprecedented levels of accountability and transparency in government

The Recovery Act intended to achieve those goals by providing $787 billion in:

- Tax cuts and benefits for millions of working families and businesses
- Funding for entitlement programs, such as unemployment benefits
- Funding for federal contracts, grants and loans

In 2011, the original expenditure estimate of $787 billion was increased to $840 billion with the President's 2012 budget and with scoring changes made by the Congressiona Office since the enactment of the Recovery Act.

To achieve the goal of transparency, the Act requires recipients of Recovery funds to January, April, July, and October on how they are using the money. All the data is pos Recovery.gov so the public can track the Recovery funds.

In addition to offering financial aid directly to local school districts, expanding the Child and underwriting the computerization of health records, the Recovery Act is targeted a development and enhancement. For instance, the Act provides for the weatherizing of federal buildings and more than one million private homes.

Construction and repair of roads and bridges as well as scientific research and the exp broadband and wireless service are being funded.

There is no end date written into the Recovery Act because, while many of Recovery A projects are focused on jumpstarting the economy, others are expected to contribute t growth for many years.

U.S. ENVIRONMENTAL PROTECTION AGENCY
OFFICE OF INSPECTOR GENERAL

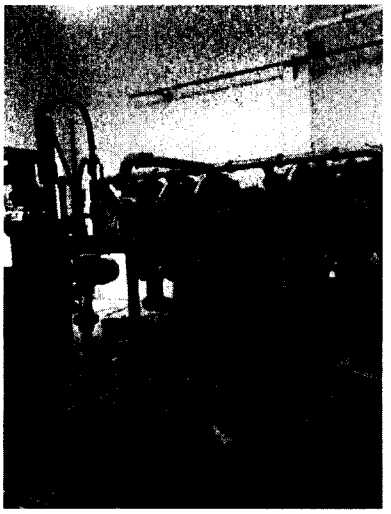
Catalyst for Improving the Environment

Site Visit Report

American Recovery and Reinvestment Act Site Visit of Wastewater Treatment Plant—Phase II Improvements Project, City of Ottawa, Illinois

Report No. 11-R-0700

September 23, 2011



Report Contributors:

Michael Rickey
Larry Brannon
Patrick McIntyre

Abbreviations

CFR Code of Federal Regulations
EPA U.S. Environmental Protection Agency

Cover photo: New rotary press system at the Ottawa, Illinois, wastewater treatment plant construction site. (EPA OIG photo)

U.S. Environmental Protection Agency
Office of Inspector General

11-R-0700
September 23, 2011

At a Glance

Catalyst for Improving the Environment

Why We Did This Review

The U.S. Environmental Protection Agency, Office of Inspector General, conducts site visits of American Recovery and Reinvestment Act of 2009 (Recovery Act) clean water and drinking water projects. The purpose of the visits is to confirm compliance with selected Recovery Act requirements. We selected the wastewater treatment plant project in the City of Ottawa, Illinois, for review.

Background

The city received a $7,720,293 loan from the State of Illinois under the Water Pollution Control Loan Program. The loan included $3,860,147 in Recovery Act funds. The city will use these funds to rehabilitate and improve the city's wastewater treatment plant.

For further information, contact our Office of Congressional, Public Affairs and Management at (202) 566-2391.

The full report is at: www.epa.gov/oig/reports/2011/20110923-11-R-0700.pdf

American Recovery and Reinvestment Act Site Visit of Wastewater Treatment Plant—Phase II Improvements Project, City of Ottawa, Illinois

What We Found

We conducted an unannounced site visit of the wastewater treatment plant project in the City of Ottawa, Illinois. As part of our site visit, we toured the project, interviewed city representatives and engineering and contractor personnel, and reviewed documentation related to Recovery Act requirements.

The city could not provide sufficient documentation to support that some manufactured goods used on the project met the Buy American requirements of Section 1605 of the Recovery Act. In these instances, the documentation did not demonstrate clearly that items were either manufactured in the United States or substantially transformed in the United States. As a result, the state's use of over $3.8 million of Recovery Act funds on the Ottawa project is prohibited by Section 1605 of the Recovery Act, unless a regulatory option is exercised.

What We Recommend

We recommend the Regional Administrator, Region 5, employ the procedures set out in Title 2 of the Code of Federal Regulations (CFR) to resolve the noncompliance on the Ottawa project. In the event that the region decides to retain foreign-manufactured goods in the Ottawa project under 2 CFR §176.130 (c)(3), the region should either "reduce the amount of the award by the cost of the steel, iron, or manufactured goods that are used in the project or . . . take enforcement or termination action in accordance with the agency's grants management regulations."

Neither the region nor the city agreed with our conclusion that the documentation was not sufficient to support Buy American compliance for some items. Based on additional documentation provided by the city, we agree that some items are now sufficiently supported, and we have revised the report accordingly. However, documentation is still insufficient in four instances.

UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

THE INSPECTOR GENERAL

September 23, 2011

MEMORANDUM

SUBJECT: American Recovery and Reinvestment Act Site Visit of
Wastewater Treatment Plant—Phase II Improvements Project,
City of Ottawa, Illinois
Report No. 11-R-0700

FROM: Arthur A. Elkins,
Inspector General

TO: Susan Hedman
Regional Administrator, Region 5
U.S. Environmental Protection Agency

This is our report on the subject site visit conducted by the Office of Inspector General of the U.S. Environmental Protection Agency (EPA). The report summarizes the results of our site visit to the Wastewater Treatment Plant—Phase II Improvements Project, City of Ottawa, Illinois.

We performed this site visit as part of our responsibility under the American Recovery and Reinvestment Act of 2009 (Recovery Act). The purpose of our site visit was to determine the city's compliance with selected requirements of the Recovery Act pertaining to the Clean Water State Revolving Fund Program. The Illinois Environmental Protection Agency approved the city's project. The city received a $7,720,293 loan, including $3,860,147 in Recovery Act funds.

The estimated direct labor and travel costs for this report are $170,910.

Action Required

The Agency disagreed with our recommendation, and the recommendation is considered unresolved with resolution efforts in progress. In accordance with EPA Manual 2750, Chapter 3, Section 6(f), you are required to provide us your proposed management decision for resolution of the findings contained in this report before you formally complete resolution with the recipient. As part of the audit resolution process, your proposed decision is due in 120 days, or on January 20, 2012. To expedite the resolution process, please e-mail an electronic version of your proposed management decision to adachi.robert@epa.gov.

Your response will be posted on the Office of Inspector General's public website, along with our memorandum commenting on your response. Your response should be provided as an Adobe PDF file that complies with the accessibility requirements of Section 508 of the Rehabilitation Act of 1973, as amended. The final response should not contain data that you do not want to be released to the public; if your response contains such data, you should identify the data for redaction or removal. We have no objection to the further release of this report to the public. This report will be available at http://www.epa.gov/oig.

If you or your staff have any questions regarding this report, please contact Melissa Heist, Assistant Inspector General for Audit, at (202) 566-0899 or heist.melissa@epa.gov; or Robert Adachi, Product Line Director, at (415) 947-4537 or adachi.robert@epa.gov.

Table of Contents

Appendices

Purpose

The purpose of our unannounced site visit was to determine whether the City of Ottawa, Illinois, complied with selected requirements of the American Recovery and Reinvestment Act of 2009 (Recovery Act), P.L. 111-5, pertaining to the wastewater treatment plant project jointly funded by the Recovery Act and the Illinois Water Pollution Control Loan Program.

Background

In May 2009, the U.S. Environmental Protection Agency (EPA) awarded over $177 million of Recovery Act funds to the State of Illinois to capitalize its revolving loan fund, which provides financing for construction of wastewater treatment facilities and other authorized uses. In addition to the regulatory requirements at Title 40 Code of Federal Regulations (CFR), Chapter 1, Subchapter B, the assistance award was subject to 2 CFR Part 176, "Requirements for Implementing Sections 1512, 1605, and 1606 of the American Recovery and Reinvestment Act of 2009 for Financial Assistance Awards."

In January 2010, the city accepted a $7,720,293 loan from the Illinois Environmental Protection Agency. The terms of the loan were based on an annual fixed loan rate of zero percent on a 20-year note. The loan included $3,860,147 in Recovery Act funds, of which half is to be repaid to the state. The loan balance was funded by the state's Water Pollution Control Loan Program. The city used these funds to rehabilitate and improve the city's wastewater treatment plant.

Scope and Methodology

Due to the time-critical nature of Recovery Act requirements, we did not perform this assignment in accordance with generally accepted government auditing standards. Specifically, we did not perform certain steps that would allow us to obtain information to assess the city's internal controls and any previously reported audit concerns. As a result, we do not express an opinion on the adequacy of the city's internal controls or compliance with all federal, state, or local requirements.

We made our unannounced site visit on October 5–8, 2010. On November 18–19, 2010, and again on April 4–5, 2011, we visited the city to perform additional work related to Buy American compliance. During our visits, we:

1. Toured the project
2. Interviewed city, engineering, and contractor personnel
3. Reviewed documentation maintained by the city, its engineer, and contractors on the following matters:
    a. Buy American requirements under Section 1605 of the Recovery Act

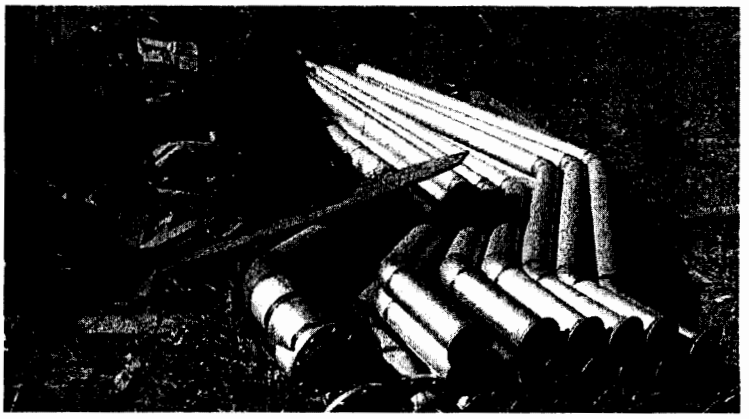
b. Wage rate requirements under Section 1606 of the Recovery Act
c. Limits on funds and reporting requirements under Sections 1604 and 1512 of the Recovery Act
d. Contract procurement

Results of Site Visit

The city could not provide sufficient documentation in four instances to assure compliance with the Buy American requirements of the Recovery Act. Unless the city can comply with Buy American requirements or obtain a waiver from EPA, the city's project to rehabilitate its wastewater treatment plant would not be eligible for Recovery Act funds. We did not identify any other Recovery Act issues. We summarize specific results below.

Buy American Requirements

Ottawa did not provide sufficient documentation to show that some manufactured goods used in the project, funded in part by the Recovery Act, were produced or manufactured in the United States. In two instances, we identified materials on site as foreign made. The federal grant to capitalize Illinois's revolving loan fund with Recovery Act funds required that all projects use manufactured goods produced in the United States, unless certain exceptions apply as provided for in 2 CFR §176.60. The state included the Buy American requirements in the loan agreement with Ottawa. However, we do not believe that the city fully understood the procedures necessary to determine and document compliance. Further, the state had not visited the project site.


Foreign-made steel pipe for the Ottawa project. (EPA OIG photo)

Because the city cannot show that it complied with the Buy American requirements and has not obtained a waiver from EPA, the treatment plant's rehabilitation project presently is not eligible for Recovery Act funding. As a result, the state's use of over $3.8 million of Recovery Act funds on the Ottawa project is prohibited by Section 1605 of the Recovery Act, unless a regulatory option is exercised.

Title 2 CFR §176.60 states that Section 1605 of the Recovery Act prohibits the use of Recovery Act funds for a project unless all of the iron, steel, and manufactured goods used in the project are produced in the United States. The regulation requires that this prohibition be consistent with U.S. obligations under international agreements, and provides for a waiver under three circumstances.

Title 2 CFR §176.140(a)(1) defines a manufactured good as a good brought to the construction site for incorporation that has been processed into a specific form and shape, or combined with raw materials to create a material that has different properties than the properties of the individual raw materials. There is no requirement with regard to the origin of components in manufactured goods, as long as the manufacture of the goods occurs in the United States.[1] In the case of a manufactured good that consists in whole or in part of materials from another country, a domestically manufactured good is one that has been substantially transformed in the United States into a new and different manufactured good distinct from the materials from which it was transformed.[2]

To assist recipients of Recovery Act funds, EPA developed several guidance documents and Internet-based training modules explaining the concept of substantial transformation and the types of documentation needed to support a substantial transformation determination. Key documents include:

- *Determining Whether "Substantial Transformation" of Components Into a "Manufactured Good" Has Occurred in the U.S.: Analysis, Roles, and Responsibilities*, dated October 22, 2009 (Determining Substantial Transformation)
- *Buy American Provisions of ARRA Section 1605 Questions and Answers—Part 1*, revised September 22, 2009 (Buy American Q&A Part 1)
- *Buy American Provisions of ARRA Section 1605 Questions and Answerers—Part 2*, dated November 16, 2009 (Buy American Q&A Part 2)

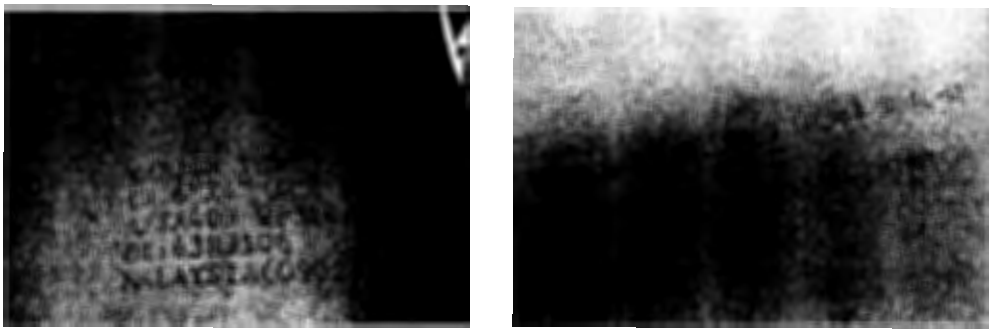
These guidance documents provide:

- An explanation of substantial transformation
- A matrix of questions for determining whether substantial transformation has occurred in the United States
- The requirements for the type of documentation needed to support substantial transformation
- The need to retain the documentation to support compliance with Section 1605 of the Recovery Act

During our initial site visit, we noted that stainless steel drop pipes had manufacturing markings from Malaysia, China, and Taiwan. We also noted that

[1] Title 2 CFR §176.70(a)(2)(ii) and Title 2 CFR §176.160(a), "Domestic iron, steel, and/or manufactured good."
[2] Title 2 CFR §176.160(a), "Domestic iron, steel, and/or manufactured good."

some of the electrical panels were made in Mexico. To explore this issue further, we reviewed supporting documentation to confirm Buy American compliance for 57 items listed in various sections of the Bidding, Contract, and Specifications document for the Ottawa project. The supporting documentation for 53 items was sufficient to confirm compliance with the Buy American requirements.



Pipe at the Ottawa project site labeled as made in Malaysia *(left)* and China. (EPA OIG photo)

The documentation provided for the equipment items in table 1 did not provide meaningful and specific technical descriptions of the manufacturing process to determine whether the items were manufactured or substantially transformed in the United States.

Table 1: Equipment for which supporting documentation was not sufficient to support Buy American compliance

Equipment	Model	No. units	Company
Submersible pumps	Flygt NP3085-183	2	ITT Water and Wastewater U.S.A.
Submersible chopper pump	Flygt FP3127.390	1	ITT Water and Wastewater U.S.A.
Positive displacement blowers	Kaeser EB 420C	2	Kaiser Compressors, Inc.
Centrifugal blowers	KTurbo TB 100-0.6S	3	KTurbo USA

Source: OIG analysis.

There was no clear support that the equipment had been substantially transformed into a "new and different manufactured good distinct from the materials from which it was transformed," as defined in 2 CFR 176.160. In all four instances, the equipment items were assembled in the United States by companies with foreign affiliations. The supporting documentation did not provide clear and persuasive evidence that the assembly processes completed in the United States were sufficiently complex or meaningful to qualify as substantial transformation.

Recipients of Recovery Act funds must have adequate, project-specific documentation to support compliance with Buy American requirements. Without such documentation, compliance cannot be credibly and meaningfully

demonstrated.[3] For items substantially transformed in the United States, the documentation must be meaningful, informative, and contain specific technical descriptions of the activities in the actual transformation process. The documentation cannot simply assert a conclusion or describe an end state.[4] Substantial transformation determinations are always made on a case-by-case basis and cannot occur by undergoing a simple combining or packaging operation.[5] Assembly operations that are minimal or simple, as opposed to complex or meaningful, generally will not result in a substantial transformation.[6] Design, planning, procurement, component production, or any other step prior to the process of physically working on and bringing together components to form an item incorporated into the project cannot constitute or be a part of substantial transformation. Activities that occur at the project site are generally considered construction, not manufacturing.[7]

Flygt Pumps

ITT Water and Wastewater U.S.A. provided two letters to Ottawa to support that the submersible pumps it supplied complied with Buy American requirements. The first letter, dated February 24, 2010, made general statements about Buy American requirements and EPA guidance, and asserted, "With the strength of ITT's nearly 10 pump factories located in more than five states, ITT WWW will comply fully with this requirement by assembling Flygt brand model **NP3085 and FP3127** submersible pumps listed on quote **2009-CHI-1810** in a facility located in the United States. . . ."

The statement is both prospective and too general to draw any conclusion regarding the actual manufacturing process. EPA's Buy American Q&A Part 2 states that documentation should include meaningful, informative, and specific technical descriptions of the activities in the actual process and not simply assert a conclusion or describe an end state.

On June 1, 2011, a business development manager for ITT Water and Wastewater U.S.A. certified that the Flygt model NP3085-183 submersible pumps and the FP3127.390 submersible chopper pump were substantially transformed based on processes performed in the United States that were complex and meaningful. According to the certification, the processes took a substantial amount of time, were costly, were completed by highly skilled labor, required a number of different processes, and added substantial value. To support this claim, the

[3] *Buy American Provisions of ARRA Section 1605 Questions and Answerers—Part 2*, dated November 16, 2009, question 5, p. 4.
[4] *Determining Whether "Substantial Transformation" of Components Into a "Manufactured Good" Has Occurred in the U.S.: Analysis, Roles, and Responsibilities*, dated October 22, 2009, p. 6.
[5] Ibid.
[6] Ibid.
[7] Ibid., pp. 7 and 8.

manufacturer provided additional detail and pictures of its Pewaukee, Wisconsin, facility in a letter, also dated June 1, 2011.

The June 1, 2011, letter stated that prior to the manufacturing process, significant design, facility development, engineering, logistics, scheduling, and training was accomplished in addition to sales company activities, which included defining, sizing, and selecting proper equipment and ordering materials, which took an average of 48 minutes per pump unit. Materials handling, which included receipt of individual components, inventorying of materials, material picking, cable cutting, and data plate printing, took an average of 82 minutes per pump unit.

This information is irrelevant when determining whether goods are manufactured in the United States. EPA guidance, Determining Substantial Transformation, states that design, planning, procurement, component production, or any other step prior to the process of physically working on or bringing together the components to form an item incorporated into the project cannot constitute or be a part of substantial transformation.

EPA's Determining Substantial Transformation also states that no good "satisfies the substantial transformation test by . . . having merely undergone '[a] simple combining or packaging operation.'"[8] Secondly, "[a]ssembly operations which are minimal or simple, as opposed to complex or meaningful, will generally not result in a substantial transformation."[9] The guidance also states:

> An oversimplified summary of substantial transformation analysis is to ask whether the activities in the U.S. substantially transformed the components that go into the completed item. . . . Because assembly is in most cases further down the spectrum towards non-transformative work, a more demanding standard is appropriate. . . .

According to the Flygt USA Internet site (http://www.flygtus.com), ITT Water and Wastewater is an international company headquartered in Sweden. Manufacturing facilities are in Sweden (main plant), China, and South America. The company has a corporate office, which supports sales and services, and branch offices in the United States. The Internet site lists no manufacturing facilities in the United States. For an international company with manufacturing facilities throughout the world, it is important to clearly understand the roles of related companies, including detailed descriptions and cost information of materials and components

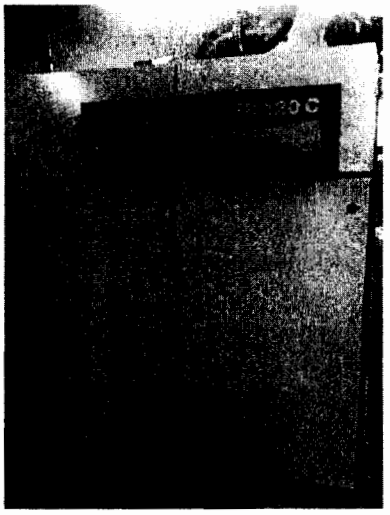
[8] *Determining Whether "Substantial Transformation" of Components Into a "Manufactured Good" Has Occurred in the U.S.: Analysis, Roles, and Responsibilities*, dated October 22, 2009, p. 6.
[9] Ibid.

that are used in the manufacturing processes performed by related companies. EPA's Buy American Q&A Part 1 states that if all the pieces are shipped by one company with the intent of providing all components necessary to be assembled in a functional good, then substantial transformation would not occur and the product would not be a U.S.-made good.

We do not believe that the manufacturer's letters adequately support its claim of substantial transformation by complex or meaningful assembly. We find no evidence that components were transformed. The company did not provide information about the manufacturing processes completed outside the United States by related companies. The company did not support its claim that the processes were costly and tripled the value of the components with any type of cost breakdown or detail. The company did not provide a description as to the type of skills and certifications needed by the labor force to assemble and test the pumps. Without detailed descriptions of the entire manufacturing process and supporting documentation, we cannot determine whether the Flygt pumps met the Buy American requirements.

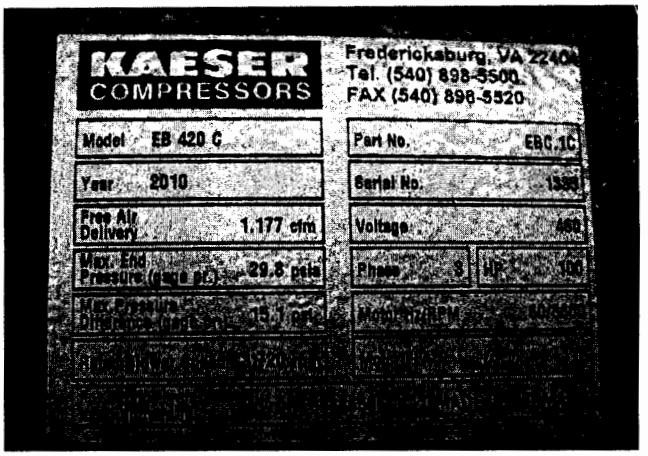
Kaeser Blower

Kaeser Compressors, Inc., provided a letter to Ottawa dated October 29, 2010, to support substantial transformation. The letter stated that for Recovery Act–funded projects, the company purchases a base chassis of proprietarily designed components from the parent company, Kaeser Kompressoren, GmbH, located in Germany. This chassis consists of components such as the blower block, silencer base, and enclosure. The items added in the United States include the electric motor, pulleys, belts, relief valves, and expansion joints. The letter described the building process as mounting and aligning the motor and v-belt pulley drive, adjusting and installing the pressure relief valve(s), and assembling and installing of check valves, fan motors, gauges, and switches. Depending on the size and complexity of the specification, additional wiring and setting of ancillary devices may be required. Each unit requires 16 to 20 hours to build. The assembly procedures, combined with the U.S.-sourced items, account for 35 to 50 percent of the package's total value.



Kaeser blower. (EPA OIG photo)

The October 29 letter does not provide a meaningful and specific technical description of the assembly process in the United States that would enable us to determine whether the Ottawa blowers were manufactured or substantially transformed in the United States.



Kaeser blower label, indicating product was made in Germany. (EPA OIG photo)

Product literature and physical inspection of the equipment at the construction site showed that the chassis manufactured in Germany was essentially a blower without a drive system. The documentation did not explain how the addition of the drive system (motor, pulley, and belts) substantially changed or transformed the character and use of the blower chassis manufactured in Germany and imported into the United States. The number of assembly hours in the United States and the added value are not meaningful without some context, i.e., a demonstration of the relationship of the assembly time in the United States to the number of hours and operations spent to manufacture the chassis obtained from the parent company in Germany. Finally, the letter is too general and does not specifically address the assembly of the blowers incorporated into the Ottawa project. Without additional documentation, there is no evidence that blowers have been substantially transformed into a "new and different manufactured good distinct from the materials from which it was transformed," as described in 2 CFR 176.160. This documentation should provide details about the entire manufacturing and assembly process to determine that the assembly process in the United States was complex or meaningful as required to qualify as substantial transformation.

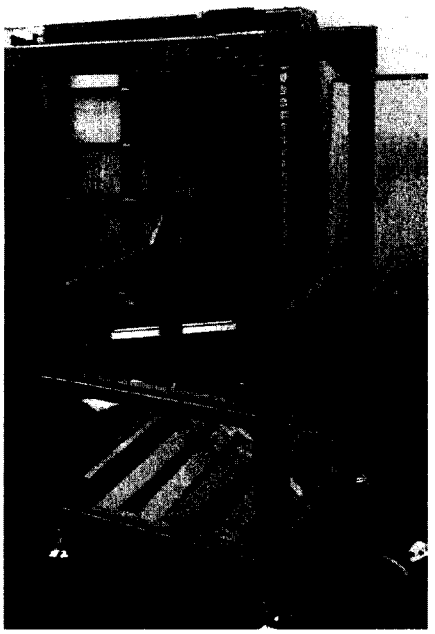
KTurbo Blower

The sole support for three KTurbo TB-100-0.6S multistage centrifugal blowers was a May 31, 2010, signed statement by the sales manager that "all iron, steel an (sic) Manufactured Goods provided by the manufacturer above is made in the United States in full conformance with requirements of ARRA Section 1605 Buy American requirements." However, catalog literature showed that KTurbo's manufacturing facility, head office, and research and development center were located in the Republic of Korea. KTurbo had an assembly and testing facility in Batavia, Illinois, near

Chicago. In catalog photographs, the Batavia assembly and testing facility resembled a warehouse and training facility. Information on the website http://www.industrydirect.com stated that KTurbo's facility in Batavia was less than 2,000 square feet in size, was subcategorized as a warehouse, and employed one to four staff.

In October 2009, Region 5, along with a contractor, visited KTurbo's Batavia facility. At that time, no manufacturing was taking place. KTurbo representatives described its intended assembly/manufacturing process. Region 5 and the contractor were told that part of the blower assembly would be imported, and part of the assembly would be done in Batavia.

KTurbo blower parts at the Batavia facility. (photo courtesy City of Ottawa)



Chassis assembled in Batavia from parts shipped from Korea. (photo courtesy City of Ottawa)

Both the contractor's report and the region's site visit summary included detail about the number or percentage of components that would be sourced from the United States. However, 2 CFR §176.70(a)(2)(ii) states, "there is no requirement with regard to the origin of components or subcomponents . . . as long as the manufacturing takes place in the United States." Therefore, the source of components cannot be part of the substantial transformation determination. Further, EPA's Buy American Q&A Part 1 states that all substantial transformation cases are matters of degree; however, the transformation or change to imported materials brought about by manufacturing or other processes in the United States must be substantial. Simple assembly or stand-alone testing is not sufficient to support substantial transformation of manufactured goods in the United States.

Both Region 5 and Office of Water staff believe that substantial transformation could occur at the Batavia, Illinois, facility. We have not been provided sufficient documentation to determine that substantial transformation can or will occur at Batavia. We cannot determine whether the assembly taking place in Batavia is complex or meaningful, or simple assembly. Further, because the blower parts are manufactured in a related foreign facility and sent to the United States for final assembly, we need detailed descriptions of the manufacturing process

and supporting documentation to determine whether the KTurbo blowers meet Buy American requirements. As previously noted, Buy American Q&A Part 1 states that if all the pieces are shipped by one company with the intent of providing all components necessary to be assembled in a functional good, then substantial transformation would not occur and the product would not be a U.S.-made good.

On April 19, 2011, KTurbo USA, Inc., in Batavia, Illinois; KTurbo, Inc., located in Chungbuk, Korea; and certain principals were placed on the federal government's Excluded Parties List System for an indefinite period. The companies and principals were suspended from receiving federal funds based on an indictment or other adequate evidence to suspect the commission of an offense that is a cause for debarment. The company provided certifications to multiple municipalities containing allegedly fraudulent statements that KTurbo blowers were manufactured in the United States and were in conformance with the Buy American provisions in the Recovery Act.

We do not believe that the city initially understood the process and documentation necessary to comply with Buy American requirements prior to our visit. The city relied on its contractor and its resident engineer to assure compliance. The city included the Buy American requirement in the construction contract, but did not include any specific Buy American compliance responsibilities in the engineering agreement. About 8 months after the initiation of construction, the city assigned the resident engineer to document Buy American compliance. The contractor obtained the manufacturer documentation and submitted the information to the resident engineer. We found no evidence that the city was directly involved in reviewing Buy American documentation.

The contractor relied on the resident engineer, as the representative of the city, to determine the adequacy of the Buy American certifications and supporting documentation submitted by the supplier. The engineer reviewed the documentation as part of the shop drawing review. At the time of our review, the resident engineer stated that the contractor and the city, not the engineering firm, were responsible for ensuring Buy American compliance. The resident engineer noted that the engineering firm had neither received any training to understand whether Buy American certifications were adequate or legitimate, nor received any additional methods to research this information. In cases where the contractor submitted shop drawing information without Buy American documentation, the resident engineer returned the submission to the contractor for appropriate followup. On October 29, 2010, during a weekly status meeting, the city assigned additional responsibility to the resident engineer to document Buy American compliance based on information provided by the contractor.

The city also told us that the state had not visited the project. We spoke with a state project manager familiar with the Ottawa project. He stated that the state had

done little on-site monitoring of municipal Recovery Act projects because of the large number of projects and the state's limited resources. The project manager also said that he was not aware that the city had contacted the state to request guidance related to areas of uncertainty specific to federal requirements when using Recovery Act funds for its project.

The city, its engineering firm, and contractors used information we provided during the site visits to enhance their understanding of Buy American requirements, which assisted them in making Buy American determinations for the remainder of the project. The engineering firm used EPA guidance to reject inadequate Buy American documentation. The foreign-made steel pipes and electrical panels identified during our site visit were replaced with American-made goods. The prime contractor rejected questionable equipment and asked vendors to provide goods that were better supported as being manufactured or substantially transformed in the United States.

However, based on our review of supporting documentation for four items, the city did not comply with Buy American requirements. The Recovery Act does not permit the use of Recovery Act funds unless the requirements of Section 1605 are met. Consequently, the state's use of Recovery Act funds on the Ottawa project is not permitted.

Wage Rates

The construction contractor and subcontractor complied with Section 1606 of the Recovery Act. We interviewed all general contractor and subcontractor employees at the construction site on October 5, 2010, to obtain information about their job duties, training, qualifications, and compensation. We compared the pay rates to those specified by the U.S. Department of Labor for workers in La Salle County, Illinois, where Ottawa is located. All employees were paid union wages equal to or above the required wage rate specified by the U.S. Department of Labor.

Limits on Use of Funds and Reporting Requirements

Ottawa complied with Recovery Act Sections 1604 and 1512(c). Based on our review of the loan document and a visual inspection of the construction site, Ottawa has not used Recovery Act funds for any prohibited facilities as described in Section 1604 of the Recovery Act. We also reviewed quarterly reports and supporting documentation prepared by the city's project engineer and submitted to the state to verify that Ottawa complied with the reporting requirements in Section 1512(c) of the Recovery Act.

Contract Procurement

We did not identify any issues of concern related to contract procurement. Ottawa publicly advertised for sealed bids and received 10 bids. Based on the engineer's recommendation, the city awarded the contract to the lowest bidder. We reviewed the bid tabulation and also contacted several of the unsuccessful bidders to obtain their viewpoint on the bidding process. We did not identify any inappropriate or unfair bidding practices.

Recommendation

We recommend that the Regional Administrator, Region 5:

1. Employ the procedures set out in 2 CFR §176.130 to resolve the noncompliance on the Ottawa project. In the event that the region makes a determination to retain foreign-manufactured goods in the Ottawa project under 2 CFR§176.130 (c)(3), the region should either "reduce the amount of the award by the cost steel, iron, or manufactured goods that are used in the project or . . . take enforcement or termination action in accordance with the agency's grants management regulations."

City, Region 5, and State Responses

The OIG received comments on the draft report from the City of Ottawa, Region 5, and the Illinois Environmental Protection Agency. The City of Ottawa also provided supplemental documentation to support its comments.

The city disagreed with our conclusion that the documentation for several items did not support compliance with Buy American requirements. The city stated that it had worked diligently to comply and noted that the contract documents did not require the general contractor to provide Buy American documentation until the iron, steel, or manufactured goods were ready to be incorporated into the project. The city stated that the final assessment of Buy American compliance could not be determined until the projected construction completion date of October 15, 2011. The city stated that it had provided sufficient documentation for all but one item identified in the draft report, the KTurbo blowers, which the city believed would be substantially transformed in the company's Batavia, Illinois, facility. The city planned to send additional documentation in the near future. The city also stated that it believed that the Kaeser blowers were acceptable based on the company's October 29, 2010, letter and an understanding that similar blowers were found acceptable to EPA on another project. The full text of the city's comments and the OIG's detailed response are included in appendix A.

Region 5 did not agree with the conclusions in the draft report. The region provided an initial response on June 23, 2011, and stated that it would review the Buy American documentation for compliance by July 29. In its second response,

the region concluded that the documentation was sufficient to support Buy American compliance for all the items questioned in the draft report except for the KTurbo blowers, which were still being built. The region stated that it would monitor the process and take corrective action if it subsequently found that the item did not meet the test of substantial transformation. The region stated that it would not reduce the amount of Recovery Act funds applied to this project at this time. The region's second response is in appendix B.

Illinois EPA agreed with our recommendation. A copy of the state's response is in appendix C.

Office of Inspector General Comment

Our recommendation remains unchanged. We modified our report based on the comments and additional documentation. However, we do not agree with the city and the region that all items except the KTurbo blowers comply with Buy American requirements. We believe that supporting documentation is not sufficient to support Buy American compliance in four instances. Except for the June 21, 2011, letter from KTurbo USA, neither the city nor the region identified any new documentation that we had not already evaluated during the course of our review.

The documentation provided for the questioned equipment items did not provide sufficiently meaningful and specific technical descriptions of the manufacturing process to enable us to determine whether the items were manufactured or substantially transformed in the United States. The companies did not provide clear support that the equipment had been substantially transformed into a "new and different manufactured good distinct from the materials from which it was transformed," as defined in 2 CFR 176.160. In all four instances, the equipment items were assembled in the United States by companies with foreign affiliations. The supporting documentation did not provide clear and persuasive evidence that the assembly processes completed in the United States were complex or meaningful to support that substantial transformation occurred.

With regard to the Kaeser blowers, the region stated that EPA Office of Water staff engineers provided "anticipatory" oversight to address the issue of substantial transformation to determine whether the products were actually manufactured in the United States. Office of Water staff engineers opined that substantial transformation is occurring at Kaeser's Fredericksburg, Virginia, facility, and that the products are therefore made in the United States. An Office of Water e-mail message to Kaeser, dated November 1, 2010, documents this opinion. During our review, we discussed the November 1, 2010, e-mail with Office of Water staff. We were not made aware that the Office of Water had any additional information beyond Kaeser's October 29, 2010, letter, which we determined to be insufficient in this report. EPA's Buy American Q&A Part 2 states, "Substantial transformation determinations are made by assistance

recipients . . . EPA does not and will not make determinations as to substantial transformations . . . EPA's role under §1605 is to review waiver requests. . . ." Office of Water staff providing an opinion on substantial transformation to Kaeser is inconsistent with EPA's guidance and its role under Section 1605 of the Recovery Act.

Status of Recommendations and Potential Monetary Benefits

RECOMMENDATIONS						POTENTIAL MONETARY BENEFITS (in $000s)	
Rec. No.	Page No.	Subject	Status[1]	Action Official	Planned Completion Date	Claimed Amount	Agreed-To Amount
1	12	Employ the procedures set out in 2 CFR §176.130 to resolve the noncompliance on the Ottawa project. In the event that the region makes a determination to retain foreign-manufactured goods in the Ottawa project under 2 CFR§176.130 (c)(3), the region should either "reduce the amount of the award by the cost of the steel, iron, or manufactured goods that are used in the project or . . . take enforcement or termination action in accordance with the agency's grants management regulations."	U	Regional Administrator, Region 5		$3,860	

[1] O = recommendation is open with agreed-to corrective actions pending
C = recommendation is closed with all agreed-to actions completed
U = recommendation is unresolved with resolution efforts in progress

Appendix A

City of Ottawa Response to Draft Report

City Commissioners

Daniel Aussem
Accounts & Finance

Wayne A. Eichelkraut, Jr.
Public Property

Dale F. Baxter
Streets & Public Improvements

Edward V. Whitney
Public Health & Safety

CITY OF OTTAWA

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June 22, 2011

Robert Adachi
Director of Forensic Audits
USEPA
Office of Inspector General
Washington, DC 20460

Re: Draft Report:
American Recovery and Reinvestment Act Site Visit of
Wastewater Treatment Plant-Phase II Improvements Project
City of Ottawa, Illinois
Project No. OA-FY11-A-0001

This is the City of Ottawa response to the Draft Report.

In February 2009, the ARRA program was passed in an effort to put Americans back to work. The program was designed to support projects that were "shovel ready." The plans and specifications for the project at issue here, the City of Ottawa Wastewater Treatment Plant, were substantially complete at the time ARRA was passed. It was the perfect "shovel ready" project. Being one of the first projects funded under ARRA has brought many challenges. First, the construction documents had to be modified to comply with ARRA requirements. Second, and more importantly, both the City of Ottawa and the enforcing agencies have had to struggle with the interpretation and application of ARRA's requirements. It has become clear that all the parties—the City, the USEPA and the Inspector General—have been working their way through the requirements of the ARRA and trying to give life and "teeth" to those requirements. It is unfair to suggest that the City alone has been uninformed and ill-prepared when the

representatives of other government agencies have expressed similar confusion over some of the ARRA's requirements. As the federal agencies made determinations that affected the City's obligations, the City worked diligently to comply with those determinations and to gather the information necessary to satisfy USEPA and the OIG.

OIG Response 1: We recognize that the Recovery Act's Buy American requirements were new, and that projects were required to be under contract or construction 12 months after the Recovery Act was signed. The city accepted funds from the State of Illinois through the Water Pollution Control Loan Program. The loan agreement between the city and the Illinois Environmental Protection Agency stated that acceptance of the loaned funds required the city to "comply with any future reporting and/or accountability requirements that may result as a condition for receiving ARRA funds." Further, paragraph 16 of the loan agreement's standard conditions required Buy American compliance and incorporated by reference a notice on the Illinois Environmental Protection Agency's Internet site that provided guidance on Buy American compliance. If the city was unclear about the procedures necessary to fulfill its responsibilities under the loan agreement, the city should have sought guidance from the state. In addition, EPA published several training and guidance documents on its public Internet site to assist recipients in meeting Recovery Act requirements.

Initially, the City would note that the contract documents for the project require the general contractor to provide and document that "all iron, steel and manufactured goods used in the project are produced in the United States" as defined in Section 1605 of ARRA. However, the contract documents also provide that such documentation is not required until the iron, steel or manufactured goods are ready to be incorporated into the project. The work is currently only 93% complete with an expected completion date of October 15, 2011. Consequently, there are products for which the required documentation has not yet been provided to the City. Only when the project is complete and all the documentation has been provided can a final assessment of the City's compliance with ARRA be reached.

OIG Response 2: The city's procedure to wait until iron, steel, or manufactured goods were ready to be incorporated into the project before confirming compliance with Buy American requirements was risky and not fully consistent with regulations. For example, both 2 CFR 176.100, "Timely determination concerning the inapplicability of section 1605 of the Recovery Act," and 2 CFR 176.150, "Notice of Required Use of American Iron, Steel, and Manufactured Goods - Section 1605 of the American Recovery and Reinvestment Act of 2009," suggest a waiver process that takes place before funds are obligated. Further, 2 CFR 176.120, "Determinations on late requests," provides specific procedures for instances in which a recipient requests a determination regarding the inapplicability of Section 1605 after obligating Recovery Act funds. The award official may deny the request. If an exception determination is made after funds are obligated for a project, the award official must amend the award to allow the use of foreign iron, steel, and/or relevant manufactured goods. In certain circumstances, the award official must adjust the award amount, redistribute budgeted funds, and/or take other appropriate actions to cover the costs associated with acquiring or using the foreign iron, steel, or manufactured goods. By waiting until iron, steel, or manufactured goods were ready to be incorporated or already installed to confirm compliance with Buy American requirements, the

city limited its ability to substitute foreign products with domestic products and increased its risk of losing federal assistance. The city should have determined compliance before products and materials were ordered.

Documentation for the 18 Items

Since the OIG report was received, the documentation for 17 of the 18 items listed as not having "meaningful, informative, and specific technical descriptions of activities to determine if the items were manufactured or substantially transformed in the United States" has been sent to OIG. The City believes the documentation for these 17 items now shows they were manufactured or substantially transformed in the U.S. and ask for OIG to review the documentation. The documents are not included with this response since they have been transmitted to OIG with acknowledgment of receipt and because of the large volume of the files. If additional copies are required, they will be provided upon request.

OIG Response 3: We reviewed the additional documentation and concluded that supporting documentation in four instances did not provide sufficiently meaningful, informative, and specific technical descriptions to determine whether the items were manufactured or substantially transformed in the United States. We revised our report to identify the questioned items and the documentation deficiency.

The remaining undocumented item is the K-Turbo blowers. The equipment representative, the Contractor, the consulting engineer and the Asst. City Engineer are working with K-Turbo and we feel the blowers that are being made in Batavia, IL will be found "substantially transformed" based on our visit to the fabrication facility and additional communication. See the attached memo, dated June 21, 2011, from K-Turbo USA, Inc. USEPA and their consultants have visited K-Turbo in Batavia and have told us that the feel K-Turbo has the capability to meet the substantially transformation guidelines. The City is making every effort to assure this is achieved. The Substantial Transformation checklist is being completed at this time and will be forwarded to OIG in the near future.

OIG Response 4: Regarding the KTurbo blower, we cannot make a determination on Section 1605 compliance without the documentation supporting the actual manufacturing process of the equipment used in the Ottawa project. To date, all information has been prospective. Because the company has been suspended indefinitely from receiving any new federal funds, we need to clearly understand KTurbo's manufacturing process. Supporting documentation should include: (1) a detailed list of all parts and components and their sources, supported by bills of lading and invoices; (2) a detailed description of the manufacturing and/or assembly steps completed in Batavia; (3) a detailed list of manufacturing and/or assembly steps completed by KTurbo in Korea or any other related or formerly related company in a foreign country; (4) a detailed description of the specialized labor and tools used in the Batavia facility; and (5) a detailed description of material and labor costs incurred for the blowers built for the Ottawa project.

The Kaeser blowers are considered to be acceptable based on the submittal letter to the blower supplier, Peter Lynch, LAI, Ltd. of October 29, 2010 describing substantial transformation. The letter is similar to a letter regarding similar blowers for a project in Fredricksburg, VA which we understand was acceptable to USEPA.

OIG Response 5: We reviewed the referenced October 29, 2010, letter during our field work and discussed our conclusion in the Kaeser example beginning on page 7 of this report. Also, we were aware of the e-mail sent by an employee from EPA's Office of Water. We find no authority in Section 1605 of the Recovery Act or the relevant regulations at 2 CFR Part 176, "Requirements for Implementing Sections 1512, 1605, and 1606 of the American Recovery and Reinvestment Act of 2009 for Financial Assistance Awards," that would authorize EPA to make a determination of substantial transformation. In fact, EPA's Determining Substantial Transformation clearly states that "EPA does not and will not make determinations as to substantial transformation or the U.S. or foreign origin of manufactured goods." Since Kaeser Compressors, Inc., is an affiliate of Kaeser Kompressoren, GmbH, and "the base chassis of proprietary designed components" was obtained from the parent, we need to clearly understand the precise steps and costs completed in the United States versus the process and steps completed in Germany for the actual blowers used in the Ottawa project. Because we did not receive any new documentation, we did not change our position in the report.

De minimis waiver items

The Contractor has tabulated the cost of all materials in the project, $3,709,957 (see attached memo). The 5% allowable for non-domestic goods is $185,500 according to the *de minimis* waiver, ARRA Section 1605 (b)(1). The identified non-domestic item on the OIG list is number 39, Specification 15915 – Electric and Electronic Control. This is the thermostat for hydronic heating system in the sludge dewatering building. Cost = $248.

Two other items not on the OIG List that are not American made are:

1. Specification Section 16905: computer and monitor for the SCADA system in the operations building. Cost = $1,201
2. Specification Section 16496 Enclosed Transfer Switch: Cost = $4,863

The total cost of these three items is $6,312. This is 0.17% of the material cost. Therefore it is accepted within the guidelines of the *de minimus* waiver.

OIG Response 6: We agree and have revised the report accordingly.

Consulting engineer as Agent for the City

The City hired the consulting firm of McClure Engineering Associates, Inc. for the Construction Phase services as defined in paragraph A.1.05 of the Agreement between the Owner and Engineer for Professional Services dated 2/3/2010. The addition of services for review of the ARRA compliance documentation was authorized in the weekly project progress review meetings when the need and magnitude of the effort became apparent. The authorization is recorded in the meeting notes. It is best to review the ARRA documentation along with the Shop Drawing review since the system is already in place for review, receiving transmittal from the Contractor, systematic filing

and communication with the City on items needing specific involvement of the City staff or Commissioners. It is normal for the City of Ottawa to rely on the consulting engineer for such detailed reviews.

OIG Response 7: We agree with the city's comments. Based on our review of the meeting notes, which state that the engineering firm received additional responsibilities regarding the review of Recovery Act Buy American documentation, we have revised the report accordingly.

Project Funding Status

The current financial status of the project cost and the funding are as follows:

The current Construction Contract		$8,233,169.93
	Design Engineering	$ 435,000.00
	Construction Engrg	$ 487,857.86
	Total eligible cost	$9,155,027.79
Funding:	SRF Loan	$7,720,293.00
	Illinois Clean Energy	$ 250,000.00
	City Bonding	$1,184,734.79

Excluded items which still comply with ARRA requirements

IEPA has previously eliminated the following items from the project funding as ineligible cost items:

OIG List No.	Spec. Section	Item	Cost
11	11304	RAS Pumps	$ 65,200
15	11315	Floating Mixers Equipmt	$ 40,000
18	11336	Grit Removal Equipment	$118,100
19	11337	Rotary Press System	$901,500
Engineering services associated with the above items			$202,063
Other construction items			$ 57,000
Total ineligible costs per award letter			$1,419,317

This is to show that the above four items, though they have met the ARRA Buy American provision are not being covered by the ARRA funding.

OIG Response 8: We agree with the city's comments. The supporting documentation for the ineligible items sufficiently demonstrated compliance with Buy American requirements.

On June 2, 2011, Andrew Bielanski, USEPA Region 5 and Mike Grimm, Cadmus Group, consultant to USEPA, conducted a site visit to review the City's documentation of compliance with the terms of the SRF/ARRA loan/grant. Although we have not received a report from their evaluation, they indicated that our compliance appeared to be in order.

OIG Response 9: The region's response to the draft report is in appendix B. We have not changed our position as a result of the region's comments.

We appreciate the funding provided for our project and have made every effort to understand the requirements. We feel we have met the requirements up to this date and will continue to by the time the project is completed later this year. We stand ready to answer any questions or clarifications need to fully comply. I am available by phone, 815-433-0161 ext 41 or e-mail engineer@cityofottawa.org.

Sincerely,

Robert M. Eschbach
Mayor

cc: John Trefry, via e-mail
Michael Rickey, via e-mail
Larry Brannon, via e-mail
Dave Hall, McClure Engineering

Attachments: *de minimus* tabulation
K-Turbo memo, June 21, 2011

Agency Response to Draft Report

MEMORANDUM

SUBJECT: Final Comments on Draft Report
American Recovery and Reinvestment Act Site Visit of Wastewater Treatment Plant – Phase II Improvements Project, City of Ottawa, Illinois
Project No. OA-FY11-A-000

FROM: Susan Hedman */signed July 29, 2011/*
Regional Administrator, Region 5
U.S. Environmental Protection Agency

TO: Robert Adachi
Director of Forensic Audits

We have completed the actions outlined in our memorandum dated June 23, 2011, and are providing final comments on the draft report, *American Recovery and Reinvestment Act Site Visit of Wastewater Treatment Plant – Phase II Improvements Projects, City of Ottawa, Illinois*. The attached table summarizes our concurrence or non-concurrence with the 18 findings of Recovery Act non-compliance, the basis and rationale for our determination, and a description of any corrective actions taken or planned.

We obtained documentation from the City of Ottawa for the 18 questioned items (which was also provided to the OIG in response to the draft report). We coordinated our review with the Office of Water to ensure a consistent and fair application of EPA's Buy American guidance. Our engineers evaluated product documentation to ensure that the items were either manufactured or substantially transformed in the United States as required under the Buy American provision. We also applied EPA's *de minimis* waiver for incidental and low-cost items as appropriate.

We conclude that 17 of the 18 items complied with Buy American requirements. One item (K-Turbo blower) is currently being manufactured, and the city is closely monitoring this process to ensure that substantial transformation is taking place in the U.S., making the item eligible for Recovery Act funding. We will monitor this process and take corrective action if we find that the item did not meet the test of substantial transformation. We will not reduce the amount of Recovery Act funds applied to this project at this time. If you have any questions, please contact Debbie Baltazar at 312-886-3205.

Attachment

cc: Geoff Andres, Manager, Infrastructure Financial Assistance Section, Illinois EPA
Arnold Bandstra, Assistant City Engineer, City of Ottawa, Illinois
Arthur A. Elkins, Jr., Inspector General
Melissa Heist, Assistant Inspector General for Audit
John Manibusan, EPA OIG Office of Congressional, Public Affairs and Management

bcc: Eric Levy, Audit Follow-up Coordinator, Region 5
Tinka Hyde, Director, Water Division, Region 5
Debbie Baltazar, Chief, State and Tribal Programs Branch, Region 5

Item Number	Section Number	Equipment Description	Manufacturer	Concur or Non-concur	Basis & Rationale for Determination	Planned Corrective Action
8	08520	Aluminum Windows	Kawneer	Non-concur	We find the documentation sufficient to support Buy American compliance. Alternatively, the City of Ottawa would be reasonably justified in claiming these items under EPA's "de minimis" waiver. • Kawneer Buy American certification indicates that all Kawneer products are manufactured in 13 locations across the United States. These domestic construction materials are in compliance with Buy American requirements. • Certification clearly references the Ottawa project. • Bill of Lading lists Kawneer's facility in Itasca, Illinois as the place of origin for the shipment. The Itasca facility was listed on Kawneer's Buy American certification. • Bill of Lading indicates two boxes containing window and door frames totaling 141 pounds were shipped. Due to the very limited quantities of this item, the City of Ottawa would be reasonably justified in claiming these items under EPA's "de minimis" waiver.	N/A

Item Number	Section Number	Equipment Description	Manufacturer	Concur or Non-concur	Basis & Rationale for Determination	Planned Corrective Action
10	11300	Progressive Cavity Sludge Pumps	Moyno	Non-concur	We find the documentation sufficient to support Buy American compliance. • Moyno Buy American certification documentation includes two letters dated May 11, 2011, and May 27, 2011. • Letters reference pumps provided in the Ottawa project by section number. • Documentation indicates that the only manufacturing facility of Moyno pumps is located in Springfield, Ohio, and it is the sole supplier of Moyno products destined for the US. • Documentation indicates that the following manufacturing operations are performed at the Springfield facility by highly trained individuals: 1) injection molding; 2) machining; 3) buffing; 4) chrome plating; 5) pump assembly; 6) unit assembly; and 7) painting. • The manufacturing process requires over 100 operations and can take up to 12 weeks of production time for a single pump.	N/A

Item Number	Section Number	Equipment Description	Manufacturer	Concur or Non-concur	Basis & Rationale for Determination	Planned Corrective Action
11	11304	RAS Pumps	WEMCO	Non-concur	We find the documentation sufficient to support Buy American compliance. • WEMCO Buy American certification documentation includes two letters dated May 4, 2011, and May 27, 2011. • Letters reference pumps provided in the Ottawa project. • Documentation indicates that the manufacturing facility is located in Salt Lake City, Utah. • Documentation indicates that the following manufacturing operations are performed at the Salt Lake City facility by highly trained individuals such as welders and machinists: 1) machining raw castings and shafts; 2) fabricating base plates and guards; and 3) final assembly involving belts, fasteners, bearings, and gaskets. • The manufacturing process requires a stated minimum of 25 different standard procedures. Production time ranges from several weeks to several months depending on the type of pump.	N/A

Item Number	Section Number	Equipment Description	Manufacturer	Concur or Non-concur	Basis & Rationale for Determination	Planned Corrective Action
12	11310	Submersible Pumps	ITT-Flygt	Non-concur	We find the documentation sufficient to support Buy American compliance. • ITT-Flygt Buy American certification documentation includes two letters dated February 24, 2010, and June 1, 2011. • Letters reference pumps provided in the Ottawa project. • Documentation indicates that the manufacturing facility is located in Pewaukee, Wisconsin. • Documentation indicates that the following manufacturing operations are performed at the Pewaukee facility by highly trained individuals: 1) motor stator installation; 2) rotor unit manufacture; 3) mechanical seal assembly; 4) impeller assembly; 5) pump housing assembly; 6) electrical sensor installation and connection; 7) power cable installation; and 8) painting. • Photographs were included with documentation that showed the facility and various manufacturing areas within the facility.	N/A

Item Number	Section Number	Equipment Description	Manufacturer	Concur or Non-concur	Basis & Rationale for Determination	Planned Corrective Action
13	11311	Submersible Chopper Pumps	ITT-Flygt	Non-concur	We find the documentation sufficient to support Buy American compliance. • ITT-Flygt Buy American certification documentation includes two letters dated February 24, 2010, and June 1, 2011. • Letters reference pumps provided in the Ottawa project. • Documentation indicates that the manufacturing facility is located in Pewaukee, WI. • Documentation indicates that the following manufacturing operations are performed at the Pewaukee facility by highly trained individuals: 1) motor stator installation; 2) rotor unit manufacture; 3) mechanical seal assembly; 4) impeller assembly; 5) pump housing assembly; 6) electrical sensor installation and connection; 7) power cable installation; and 8) painting. • Photographs were included with documentation that showed the facility and various manufacturing areas within the facility.	N/A

Item Number	Section Number	Equipment Description	Manufacturer	Concur or Non-concur	Basis & Rationale for Determination	Planned Corrective Action
16	11330	Electric Grinder	Moyno	Non-concur	We find the documentation sufficient to support Buy American compliance. • Moyno Buy American certification documentation includes two letters dated May 11, 2011, and May 27, 2011. • Letters reference pumps provided in the Ottawa project by section number. • Documentation indicates that the only manufacturing facility of Moyno pumps is located in Springfield, Ohio, and it is the sole supplier of Moyno products destined for the US. • Documentation indicates that the following manufacturing operations are performed at the Springfield facility by highly trained individuals: 1) injection molding; 2) machining; 3) buffing; 4) chrome plating; 5) pump assembly; 6) unit assembly; and 7) painting. • The manufacturing process requires over 100 operations and can take up to 12 weeks of production time for a single pump.	N/A
21	11338	Chemical Feed Equipment	Periflo	Non-concur	We find the documentation sufficient to support Buy American compliance. • Periflo Buy American certification identifies items provided in the Ottawa project, and states that they were manufactured at Periflo's manufacturing plant in Loveland, Ohio. • Documentation detailed the amount of hours (40 hours) required to manufacture the product, the percentage of the final product cost coming for direct labor (45%), level of skilled employees such as machinists and mechanics needed to perform the various operations, and the operations performed.	N/A

Item Number	Section Number	Equipment Description	Manufacturer	Concur or Non-concur	Basis & Rationale for Determination	Planned Corrective Action
22	11370	Positive Displacement Blower	Kaeser	Non-concur	We find the documentation sufficient to support Buy American compliance. • Kaeser Buy American certification documentation includes letter dated October 29, 2010 to sales representative who sold the positive displacement blowers supplied to the Ottawa project. Additional documentation was also included involving correspondence between Kaeser and EPA Headquarters Office of Water (OW) staff engineers regarding whether the items are "substantially transformed" and actually made/manufactured in the USA. • Documentation indicates that the items are manufactured in at the Kaeser facility in Fredericksburg, Virginia. • Documentation focused on the issue of substantial transformation since questions arose as to whether the products we actually made/manufactured in the USA. Narrative responses from Kaeser provided affirmation to Question #3 of EPA's Substantial Transformation Checklist ("Was the process performed in the USA complex and meaningful?"). • The manufacturing process requires an estimated 16 to 20 hours of labor. The added labor comprises 30 to 50 percent of the product's value. • EPA Headquarters OW staff engineers provided "anticipatory" oversight to address the issue of substantial transformation in order to determine if the products were actually made/manufactured in the USA. • EPA OW staff engineers opined that substantial transformation is occurring at Kaeser's Fredericksburg, Virginia facility, and that the products are therefore made in the USA. An e-mail message dated November 1, 2010 documents this opinion.	N/A

Item Number	Section Number	Equipment Description	Manufacturer	Concur or Non-concur	Basis & Rationale for Determination	Planned Corrective Action
23	11375	Centrifugal Blower	K-Turbo /Aerzyn	Neither Concur or Non-concur	We cannot yet make a determination as to Buy American compliance, as the centrifugal blowers for the Ottawa project have not yet completed fabrication/manufacture at the K-Turbo facility in Batavia, IL. • Representatives from Ottawa have been monitoring and documenting the fabrication and manufacture processes while applying the standard of substantial transformation to verify the blowers are American made. • EPA Headquarters OW provided "anticipatory" oversight to address the issue of substantial transformation in order to determine if the products were actually made or manufactured at the Batavia, IL facility. An EPA contractor (an engineer) and EPA Region 5 staff engineer were sent to view the fabrication and manufacturing processes at the K-Turbo Batavia facility in October 2009. • Both the EPA OW staff engineers opined that substantial transformation could occur at K-Turbo's Batavia, Illinois facility based upon the processes described to them during the visit. The Batavia facility was not operational as the fit-up of the facility was not yet fully complete.	Provide follow-up review of the substantial trans-formation document-ation and progress reports submitted by Ottawa.

Item Number	Section Number	Equipment Description	Manufacturer	Concur or Non-concur	Basis & Rationale for Determination	Planned Corrective Action
24	11376	Activated Sludge Aeration System	SSI Aeration	Non-concur	We find the documentation sufficient to support Buy American compliance. • SSI Aeration Buy American certification identifies all items provided in the Ottawa project. • Documentation indicated that the aeration systems are comprised of stainless steel piping and fittings, PVC piping and fittings, fine and course bubble diffusers, and stainless steel support stands. Manufacturing locations were specified for all components, and all are made in the USA. • Mill certifications showing USA origin were provided for the stainless steel piping and fittings.	N/A
25	11378	WAS Aeration System	SSI Aeration	Non-concur	We find the documentation sufficient to support Buy American compliance. • SSI Aeration Buy American certification identifies all items provided in the Ottawa, IL project. • Documentation indicated that the aeration systems are comprised of stainless steel piping and fittings, PVC piping and fittings, fine and course bubble diffusers, and stainless steel support stands. Manufacturing locations were specified for all components, and all are made in the USA. • Mill certifications showing USA origin were provided for the stainless steel piping and fittings.	N/A

Item Number	Section Number	Equipment Description	Manufacturer	Concur or Non-concur	Basis & Rationale for Determination	Planned Corrective Action
8	13424	Dissolved Oxygen Monitor	ITT-Royce	Non-concur	We find the documentation sufficient to support Buy American compliance. • ITT-Royce Buy American certification indicates that the products listed on the certification are manufactured in Charlotte, North Carolina. • Model/part numbers are listed for the items provided for the Ottawa project including quantities. • The ITT-Royce Buy American certification is simple but sufficient.	N/A
31	15260	Plant Pipe and Pipe Fittings	Clow Water Systems	Non-concur	We find the documentation sufficient to support Buy American compliance. • Clow Water Systems Buy American certification states that all manufacturing of their 6 inch to 36 inch diameter ductile iron pipe and fittings is done at their Coshocton, Ohio facility with exception of 3 inch and 4 inch diameter pipe which are outsourced and produced by other domestic producers such as Atlantic States Pipe, McWane Pipe, or Griffin Pipe. • All mechanical joint fittings and flanges are stamped "Made in the USA." • Clow Water Systems website provides additional Buy American information on their website at http://www.clowwatersystems.com .	N/A

Item Number	Section Number	Equipment Description	Manufacturer	Concur or Non-concur	Basis & Rationale for Determination	Planned Corrective Action
33	15410	Plumbing Fixtures	Amtrol, Inc.	Non-concur	We find the documentation sufficient to support Buy American compliance. Alternatively, the City of Ottawa would be reasonably justified in claiming these items under EPA's "de minimis" waiver. • Amtrol, Inc. Buy American certification indicates that Amtrol products are manufactured in two locations in the United States – Paducah, Kentucky and West Warwick, Rhode Island. • The Amtrol, Inc. certification is simple but sufficient. • Amtrol, Inc. provided a thermal expansion tank of approximately one gallon in size for the water supply plumbing to a water heater. Due to the single quantity and low cost of this item the City of Ottawa would be reasonably justified in claiming the item under EPA's "de minimis" waiver.	N/A

Item Number	Section Number	Equipment Description	Manufacturer	Concur or Non-concur	Basis & Rationale for Determination	Planned Corrective Action
38	15832	Power Ventilators	Greenheck	Non-concur	We find the documentation sufficient to support Buy American compliance. • Greenheck Buy American certification documentation includes three documents dated November 17, 2010; January 19, 2011; and April 20, 2011. • Documentation clearly references the Ottawa project via order number/project name, and the two earlier documents also list Greenheck model numbers. • Documentation indicates that items supplied for the Ottawa project were manufactured at Greenheck facilities in Schofield, Wisconsin; Mosinee, Wisconsin; and Frankfort, Kentucky. • The estimated production time for the items supplied for the Ottawa project is 60 hours. • Documentation indicates that approximately 540 steps were involved in completing the items supplied for the Ottawa project. The manufacturing processes utilized roll formers, stamping machines and fixturing equipment to allow for consistent and quality construction of products.	N/A
39	15915	Electric and Electronic Control	Tekmar	Non-concur	This item qualifies under EPA's "de mimimis" waiver. • Information from the City of Ottawa indicates this is a low cost (approximately $250) item that can be claimed under EPA's "de minimis" waiver. The City of Ottawa did claim this item under EPA's "de minimis" waiver.	N/A

Item Number	Section Number	Equipment Description	Manufacturer	Concur or Non-concur	Basis & Rationale for Determination	Planned Corrective Action
42	16130	Boxes	Cooper B-Line	Non-concur	We find the documentation sufficient to support Buy American compliance. Alternatively, the City of Ottawa would be reasonably justified in claiming these items under EPA's "de minimis" waiver. • Cooper B-Line Buy American certification documentation includes documentation dated December 16, 2010 and June 2, 2011. • Documentation clearly references the Ottawa, IL project via order number, and the earlier documentation also lists Cooper B-Line part/product numbers. • Documentation indicates that items supplied for the Ottawa project were manufactured at the Cooper B-Line Highland, Illinois facility. • The Cooper B-Line Buy American certification is simple but sufficient. • Cooper B-Line provided rigid conduit of various pipe diameters (3/4", 1", 1 ½", 2", 3", and 4") plus galvanized strut channel. Since these products could be considered incidental to the construction of the project the City of Ottawa would be reasonably justified in claiming the items under EPA's "de minimis" waiver.	N/A

Item Number	Section Number	Equipment Description	Manufacturer	Concur or Non-concur	Basis & Rationale for Determination	Planned Corrective Action
53	16620	Packaged Engine Generator System	Kohler	Non-concur	We find the documentation sufficient to support Buy American compliance • Kohler Buy American certification documentation includes documentation dated November 17, 2010 and June 2, 2011. • Documentation clearly references the Ottawa project. • Documentation indicates that the manufacturing was performed at Kohler's facility in Sheboygan, Wisconsin. • Documentation indicates that the following manufacturing operations are performed at the Sheboygan facility: 1) metal fabrication, including manufacturing skids, support brackets, controller boxes, panels, and enclosures; 2) electrical manufacturing, including circuit boards, controllers, and battery chargers; and 3) generator set final assembly processes, including mounting the engine and wiring, installing the cooling system for the motor, and installing the exhaust system. • The manufacturing process required over 200 hours of labor for the generator provided for the Ottawa project.	N/A

Illinois EPA Response to Draft Report

217/782-2027

June 24, 2011

Mr. Larry Brannon
EPA-OIG
77 W. Jackson Boulevard, Mail Code IA-13J
Chicago, IL 60604

Re: Draft Report: American Recovery and Reinvestment Act Site Visit of Wastewater Treatment Plant – Phase II Improvements Project, City of Ottawa, Illinois

Dear Mr. Brannan:

The State of Illinois is in concurrence with the recommendation that the Region 5 Regional Administrator employ the procedures in 2 CFR 176.130 to resolve the issues of noncompliance on the Ottawa project.

The City of Ottawa has invested a considerable amount of time and resources in a cooperative effort with the USEPA in an effort to resolve these issues. It is our opinion that the City did not intentionally disregard the Buy American requirements of the Recovery Act, and that there was no malfeasance on the part of City officials. The Illinois EPA urges the continued cooperation of the parties involved.

If you need further information regarding this response, or regarding the City of Ottawa project that is the subject of the draft report, please feel to contact Geoff Andres of my staff at 217/782-2027. Thank you.

Sincerely,

Lisa Bonnett
Interim Director

Cc: Robert Adachi, EPA-OIG
Susan Hedman, USEPA Administrator, Region 5
Robert M. Esbach, Mayor, City of Ottawa, Illinois

Distribution

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Interim Director, Illinois Environmental Protection Agency
Mayor, City of Ottawa, Illinois
Assistant City Engineer, City of Ottawa, Illinois

DETERMINING WHETHER "SUBSTANTIAL TRANSFORMATION" OF COMPONENTS INTO A "MANUFACTURED GOOD" HAS OCCURRED IN THE U.S.: ANALYSIS, ROLES, AND RESPONSIBILITIES

Section 1605 of the American Recovery and Reinvestment Act of 2009 (ARRA) requires that of the all iron, steel, and manufactured goods used in ARRA funded projects to construct public buildings or public works be produced in the U.S. This is the expected means of compliance. OMB published Guidance for Federal agencies subject to this provision on April 23, 2009 (at 74 FR 18452, found at http://edocket.access.gpo.gov/2009/pdf/E9-9073.pdf), elaborating on this ARRA requirement, including the provisions of Section 1605(b) and (c) for a waiver of this requirement under specified circumstances, and of Section 1605(d) that this requirement must be implemented "consistent with U.S. obligations under international agreements."

That Guidance includes at §176.140 the definition of a "manufactured good" as "[a] good brought to the construction site for incorporation into the building or work that has been processed into a specific form and shape, or combined with other raw material to create a material that has different properties than the properties of the individual raw materials." §176.70(a)(2)(ii) of the Guidance further states that "[t]here is no requirement 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."

Thus, recipients of assistance from the Clean or Drinking Water State Revolving Funds (SRF) provided under ARRA must determine, have the goods to be used in this project been "manufactured" in the U.S.? This may be relatively simple to determine for many goods used in a water infrastructure project. However, many other manufactured goods used in ARRA SRF projects are brought together in the U.S. through a widely varying spectrum of activities. When such goods are comprised of any components produced in countries other than the U.S., SRF assistance recipients can use substantial transformation analysis to determine whether the activities in the U.S. by which a particular good is brought together do or do not enable it to be considered "manufactured" in the U.S. under §1605 and the Guidance.

The Concept of Substantial Transformation

To assess whether these varied activities do or do not enable the assistance recipient to consider a good as "produced in the U.S.", OMB included in a section of their Guidance on international agreements the concept of "substantial transformation". §176.160 provides that recipients need to inquire whether, "[i]n the case of a manufactured good that consists in whole or in part of materials from another country, [the good] has been substantially transformed in the United States into a new and different manufactured good distinct from the materials from which it was transformed." This OMB Guidance term itself directly applies to and is binding on few if any SRF recipients, because it appears only in a term for international agreements. However, EPA believes the

substantial transformation concept provides necessary guidance on this issue. The origins and applications of the term are rooted in well-established Federal interpretations, particularly by the Customs Department and the Federal courts, and EPA is not aware of any alternative standard – particularly, any alternative appropriate for application under §1605 – to determine whether or not a manufactured good is U.S.-produced.

Applying Substantial Transformation Analysis – Roles and Responsibilities

Before exploring the principles and means to interpret and apply the substantial transformation concept, it is important to clarify the roles of ARRA assistance recipients, EPA, and the States in the process of applying this concept. These roles are, of necessity, a combination of the traditional responsibilities among these partners in the SRF programs, and the specific, new mandates imposed by §1605.

Assistance Recipients' Role: SRF assistance recipients bear the direct responsibility to comply with the Buy American requirement of §1605, because that section applies the requirement to each "project". The statutory expectation is that recipients will comply by buying U.S.-produced iron, steel, and manufactured goods. This expectation is illustrated by the characterization in the OMB Guidance (at §176.80) of waivers as "exceptions" to the general rule of Buy American. Recipients, in conjunction with consultants, contractors, suppliers/distributors, and others, thus are responsible to decide if products are U.S.-made, by applying the substantial transformation analysis specified by OMB.

Assistance recipients will make this determination for a finished good by obtaining information about the processes used and applying the questions set forth in the Section below, "*Analysis to Determine Whether Substantial Transformation Has Occurred in the U.S.*" To decide in unclear (marginal) cases, recipients should ask themselves: would we be confident to use information from the analysis to document our Buy American compliance – that this good is U.S.-produced – to our State or EPA in a compliance audit?

For recipients considering use of goods claimed to be U.S.-produced, if a competing manufacturer, bidder or supplier protests such claim, you can ask such competitors to frame any concerns in the form of specific responses to these questions, both as to their product and that of another competing company. This information can equip recipients to ask further questions of their intended manufacturers, to better inform the recipient's decision, and to preemptively address the subject of potential bid protests later on that might otherwise complicate an ARRA project's timely contracting. In other words, if a competitor states a complaint – that its goods are U.S.-produced, but the other company's claim that their goods comply with §1605 is false – then the assistance recipient should request this response be framed in the format of appropriately detailed answers by the competitor to the substantial transformation questions, both as to their product and that of another competing company.

Upon applying a substantial transformation analysis through these questions, many assistance recipients will determine that a good to be used in their project is substantially

transformed in the U.S. Because it is thus manufactured in the U.S., such recipients can comply with §1605 by using the good in their projects and retaining appropriate documentation in their files. This documentation will include (1) appropriately detailed answers from the manufacturer to the substantial transformation questions, as described in the "*Analysis to Determine Whether Substantial Transformation Has Occurred in the U.S.*" section of this paper, below; (2) any additional material the recipient may have from the manufacturer that provides detail supporting the answers; and, (3) upon procurement of the good, documentation from the manufacturer verifying that the product originated in a U.S. plant where substantial transformation occurred as demonstrated by the answers above. **This information and documentation will be such assistance recipients' basis for demonstrating compliance with the Buy American requirement of §1605(a).**

After receiving information to answer the substantial transformation questions as to an intended manufacturer's product, an assistance recipient may have continuing, reasonable doubt as to the adequacy of the answers to establish the U.S. origins of that product. By requesting and analyzing substantial transformation information, a recipient will also be better equipped to understand other potential options. This analysis may provide a basis to see whether a competing manufacturer's U.S.-made product does meet, or can be timely adapted to meet the recipient's justified specifications. If the U.S.-made product does not meet those specifications, and other U.S.-made goods that do meet them are not available, then the recipient should have sufficient information to apply for a waiver from EPA. While assistance recipients assisted by the engineering community and others will use best professional judgment in making determinations as to substantial transformation, such determinations must be supported by appropriately detailed information from manufacturers describing the specific operations in their manufacturing process that warrant a determination that substantial transformation has occurred in the U.S.

EPA Role: **EPA does not and will not make determinations as to substantial transformation** or the U.S. or foreign origin of manufactured goods. EPA's role under §1605 is to review waiver requests when an assistance recipient believes it cannot comply by buying U.S.-made goods, and to undertake compliance oversight. The limitations on EPA's role in this issue are driven by responsibilities assigned by ARRA.

ARRA's SRF appropriations heading requires that if all funds allotted to each State are not under contract or construction within 12 months of enactment (February 17, 2010), EPA must reallocate such un-contracted-for funds to States that have placed all their funds under contract by that date. OMB's Guidance (at §176.120), reflected also in EPA's April 28, 2009 Memorandum on the "Implementation of Section 1605" (found at http://www.epa.gov/water/eparecovery/docs/04-29-2009_BA_waiver_process_final.pdf, "Application by Assistance Recipient" section), stresses the importance of ascertaining the U.S.-produced origins of goods or securing any necessary waivers before signing construction contracts. In light of these requirements and SRFs-specific time constraints, EPA must view the role assigned to Federal agencies by §1605 itself – to decide on requests for waivers – as the Agency's central focus in implementing §1605.

However, EPA does recognize that, for assistance recipients, these issues may be as novel, complex, and demanding as they are for EPA, and that prior to contracting, they are at risk of losing ARRA funding provided to them by their State if it is not under contract by February 17, 2010. Thus, **at the discretion of the EPA Region and upon the direct request of an assistance recipient only, EPA may undertake informal "anticipatory" oversight.**

As per the preceding paragraph, EPA will not itself make any substantial transformation determinations. However, where an assistance recipient has made at least a tentative determination that substantial transformation of a specific good has occurred in the U.S., EPA may review detailed information about substantial transformation that the assistance recipient believes is or may be sufficient to support its determination, and will in such cases, as a matter of "anticipatory" oversight, advise the recipient as to whether in EPA's judgment the supporting information is sufficient.

In this effort, EPA will review only information provided by the recipient, or on its behalf by another party (e.g., a manufacturer or consulting engineer) with the recipient's express consent. This will ensure that any EPA review of a recipient's substantial transformation determination and supporting information is undertaken because the assistance recipient considers it to be genuinely in its own interest, and is not primarily for the benefit or convenience of any other party.

State Buy American Role: §1605 does not authorize or provide a role for States in the consideration or granting of waivers. However, as with the typical situation pertaining to oversight of SRF assistance, States do have a lead oversight role – particularly through their conduct of oversight audits – in ensuring assistance recipients comply with all applicable requirements. This includes §1605, as the terms and conditions in the SRF capitalization grant agreements for ARRA require that applicable provisions be placed in all assistance agreements. Applying Buy American information posted on www.epa.gov/water/eparecovery, States can advise assistance recipients to help ensure that the documentation in recipients' project files is appropriate for review of any applicable means of compliance with §1605.

- For the procurement of U.S.-made iron, steel, and manufactured goods (the preferred approach), this would include verification of U.S. production (as stated in sample certification point 2 in Appendix 5 of EPA's April 28, 2009 Buy American memo, cited above, and as referred to in point (3) of "Assistance Recipients' Role", above), in conjunction with, where necessary, the information provided and determination made that substantial transformation occurred in the U.S., as indicated in this paper.

- For items covered by a categorical (e.g., nationwide) waiver, the documentation must include all elements specified in and required by the waiver for an item or project to be covered. For any individual project component that has been granted a waiver, documentation will include a copy of the Federal Register notice of the project specific waiver.

- For items subject to an international agreement, the recipient documentation will include a communication from the applicable state or municipal party to the agreement that the recipient and any specific components are covered, a substantiated estimate that the value of the project is $7,443,000 or more, and verification of the components' origin from a country covered by the agreement.

Substantial Transformation Concerns for States and EPA

Both EPA and States should recognize that, if they wish to provide technical assistance in areas of Buy American activities beyond the scope of the above responsibilities, there is a tension between the State or EPA role for compliance oversight on the one hand, and the discretionary provision of technical assistance with respect to that compliance on the other. Both EPA and States should be cautious regarding recipient requests to consult on substantial transformation, keeping in mind their primary responsibility for ensuring compliance.

However, like EPA, States can provide their own "anticipatory oversight" to their assistance recipients. States can choose to review detailed information and analysis provided by or on behalf of the recipient that presents a case about the potential substantial transformation of a product the recipient wishes to procure for an ARRA project. While this review by the State is purely discretionary and, like any EPA may do in this regard, is not a formal decision-making process under ARRA, such review also would recognize the reality faced by ARRA's SRF assistance recipients: of complying with new, unfamiliar, and complex Buy American requirements prior to a tight deadline for signing contracts. Both EPA and States, in undertaking this role, should inform recipients seeking such review of those recipients' obligation to scrutinize and analyze to the best of their ability the information proffered by manufacturers asserting U.S. production of their goods, and to consider information put forward by competing manufacturers who may be contesting such assertions. Under these circumstances, neither EPA nor States are compelled to provide an "anticipatory" oversight review, and should concur in such requests only if the State or EPA believes they have a sufficient basis to be able to determine whether substantial transformation had occurred if they were undertaking a direct oversight audit.

Some Basic Principles of Substantial Transformation Analysis

With the widely diverse conditions of production in the water infrastructure industry, circumstances of creating a finished good may range from production lines that are nearly or entirely integrated vertically, to the bringing together of components from dispersed sources. The challenge for substantial transformation analysis is to determine whether – on the spectrum from :"minimal assembly required" in a simple kit (such as an IKEA box) to heavy machining involving high value labor and sophisticated equipment – the U.S.-based production process for each specific finished good reached a point where one

could fairly say that substantial transformation has occurred. The simple assembly case is clearly not substantial transformation, the heavy machining clearly is. The focus of substantial transformation analysis is on the many, individualized, more complex cases in between these two, obvious poles.

An oversimplified summary of this analysis is to ask whether the activities in the U.S. substantially transform the components that go into the completed item. EPA has relied on long-articulated Federal legal interpretations to provide more useful detail. Some basic principles in "substantial transformation" analysis include the following.

- First, the determination of whether "substantial transformation" has occurred is always case-by case, using questions and criteria well-established in administrative and judicial case law. [*SDI Technologies v. U.S.*, 977 F.Supp 1235 (C.I.T. 1997), at 1239 n. 2. *Customs Ruling* HQ 560427 (August 21, 1997)]

- Second, no good "satisfies the substantial transformation test by ... having merely undergone '[a] simple combining or packaging operation.'" [19 USC Sec. 2463(b)(2)(A), cited in *Uniden America Corp. v. U.S.*, C.I.T. Slip Op. 00-139, Court No. 98-05-01311 at 8, n. 4.]

- Third, "[a]ssembly operations which are minimal or simple, as opposed to complex or meaningful, will generally not result in a substantial transformation." [*Customs Ruling* HQ 734097 (November 25, 1991) (and Customs Cases cited therein)]

These principles are helpful in offering a basic framework and sideboards for more searching substantial transformation analysis, as described herein.

Analysis to Determine Whether Substantial Transformation Has Occurred in the U.S.

EPA has developed several questions for assistance recipients to ask when determining whether substantial transformation has occurred in the U.S. As EPA entered the work of ARRA implementation without current experience in the Office of Water with Buy American programs, these questions were derived directly from numerous Federal court cases, Customs Department administrative rulings, and interpretive rules for U.S. trade agreements.

In applying these questions to individual cases, "yes" answers must in all cases be documented by meaningful, informative, and specific technical descriptions of the activities in the actual process asked about in each question. These descriptions need not be of great length, but must be sufficiently detailed and clearly written to inform assistance recipients and agency reviewers about the activities that have occurred in the process(es), enough to understand their nature and purpose. They should not simply assert a conclusion, describe an end state, or essentially repeat the words of the question

as a statement. **Simple "yes" answers are always entirely insufficient to make a case that an item has been substantially transformed in the U.S.**

These questions all focus on processing work on and assembly/integration of the components into a finished good. Design, planning, procurement, component production, or any other step prior to the process of physically working on and bringing together the components into the item used in and incorporated into the project cannot constitute or be a part of substantial transformation.

Substantial Transformation has occurred in the U.S. if answer is "yes" to either Question 1, 2, or 3 below.

> 1. Were all of the components of the manufactured good manufactured in the United States, **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., and the inquiry is complete)

Question 2 addresses primarily the situations where important processing work is done on components of the complete item. While assembly is typically also involved, the focus of the question 2 steps is generally on that work prior to final assembly. Because each of the subquestions of 2 call for relatively significant and demanding steps, the answer to question 2 is "yes" if answer to any of 2a, 2b, or 2c is "yes."

> 2. 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)
>
> a. Was there a change in the physical and/or chemical properties or characteristics designed to alter the functionality of the good?
>
> b. Did the manufacturing or processing operation result in a change of a product(s) with one use into a product with a different use?
>
> c. Did the manufacturing or processing operation result in the narrowing of the range of possible uses of a multi-use product?

Question 3 generally addresses situations where the most significant of the potentially transformative work is assembly. Because assembly is in most cases further down the spectrum towards non-transformative work, a more demanding standard is appropriate. Thus, if the answer to at least two of 3a, 3b, 3c, 3d, or 3e is "yes", then the answer to Question 3 is "yes". Manufacturers who wish to establish beyond a doubt that their product has been substantially transformed in the U.S. via answers to Question 3 will want to provide descriptions of their process(es) that support affirmative answers to as many of the subquestions as are applicable, to increase the likelihood that the answers to at least two of the questions are sufficient.

3. Was(/were) the process(es) performed in the U.S. (including but not limited to assembly) complex and meaningful?

a. Did the process(es) take a substantial amount of time?

b. Was(/were) the process(es) costly?

c. Did the process(es) require particular high level skills?

d. Did the process(es) require a number of different operations?

e. Was substantial value added in the process(es)?

Some Actions Are Not Substantial Transformation under Any Circumstances

Work that makes simply cosmetic or surface changes only in a component, e.g., painting, lacquering, or cleaning, cannot amount or contribute to a finding of substantial transformation. [One example of this: *Rules of Origin under the U.S.-Jordan Free Trade Agreement, Final Report*, at 4.9 (at http://www.jordanusfta.com/documents/chap4.pdf).] Similarly, simply cutting a material to length or width, e.g., cutting steel pipe to particular length, is considered a minor change that is not and does not advance the case for substantial transformation [*Rules of Origin* above, at 4.11.2].

Can Substantial Transformation Occur Onsite?

The OMB Guidance definition of "manufactured good" as a "good brought to the construction site" suggests a few general operating presumptions: (1) what occurs onsite is construction; (2) "manufacturing" occurs prior to the point at which a "good [is] brought to the construction site," and (3) the substantial transformation test is applied to determine the U.S. or non-U.S. origin of goods at that point, as they arrive onsite. On the other hand, the OMB Guidance also provided for "substantial transformation" analysis to determine where manufacturing has occurred. In such analysis, the principle is inherent and well-established that a good is manufactured at any site where substantial transformation occurs. (See, e.g., *Torrington v. U.S.* 764 F.2d 1563 (1985), at 1568: "a substantial transformation occurs when an article emerges from a manufacturing process [having met the applicable criteria for transformation]", cited at *SDI Technologies, Inc. v. U.S.* (977 F.Supp. 1235 (CIT 1977), at 1239.) Thus, substantial transformation can encompass onsite manufacturing. Because the OMB Guidance was signed April 6, 2009, less than seven weeks after enactment of ARRA, this did not allow time to coordinate or integrate the "manufactured goods" definition with the "substantial transformation" term.

Interpretation of these two terms can be coordinated by maintaining the distinctions made in each term. Under the "manufactured goods" definition, what occurs at the project site is presumed to be construction; under the "substantial transformation" analysis,

manufacturing may occur at the project site, but only if the process there is both substantial transformation and it occurs under conditions ordinarily and customarily associated with manufacturing at a conventional plant.

In other words, for an activity at the project site to be considered "manufacturing," the manufacturer must, first, bring all components of the good to the site and must always do so in normal course of business. This ensures that the U.S. company is not changing the terms of its customary operations in an attempt to game the Buy American requirements. In addition, the manufacturer does all the work onsite with its own personnel, and may use a subcontractor for this only if the manufacturer does so already in the normal course of business. Thus, by ensuring the manufacturer maintains essentially full custody and control at the project site to the point where the good is finished, this condition requires that the manufacturer customarily engages in work at project sites as the functional equivalent of a manufacturing plant for that particular good.

If the U.S. company that meets these "customary operation" conditions does retain custody through the onsite completion of the good and its installation into the project, the final issue is whether that onsite work amounts to substantial transformation under the Questions 1, 2, or 3 above. The U.S. company's case will be strongest if the transformative work must be done onsite. For example, the U.S. manufacturer may provide that onsite assembly and installation include sophisticated adjustments, calibration, etc., by the U.S. company or its authorized and customary subcontractors, which must necessarily be done onsite to meet project performance specifications and establish warranty conditions.

This discussion also explains why, in a "kit" situation, where all pieces are shipped by one company with the intent of providing all components necessary to be assembled into a functional good (e.g., pump station), their assembly by a contractor or third party is properly considered as "construction" and not substantial transformation.

UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
REGION 5
77 WEST JACKSON BOULEVARD
CHICAGO, IL 60604-3590

JAN 2 7 2012

REPLY TO THE ATTENTION OF

MEMORANDUM

SUBJECT: Proposed Management Decision
American Recovery and Reinvestment Act Site Visit of Wastewater Treatment Plant – Phase II Improvements Project, City of Ottawa, Illinois
Project Number: OA-FY11-A-000

FROM: Susan Hedman
Regional Administrator

TO: Arthur A. Elkins, Jr.
Inspector General

We have reviewed the final report titled *American Recovery and Reinvestment Act Site Visit of Wastewater Treatment Plant – Phase II Improvements Projects, City of Ottawa, Illinois*, and we continue to disagree with the Office of Inspector General's (OIG) position that Buy American documentation is insufficient for the four items listed in the report. We affirm our prior determination that the Buy American documentation for the Kaeser blowers and the ITT Flygt pumps (two different models) is sufficient to prove compliance with Recovery Act requirements. Further, as promised in our July 29, 2011 response, we monitored the status of the K-Turbo blowers that were being manufactured at the time the final OIG report was issued. We received an inspection report and Buy American documentation from the City of Ottawa; the OIG has received the same information. Based on this information, we have concluded that the K-Turbo Buy American documentation also demonstrates compliance with Recovery Act requirements. The attached table summarizes the basis and rationale for our determinations for all four items.

Central to our disagreement with the report's conclusions is the amount and meaning of technical information presented in the submitted documents. In introducing the concept of substantial transformation, EPA provided a means for Recovery Act assistance recipients to analyze and determine whether manufactured goods meet Buy American requirements. Such determinations must be supported by detailed documentation from manufacturers. EPA also anticipated that Recovery Act assistance recipients would be assisted by the engineering community using their best professional judgment in reviewing and analyzing manufacturing information. City of Ottawa engineers evaluated and reviewed Buy American documentation and using their best engineering professional judgment found it sufficient to prove substantial transformation. EPA engineers have affirmed the City of Ottawa's determination and find the documentation sufficient as well.

EPA has met its obligations, under 2 CFR Section 176.130, to review the OIG's allegations of Recovery Act noncompliance. We have reviewed and evaluated Buy American documentation, resulting in no finding of noncompliant items. Therefore, I have concluded that Recovery Act funding to the City of Ottawa should not be reduced for this project and that no corrective action is required.

Attachment

cc: Geoff Andres, Manager, Infrastructure Financial Assistance Section, Illinois EPA
Arnold Bandstra, Assistant City Engineer, City of Ottawa, Illinois
Melissa Heist, Assistant Inspector General for Audit
Robert Adachi, Director of Forensic Audits
John Manibusan, EPA OIG Office of Congressional, Public Affairs and Management

ATTACHMENT 1

UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

MAR 15 2012

MEMORANDUM

SUBJECT: Response to Region 5's Proposed Management Decision on OIG Report No. 11-R-0700, *American Recovery and Reinvestment Act Site Visit of Wastewater Treatment Plant—Phase II Improvements Project, City of Ottawa, Illinois*, September 23, 2011

TO: Susan Hedman
Regional Administrator, Region 5

Nancy Stoner
Acting Assistant Administrator
Office of Water

This memorandum notes our disagreement with the proposed management decision provided by Region 5 for Office of Inspector General (OIG) Report No. 11-R-0700, *American Recovery and Reinvestment Act Site Visit of Wastewater Treatment Plant—Phase II Improvements Project, City of Ottawa, Illinois*, issued September 23, 2011. In addition to this memorandum being addressed to Region 5, the author of the decision, the memorandum is also addressed to the Office of Water (OW) because it authored the guidance that the region relied on to make its decision.[1]

The proposed management decision in question, dated January 27, 2012, concluded that there was compliance with Section 1605 of the American Recovery and Reinvestment Act of 2009 (Recovery Act). Specifically, the region determined that in applying a test set out in guidance prepared by OW, a number of products that were discussed in the audit had in fact met the substantial transformation test. For the purposes of this document, we would like to focus on one of those products, the Kaeser Blower. We disagree with the proposed management decision because we believe that the OW guidance on which that decision is based is significantly flawed and therefore led to the wrong decision. The OW guidance includes legal definitions of substantial transformation, but then employs a test for use in assessing substantial transformation that seemingly does not comport with those legal definitions. We request that OW modify its guidance so that the definitions of substantial transformation are met via an appropriate test, and we request that the region apply the modified test to the Kaeser Blower product. We believe that

[1] The resolution of the substantial transformation issue that is the subject of this memorandum will affect other OIG audits and investigations of Recovery Act projects throughout the country.

the likely result will be that the region will determine that the Kaeser Blower is not in compliance with the Buy American provisions of the Recovery Act.

The region and any OW staff who opined on the issue most certainly relied on the OW guidance document, *DETERMINING WHETHER "SUBSTANTIAL TRANSFORMATION" OF COMPONENTS INTO A "MANUFACTURED GOOD" HAS OCCURRED IN THE U.S.: ANALYSIS, ROLES, AND RESPONSIBILITIES*, dated October 22, 2009. The purpose of this document was to help assistance recipients fulfill their responsibilities to use iron, steel, and manufactured goods produced in the United States as required by Section 1605 of the Recovery Act. Specifically, the guidance notes that when "goods are comprised of any components produced in countries other than the U.S., SRF [State Revolving Fund] assistance recipients can use substantial transformation analysis to determine whether the activities in the U.S. by which a particular good is brought together do or do not enable it to be considered 'manufactured' in the U.S. under Section 1605 and the Guidance." The term "Guidance," as found in the OW document, refers to related Office of Management and Budget (OMB) regulations dated April 23, 2009.

In its 2009 substantial transformation document, OW referenced the OMB Guidance – which in turn had quoted 2 C.F.R. § 176.160 – as requiring that "[i]n the case of a manufactured good that consists in whole or in part of materials from another country, [the good] has been substantially transformed in the United States into a new and different manufactured good distinct from the materials from which it was transformed." OW's focus on the idea of a new and different final product as being a key aspect of substantial transformation was reinforced by an additional cited definition – taken from 2 C.F.R. § 176.140 – of a "manufactured good" as "[a] good brought to the construction site for incorporation into the building or work that has been processed into a specific form and shape, or combined with other raw material to create a material that has different properties than the properties of the individual raw materials." By including these definitions of substantial transformation front and center, OW clearly established that foreign-made components – to satisfy a substantial transformation test – must be combined in such a way or modified in such a way within the United States so that the components are actually transformed into new and different items that are obviously different from those which were imported.

Case law referenced in the OW document reinforces the idea that, to have substantial transformation, there must be actual, significant change to the foreign component. In *SDI Technologies v. United States,* 21 Ct. Int'l Trade 895, 897 (1997), the court began by adopting the concept from another case that "[s]ubstantial transformation occurs when an article emerges from a manufacturing process with a name, character, or use which differs from those of the original material subjected to the process." In this matter, an electronic stereo chassis and other stereo system components, including speakers, were imported. The chassis was then encased and the speakers were attached in the receiving country. The court considered whether the character and use of the imported components had been changed. First, the court found that because the "essence" of the chassis and speakers remained the same, their character had not been substantially transformed by the addition of a shell and the assembly of the components. Second, the court, among other things, concluded that the addition of speakers did not result in a new use because it involved a simple combining of components; hence, there was no evidence of

substantial transformation. The court also noted that it is important to assess which country is the source of the most complex part of the manufacturing; if the country that is exporting the component is responsible for creating the complex item then it is unlikely the country that is importing the component will be seen as a source of substantial transformation. In short, the character and use of the chassis and speakers had not significantly changed during the production process, so there was no substantial transformation.

A second case cited in the OW guidance, *Customs Ruling* HQ 734097 (November 25, 1991), set out a particularly relevant definition of substantial transformation. It stated: "[i]n determining whether the combining of parts or materials constitutes a substantial transformation, the issue is the extent of operations performed **and** whether the parts lose their identity and become an integral part of the new article" (emphasis added). The case noted that, in assessing substantial transformation, one should look to the complexity of the process to help make that determination. But, in the end, a complex manufacturing process alone is not sufficient to evidence substantial transformation; the component from overseas must also lose its original identity. The case offered the following substantial transformation test: (1) were the parts physically transformed, (2) did the assembly process require large amounts of skilled labor or specialized equipment, (3) was the cost of manufacture high, and (4) did the components lose their identity by becoming an integral part of a new article. This test combines inquiries into straightforward manufacturing issues like labor and cost with the traditional criteria of physical transformation and integration into a new identity.

To help assistance recipients determine whether a product has been substantially transformed, OW developed a questionnaire with three questions. The first question asked whether all components had been manufactured in the United States. The second question asked whether there had been a change in character or use of a component in the United States. The third question focused on whether the United States manufacturing process was complex and meaningful. OW determined that only one of the questions must be answered in the affirmative to conclude that substantial transformation occurred. Indeed, there is no need to apply a substantial transformation test if the answer to question one is in the affirmative. Question two poses the standard substantial transformation test that is identified in the definitions and case law found in the OW guidance; it requires a change in character or use of the original component.

Our concern here lies with the use of question three – standing ALONE – to determine whether substantial transformation occurred. That question has five subparts:

a. Did the process take a substantial amount of time?
b. Was the process costly?
c. Did the process require particular high level skills?
d. Did the process require a number of different operations?
e. Was substantial value added in the process?

According to the guidance, two of the five subparts must be answered in the affirmative for there to be an overall "yes" for the question. This is the question that the region applied when concluding whether the Kaeser Blower chassis had been substantially transformed. However, the major flaw is that while each of the subparts may well be satisfied with whatever calculable (and

hopefully supportable) manufacturing data is provided by the contractor, there is no additional, necessary determination of whether the components in question may, in fact, have "[lost] their identity and become an integral part of the new article." This test is missing half of the analysis required by the Customs Ruling above.

OW repeatedly noted – through case law and regulations – that substantial transformation must involve actual transformation of a component into a new and different good that is distinct from the original component. Proof of costly, complex, value-enhancing processes may well be established via question three, but all of that does not also evidence whether, ultimately, the component was significantly modified.

The problem identified above with regard to question three of the OW questionnaire is apparent in the decision making about the Kaeser Blower that was referenced in the audit report. The "base chassis" core of the Kaeser Blower – the key component of the final product – was imported from Germany. It is a complex, large unit. American-made components (motor, valves) were added in the United States. The region concluded that because time had been spent adding the components and because the value of the chassis had been increased by the components, question three was satisfied and substantial transformation had been established. However, if one were to apply the definitions of substantial transformation as set out in the OW guidance, one would most likely conclude that substantial transformation had not occurred. For one, the United States manufacturing process admittedly involved the addition of American components to the core German chassis, but the complex manufacturing of the chassis had occurred in Germany. Second, the U.S. manufacturing process did not result in a "new and different manufactured good distinct from the materials from which it was transformed." Although the German chassis was not fully functional when it was imported – unlike the stereo system in *SDI,* the chassis which was the essence of the blower remained essentially the same after the addition of American components. The complex, large German chassis did not lose its identity in the United States.

The critical flaw in the OW substantial transformation questionnaire is that in accepting responses to question three ALONE as sufficient evidence of substantial transformation, OW has ultimately not fully satisfied the test set out in the Customs Ruling (which it cited) discussed above. There it was noted that substantial transformation is the result of complex processes (question three) AND evidenced by a loss of identity and physical transformation of the original component because of the way a component is fully integrated into the final product (question two). OW's guidance fails because it allows a contractor to establish substantial transformation by showing only one part (question three) of a critical two-part test (questions two and three). If both critical parts of the substantial transformation test had been applied to the Kaeser Blower, the region would seemingly have concluded that substantial transformation had not occurred and there was not compliance with the Buy American provisions of the Recovery Act.

For the reasons set out above, we believe that OW must modify the substantial transformation questionnaire employed in its guidance so that some combination of both questions two and three are employed as the appropriate test for substantial transformation. We further expect that this new test – a combination of questions two and three – will be applied to the Kaeser Blower chassis from Germany.

We have two additional concerns about the region's proposed management decision. First, the region relied on vague and unsupported statements included in a letter from Kaeser dated October 29, 2010. For example, the region relied on Kaeser's claim that the combination of domestically sourced components and domestic labor "can" account for 35 to 50 percent of the product's value. The range of this value depended on the relative size of the unit when compared to the components being installed, as well as the complexity of the customer's specifications. The region also relied on the claim that each unit would require an estimated 16–24 hours of build time. Neither of these statements was supported by verifiable evidence to determine creditability, accuracy, and usefulness. These statements were seemingly prospective estimates and not specifically tailored to the Ottawa blowers, as required by Environmental Protection Agency (EPA) guidance. Additionally, these statements were addressed in the report and determined to be insufficient to support substantial transformation. The region has not provided any reason why the report's determination was incorrect or any new evidence for consideration, as required by EPA Manual 2750.

Second, the region also relied on a November 1, 2010, e-mail message from OW to Kaeser in which it advised the company that "substantial transformation is occurring in the U.S. at your Fredericksburg, VA facility." However, the OW substantial transformation guidance states that "EPA does not and will not make determinations as to substantial transformations." EPA limits its role under Section 1605 to reviewing waiver requests. Hence, the e-mail appears to not be in keeping with the limitations set out in the OW guidance. Also, the region did not provide the justification or precedence for why OW's decision is determinative in this matter, as required by EPA Manual 2750.

The Buy American provisions of the Recovery Act state, in part, that monies are only to be used for projects where the manufactured goods are produced in the United States. The provisions were included so as to help achieve the first stated goal of the Recovery Act: "To preserve and create jobs and promote economic recovery." OW adopted a substantial transformation test so as to eliminate those components that were made overseas and were not ultimately manufactured in this country. However, the OW questionnaire that is used to assess substantial transformation seems to be designed to fall short of achieving the Buy American goal with regard to at least some foreign made components. We believe that the questionnaire is flawed because it allows for a determination that a component has been transformed even though the component has in fact not been shaped into a new form or combined with other components to create a new item that has different properties (*see* 2 C.F.R. § 176.140). The result, in our opinion, is that not all components from overseas are being rigorously scrutinized to ensure they are transformed within the United States, as is required under the spirit and letter of the Buy American provisions of the Recovery Act. In addition to problems highlighted with regard to the OW questionnaire, we also noted above two examples where the process for assessing substantial transformation was seemingly less than rigorous.

If you have any questions regarding this memorandum, please contact Melissa Heist, Assistant Inspector General for Audit, at (202) 566-0899; or Robert Adachi, Product Line Director, at (415) 947-4537.

Arthur A. Elkins, Jr.

cc: Principal Deputy Assistant Administrator, Office of Water
Agency Follow-Up Official (the CFO)
Agency Follow-Up Coordinator
General Counsel
Director, Office of Ground Water and Drinking Water, Office of Water
Director, Office of Wastewater Management, Office of Water
Deputy Regional Administrator, Region 5
Audit Follow-Up Coordinator, Region 5
Director, Water Division, Region 5
Chief, State and Tribal Programs Branch, Region 5

UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
Washington, D.C. 20460

AUG 07 2012

Office of
General Counsel

MEMORANDUM

SUBJECT: EPA's Guidance on the Buy American Provisions of the ARRA

FROM: Kenneth Redden
Deputy Associate General Counsel
Civil Rights and Finance Law Office
Office of General Counsel

TO: Michael Shapiro
Deputy Assistant Administrator
Office of Water

Question Presented

Whether the analytical framework EPA provided in guidance to State Revolving Loan program grant recipients concerning the use of "substantial transformation" as a means of complying with the Buy American provisions of the American Recovery and Reinvestment Act of 2009 (ARRA or Act) is consistent with the requirements of the ARRA.

Short Answer

Yes. Substantial transformation is a legally supported means of complying with the Buy American provisions of the ARRA. The Agency's guidance provides tests for analyzing substantial transformation that are consistent with relevant legal authority.

Background

The ARRA Buy American Provisions

Section 1605 of the ARRA states that, with some limited exceptions, none of the funds awarded under the 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 . . . *manufactured goods used in the project are produced in the United States*." (Emphasis added). OMB elaborated on this requirement in guidance specific to assistance agreements, published on April 23, 2009, which has been codified at 2 CFR §176 et seq. That guidance requires Agencies to include the following definition of manufactured goods in the terms and conditions of any grant: "(1)

Manufactured Good means a good brought to the construction site for incorporation into the building or work that has been (i) processed into a specific form and shape; or (ii) combined with other raw material to create a material that has different properties than the properties of the individual raw materials."

The OMB terms and conditions did not fully address the concept of substantial transformation, nor did any OMB guidance require Agencies to elaborate on the definition of "manufactured good." Nonetheless, in order to provide some level of clarity and ease-of-use to recipients who were going to make determinations regarding the origin of a myriad and diverse set of manufactured goods, EPA issued a guidance document "Determining Whether "Substantial Transformation" of Components into a "Manufactured Good" has occurred in the U.S.: Analysis, Roles, and Responsibilities", October 22, 2009, (Substantial Transformation Guidance). The Substantial Transformation Guidance describes the concept of substantial transformation as a means of complying with the Buy American provisions of the ARRA. As noted in the Substantial Transformation Guidance, "EPA believes the substantial transformation concept provides necessary guidance on this issue [of whether a manufactured good is produced in the United States]." See Substantial Transformation Guidance, pg 1-2.

EPA's Substantial Transformation Guidance

The Substantial Transformation Guidance sets forth three principles that would apply to all substantial transformation inquiries. The Substantial Transformation Guidance is clear: "These principles are helpful in offering a basic framework and sideboards for [a] more searching substantial transformation analysis, as described herein." See Substantial Transformation Guidance at 5-6. The three principles are:

- First, the determination of whether "substantial transformation" has occurred is always case-by-case, using questions and criteria well-established in administrative and judicial case law. *SDI Technologies v. U.S.*, 977 F.Supp. 1235 (C.I.T. 1997), at 1239 n. 2. *Customs Ruling* HQ 560427 (August 21, 1997).

- Second, no good "satisfies the substantial transformation test by ... having merely undergone '[a] simple combining or packaging operation.'" 19 USC Sec. 2463(b)(2)(A), cited in *Uniden America Corp. v. U.S.*, C.I.T. Slip Op. 00-139, Court No. 98-05-01311 at 8, n. 4.

- Third, "[a]ssembly operations which are minimal or simple, as opposed to complex or meaningful, will generally not result in a substantial transformation." *Customs Ruling* HQ 734097 (November 25, 1991) (and Customs Cases cited).

See Substantial Transformation Guidance at 6.

To further aid recipients, the Substantial Transformation Guidance provides three questions for assistance recipients to ask when determining whether substantial transformation has occurred in the United States. Question 1 addresses goods where all components were made in the United States. Question 2 is designed to aid in the analysis of goods where the

transformation is process-focused. And question 3 is focused on goods where the transformative work is assembly. See Substantial Transformation Guidance at 7-8. The questions were derived directly from numerous Federal court cases, United States Customs administrative rulings, and interpretive rules for United States trade agreements.

Office of Inspector General Disagreement

In May 2011, EPA's Office of Inspector General (OIG) issued a draft report questioning whether certain items used in an Ottawa, IL, Clean Water State Revolving Fund (CWSRF) ARRA project were made other than in the United States and thus ineligible for ARRA funding. EPA Region 5, working with EPA's Office of Water, responded to the report on July 29, 2011, and disagreed with some of the findings. In September 2011, OIG issued a final report finding that three manufactured goods were not compliant with the ARRA because they had not been substantially transformed in the United States. EPA Region 5 disagreed with these findings, but was required to issue a proposed management plan within 120 days of the report. During the 120 period, EPA Region 5 staff met with OIG staff but was unsuccessful in resolving differences. Despite continued disagreement with the OIG findings, in January 2012, EPA Region 5 issued its proposed management plan for the three OIG findings at issue. In March 2012, OIG issued a response to the EPA Region 5 management plan. In that response, OIG agrees that EPA Region 5 properly used EPA HQ guidance in determining whether or not items were manufactured in the United States, but nonetheless determined that certain goods may still not be manufactured in the United States because it believes that EPA HQ guidance incorrectly interprets the statutory requirements of the ARRA.

OIG believes that the portion of the guidance relative to question 3 is not correct. In relevant part, question 3 provides the following:

> 3. Was(/were) the process(es) performed in the U.S. (including but not limited to assembly) complex and meaningful?
>
> a. Did the process(es) take a substantial amount of time?
> b. Was(/were) the process(es) costly?
> c. Did the process(es) require particular high level skills?
> d. Did the process(es) require a number of different operations?
> e. Was substantial value added in the process(es)?

See Substantial Transformation Guidance at 7-8. The Substantial Transformation Guidance explains that assembly is in most cases further down the spectrum towards non-transformative work. Therefore, at least two of 3a, 3b, 3c, 3d, or 3e must be satisfied to establish substantial transformation based on assembly.

Specifically, OIG believes that manufactured goods that satisfy the requirements of question 3, standing alone, would not necessarily meet the requirements of the ARRA to use only manufactured goods produced in the United States.

Legal Analysis

The Substantial Transformation Guidance is Consistent with the Buy American Provisions of the ARRA

As explained in the Substantial Transformation Guidance, EPA adopted the concept of substantial transformation in part because it was referenced in OMB guidance with respect to determining country of origin for assistance agreements subject to International Agreements prior to the ARRA. OMB's regulation at 2 CFR §176.160 provides that recipients need to inquire whether, "[i]n the case of a manufactured good that consists in whole or in part of materials from another country, [the good] has been substantially transformed in the United States into a new and different manufactured good distinct from the materials from which it was transformed." Absent any specific elaboration from OMB, EPA provided guidance related to substantial transformation. As explained in the guidance, "[t]he origins and applications of the term are rooted in well-established Federal interpretations, particularly by the Customs Department and the Federal courts." See Substantial Transformation Guidance at 1.

Generally, substantial transformation means a change in the name, character, or use of a manufactured good. Anheuser-Busch Brewing Assoc. v. United States, 207 U.S. 556, (1908). There are thousands of United States Customs cases and reported Federal court cases concerning substantial transformation, many of which interpret statutory language that is not relevant to the analysis under the ARRA, and many of which involve manufactured goods that would not likely be used in a water treatment plant funded under the ARRA. In its guidance, EPA attempted to distill significant concepts from relevant cases so that an entity unfamiliar with the concept of substantial transformation would have some tools to make a reasoned determination as to whether a manufactured good was produced in the United States.

The inquiries that were included in question 3 have a basis in Federal court cases and United States Customs decisions. For example, the concept of "value added" is explored in Superior Wire v. United States, 11 C.I.T. 608 (Ct. Int'l Trade 1987). The importance of the amount of time taken to perform the assembly, the use of skilled workers, the number of components, and the cost of the assembly were all discussed in Notice of Final Determination, February 13, 2003, Brunswick Pinsetters (68 FR 7407), which also references other cases. That determination involved a Bowling pinsetter assembly case where Brunswick asked for a ruling that its pinsetter be considered an American-made product. Note that in many of the cases cited, the concept of substantial transformation was applied through international trade laws to determine country of origin for favorable trade reasons, not to determine whether an item was manufactured in the United States. Nonetheless, the rationale with respect to substantial transformation is applicable in either scenario. The Brunswick case stated in relevant part: If the manufacturing or combining process is a minor one which leaves the identity of the imported article intact, a substantial transformation has not occurred. See Uniroyal Inc. v. United States, 3 CIT 220, 542 F. Supp. 1026 (CIT 1982). Assembly operations which are minimal or simple, as opposed to complex or meaningful, will generally not result in a substantial transformation. See C.S.D. 80 111, C.S.D. 8525, and C.S.D. 9097.

In finding that substantial transformation had occurred in the United States, the Brunswick case goes on to explain the type of assembly required in analyzing the assembly of bowling pinsetters:

> In this case, the complex assembly of the central block from three subassemblies, including the incorporation of three motors from the drive frame subassembly into the central block, combined with the subsequent assembly of the central block, sixpack, ball accelerator, and U.S. origin electrical controller assembly and the installation of the pinsetters in bowling facilities in the United States, when taken together, result in a substantial transformation of the foreign origin subassemblies involved. The processing in the United States requires precise calibration and involves the assembly of numerous parts and subassemblies and highly skilled labor. The name, character and use of the foreign origin subassemblies and parts change as a result of the processing and other assembly operations performed in the United States. Therefore, pursuant to 19 U.S.C. 2518(4)(B), and 19 CFR 177.22(a), we find that the country of origin of the bowling pinsetters is the United States.

Note that the complex assembly itself is what changes the use of the components. This is similar to the subcomponents in question 3 of the Substantial Transformation Guidance where if two of the questions can be answered in the affirmative, it will necessarily result in a changed character or use of the product.

The analysis provided in Brunswick, and the authorities cited therein, provide a sound legal basis for the inquiries contained in question 3 of the Substantial Transformation Guidance. We are not aware of any Federal court cases or United States Customs decisions that overrule the Brunswick analysis.

Finally, a document meant to give an overview of rules of origin analysis explains substantial transformation in a similar way to how EPA did in the Substantial Transformation Guidance. In **International Trade: Rules of Origin**, Vivian C. Jones and Michael F. Martin, January 5, 2012, Congressional Research Service, which post-dates the development of EPA's Substantial Transformation Guidance, acknowledges that in the United States Customs context, there are several factors that are taken into account when determining whether substantial transformation has occurred. This quote is from page 3:

> If an imported product consists of components that are from more than one country, a criterion known as *substantial transformation* is used to confer origin. In most cases, the origin of the good is determined to be *the last place in which it was substantially transformed into a new and distinct article of commerce* based on a change in name, character, or use. Making the determination about what constitutes a change sufficient for a product to be considered *substantially transformed* is the juncture at which an origin ruling can prove to be quite complex.

When determining origin, CBP [Customs and Border Protection] takes into account **one or more** of the following factors (emphasis added):

• the character/name/use of the article;

• the nature of the article's manufacturing process, as compared to the processes used to make the imported parts, components, or other materials used to make the product;

• the value added by the manufacturing process (as well as the cost of production, the amount of capital investment, or labor required) compared to the value imparted by other component parts; and

• whether the essential character is established by the manufacturing process or by the essential character of the imported parts or materials.

Origin determinations are very fact-specific, but as CBP itself has acknowledged, there can still be considerable uncertainty about what is deemed to be substantial transformation due to the "inherently subjective nature" which may be involved in CBP interpretations of these facts.

Taken as a whole, the Substantial Transformation Guidance issued by EPA on October 22, 2009, is consistent with the Buy American provisions of the ARRA. Additionally, EPA's interpretation of the substantial transformation is consistent with relevant legal authority and is similar to the published material from the Congressional Research Service.

Conclusion

The Substantial Transformation Guidance provides a framework for recipients to analyze the concept of substantial transformation as a means of compliance with the Buy American provisions of the ARRA. The inquiries included in the Substantial Transformation Guidance are based on relevant legal authority explaining the elements of substantial transformation in the circumstances of process and assembly.

If you have any questions, please contact Wendel Askew at 202-564-3987 or Joanne Hogan at 202-564-5463.

Cc: Sheila Frace, OW
William Anderson, OW
Sheila Platt, OW
Kirsten Anderer, OW
Peter Shanaghan, OW
Jordan Dorfman, OW

UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D C 20460

AUG 1 5 2012

OFFICE OF WATER

MEMORANDUM

SUBJECT: Response to OIG memo entitled, "Response to Region 5's Proposed Management Decision on OIG Report No. 11-R-0700, American Recovery and Reinvestment Act Site Visit of Wastewater Treatment Plant-Phase II Improvements Project, City of Ottawa, Illinois, September 23, 2011"

FROM: Nancy K. Stoner
Acting Assistant Administrator

TO: Arthur A. Elkins, Jr.
Inspector General

Thank you for the opportunity to respond to your memo entitled, "Response to Region 5's Proposed Management Decision on OIG Report No. 11-R-0700, American Recovery and Reinvestment Act Site Visit of Wastewater Treatment Plant-Phase II Improvements Project, City of Ottawa, Illinois, September 23, 2011," in which you note your disagreement with the proposed management decision provided by Region V, as well as your recommendation to the Office of Water to amend existing Buy American guidance. After numerous conversations with your counsel and staff, the Office of Water disagrees with your rejection of the Region's proposed management decision and your suggestion to amend existing Buy American guidance.

Based on legal analysis provided by the Office of General Counsel, the guidance provided to States and recipients three years ago establishes tests for analyzing substantial transformation that are consistent with relevant legal authority. Further, as a matter of policy, the Office of Water believes it would be imprudent to amend existing guidance more than two years after the February 17, 2010 ARRA statutory deadline for projects to be under to be under "contract or construction." At this time, the vast majority of the over 3,200 projects funded by the Clean Water State Revolving Fund and the Drinking Water State Revolving Fund have been completed and more than 95 percent of ARRA funds have already been expended. The Office of Water believes the guidance therefore requires no amendment and continues to support Region V's proposed management plan. If you have any questions, please contact Randolph L. Hill, Acting Director, Office of Wastewater Management, at (202) 564-0748, or Pamela S. Barr, Acting Director, Office of Ground Water and Drinking Water, at (202) 564-3750.

Attachment

UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

SEP 28 2012

THE INSPECTOR GENERAL

MEMORANDUM

SUBJECT: Response to Office of Water's August 15, 2012, Memorandum in Connection with OIG Report No. 11-R-0700, *American Recovery and Reinvestment Act Site Visit of Wastewater Treatment Plant – Phase II Improvements Project, City of Ottawa, Illinois,* September 23, 2011

TO: Nancy K. Stoner
Acting Assistant Administrator
Office of Water

Susan Hedman
Regional Administrator, Region 5

A series of hotline complaints raised questions that ultimately led the Office of Inspector General (OIG) to focus on Office of Water (OW) guidance regarding the proper assessment of products used in American Recovery and Reinvestment Act (ARRA) projects to determine whether they comply with the ARRA Buy American provision. In a memorandum dated March 15, 2012 (March 2012 memorandum), we notified EPA Region 5 and OW that we disagreed with the proposed management conclusion that certain equipment which we questioned in the referenced audit report complied with the statutory Buy American requirements. Specifically, we questioned the use of an OW alternative test for "substantial transformation" that is seemingly not based in statutory, regulatory, and case law definitions – and that resulted, in our view, in a different conclusion regarding compliance than would have been reached using an established substantial transformation test.

The OIG then met with representatives from OW, Region 5, and the EPA Office of General Counsel (OGC). At the meeting, OW and OGC maintained the legitimacy of the guidance, and OIG requested legal support for OW's position. On March 30, 2012, OGC provided an "informal legal discussion" (OGC informal opinion) in support of the OW alternative test. OIG responded to the OGC informal opinion on April 5, 2012, and noted – with explanation – our judgment that the OGC cases and analysis failed to provide sufficient legal support for the alternative test.

On August 15, 2012, OW forwarded OGC's August 7, 2012, legal opinion (OGC legal opinion) on the subject. The legal opinion did not provide any additional legal support for the OW alternative test as compared with the March 30 OGC informal opinion. OIG therefore continues to question the legal basis for OW's substantial transformation test.

Substantial Transformation Tests

OW's ARRA guidance, "DETERMINING WHETHER 'SUBSTANTIAL TRANSFORMATION' OF COMPONENTS INTO A 'MANUFACTURED GOOD' HAS OCCURRED IN THE U.S.: ANALYSIS, ROLES, AND RESPONSIBILITIES" (Substantial Transformation Guidance), was designed to assist recipients/contractors in fulfilling their responsibilities to use iron, steel, and manufactured goods produced in the United States as required by the Buy American provision (Section 1605) of ARRA. In the case where a foreign component is modified during a manufacturing process in the United States, the essential question posed by the OW guidance is whether that component was "substantially transformed" during the manufacturing process and thus considered a product manufactured in the United States. The OW guidance includes two tests for substantial transformation from which a recipient/contractor is allowed to choose: the "established test" and the "OW alternative test." See Substantial Transformation Guidance at 7-8.

The established test focuses on whether a foreign component has been substantially changed as to character or use (the test initially also included change in name but that characteristic is now typically considered not to be dispositive). This test for substantial transformation is based in statute (19 U.S.C. § 2518(4)(B)), regulation (19 C.F.R. § 177.22(a)), and is employed in case law discussed by OGC and OW. To be a product of the United States, the statute requires that "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 transformed." 19 U.S.C. § 2518(4)(B)(ii). The language in this test requires a true change in the use or character of the foreign component such that a new product results. As the Supreme Court (in one of OGC's cited cases) declared over a hundred years ago: "Manufacture implies a change, but every change is not manufacture, and yet every change in an article is the result of treatment, labor, and manipulation. **But something more is necessary**.... [T]here must be transformation; a new and different article must emerge, 'having a distinctive name, character, or use.'" Anheuser-Busch Brewing Assoc. v. United States, 207 U.S. 556, 562 (1908). (Emphasis added.)

The terms "character" and "use" have been operationally defined through a multitude of cases since the Supreme Court applied the established test in 1908. In one case referenced in OGC's informal opinion, Precision Specialty Metals, Inc. v. United States, 24 C.I.T. 1016 (Ct. Int'l Trade 2000), the court stated that substantial transformation may be found "where there is a definite and distinct point at which the identifying characteristics of the starting materials is [sic] lost and an identifiable new and different product can be ascertained." Id. at 1029. The Precision court applied the established test. Id. at 1036. In another case referenced in OGC's informal opinion, Uniroyal Inc. v. United States, 3 C.I.T. 220 (Ct. Int'l Trade 1982) (court found that attachment of outsole in the United States to the foreign-made upper part of the shoe did not result in substantial transformation), the court determined that if the manufacturing or combining process is a minor one which leaves the identity of the imported article "intact," a substantial transformation has not occurred. Id. at 224. This court also looked to whether the imported

component represented the "essence" of the finished product. Id. at 226-227. The Uniroyal court applied the established test. Id. at 224.

The focus of the established test was reiterated in and perhaps expanded by ARRA-related Office of Management and Budget (OMB) regulations. OW, in its ARRA guidance, cited to and adopted 2 C.F.R. § 176.160 to assist in defining "substantial transformation." See Substantial Transformation Guidance at 1-2. OW, quoting from the OMB regulation, stated that recipients must inquire whether "[i]n the case of a manufactured good that consists in whole or in part of materials from another country, [the good] has been substantially transformed in the United States into a new and different manufactured good distinct from the materials from which it was transformed." See 2 C.F.R. § 176.160(a)(2). OW acknowledged that the regulation is directly applicable to situations governed by international trade agreements, but also stated that the "substantial transformation" concept referenced in the OMB regulation is the only established concept available for use in determining whether or not a manufactured good is produced in the United States. See Substantial Transformation Guidance at 2. OW also cited to and adopted a second ARRA-related OMB regulation, 2 C.F.R. § 176.140, which defines the key term "manufactured good" as "[a] good brought to the construction site for incorporation into the building or work that has been processed into a specific form and shape or combined with other raw material to create a material that has different properties than the properties of the individual raw materials." See 2 C.F.R. § 176.140(a)(1). The ARRA-related regulations that were referenced in the OW ARRA guidance include definitions that are strikingly similar – and perhaps even more stringent because of their specificity – to the statute-based established test.

OW's alternative test for substantial transformation – which was not attributed by OW to any statutory or regulatory source – asks whether "the process(es) performed in the U.S. (including but not limited to assembly) [were] complex and meaningful." See Substantial Transformation Guidance at 8. To pass the test, a recipient/contractor is instructed to positively respond to two of the five following characteristics: (1) Did the process(es) take a substantial amount of time? (2) Was (were) the process(es) costly? (3) Did the process(es) require particular high level skills? (4) Did the process(es) require a number of different operations? And, (5) Was substantial value added in the process(es)? The guidance does not give examples of how much time, cost, skill level, complexity in processes, or value is considered to be substantial. According to OGC, the OW alternative test is necessary because of the nature of the products that are used on EPA projects. An OW staff engineer who is involved in the assessment of substantial transformation noted that the test is widely used by EPA contractors/recipients.

Legal Analysis

OGC's legal opinion generally asserts that OW's alternative test is supportable because the established test is "process-focused" and the OW alternative test is focused on "assembly." First, that distinction is not clear given the language in the OW test. The OW alternative test, which is supposed to be focused on "assembly" rather than "process," includes the word "process(es)" throughout and notes that the test is "not limited to assembly." Second, and most importantly, OW ignores the real distinction between the two approaches to assessing substantial transformation. The established test requires that the foreign component must undergo a true change resulting in 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 transformed"; the OW test does not require that result.

OGC, in its legal opinion, discussed in some detail three sources: a court case, a Customs Service notice, and an article – all offered to support a conclusion that the OW alternative test could be used, standing alone, to effectively assess substantial transformation. The court case, Superior Wire v. United States, 11 C.I.T. 608 (Ct. Int'l Trade 1987), according to OGC, supports the position that "value added" is a characteristic that – standing alone and as a subpart of the OW test – is an adequate test for substantial transformation. However, the Superior Wire court recognized that the established test for assessing substantial transformation involves an examination of change of use or character (not required by the OW alternative test), and that a subsidiary test – like significant added value (the OW alternative test) – might be used only as a "cross-check or additional factor" when assessing change in use or character. Id. at 614. Thus, the factor of "value added" is simply one characteristic of the manufacturing process that can, depending on the situation, be used to help check on a result achieved by using the established test, but it is not a stand-alone test. We will discuss the significance of this below.

OGC cited the Federal Register Notice of Issuance of Final Determination Concerning Bowling Pinsetters, 68 Fed. Reg. 7407 (Customs Serv. Feb. 13, 2003), as support for the proposition that complex manufacturing processes alone can be used to evidence that substantial transformation has occurred and, therefore, that the OW alternative test has a sufficient legal foundation. This Customs Service notice involved a truly complex manufacturing process in the United States that included thousands of components from other countries. The notice concluded that character and use of the foreign-origin seven subassemblies and the thousands of foreign parts clearly changed as a result of the sophisticated processing and other assembly operations performed in the United States. Id. at 7409. The assembly processes were so demonstrably complex that it was clear on its face that there was a change in use or character.

However, the fact pattern set out in the Customs Service notice involving thousands of foreign-made components is extreme when compared with the import situations that we have examined in the Ottawa, Illinois matter – and in other similar audits. The examples of assembly we have encountered (as will be detailed below) typically involve one or two foreign-made components that are modified in the United States. The processes in the United States take some time, perhaps require some skill, and may increase the value of the imported components. But the application of those sort of factors (time, value, skill and other factors set out in the OW test) to our fact situations, as required by the OW test, does not result in a clear determination of a true change in use or character. In short, the unique facts in the Customs Service notice involving thousands of components are entirely inapposite to Ottawa's facts; and the established test – not an alternative, stand-alone test – was in fact applied in the notice.

Finally, OGC referenced a Congressional Research Service article "International Trade: Rules of Origin," dated January 2012. OGC seems to suggest that the article supports the position that the established test is merely one of many separate tests/factors that may be used to assess substantial transformation. The information in the 2012 article cited by OGC is derived from a 1996 United States International Trade Commission publication. See United States International Trade Commission (USITC), Country of Origin Marking: Review of Laws,

Regulations, and Practices, USITC Publication 2975 (July 1996). The original 1996 publication, in a section entitled "The U.S. Approach to Origin," states : "Customs considers a variety of factors when determining whether a manufacturing process has changed the name, character, or use of an imported article." Id. at 2-4. The original source, contrary to OGC's inference about a variety of stand-alone tests/factors, is clear that the ultimate test is the established test, and that Customs may turn to a variety of factors when applying the established test.

Application to City of Ottawa, Illinois Audit Report

In our March 2012 memorandum, we detailed a situation where a German component had been modified in the United States. The contractor – in line with requirements of OW's alternative test – represented, among other things, that build time had been spent adding parts to the blower component, that value "can" increase due to processes in the United States – this includes upgrades to the contractor's factory in the United States, and that skill is required to build and test the units. As we noted in the March 2012 memorandum, the claims by the contractor were not documented by "meaningful, informative, and specific technical descriptions" that could be verified; hence, the representations seemingly did not comply with the requirements. An OW staff engineer made a determination about substantial transformation (something that OW guidance expressly prohibits), and communicated directly to the contractor that this component met the requirements of the OW alternative test.

The alternative test is an easier test to meet than the established test. In keeping with its alternative test, OW did not assess whether the central German component that was identified in our audit report had been changed in use or character. Also, OW did not apply the ARRA-related regulatory language that required that the transformed component must, among other things, be a "new and different manufactured good distinct from the materials from which it was transformed."

An illustration of the final blower product from the contractor's literature is included in Attachment 1. The core, complex, foreign-made blower component (light colored item) and the enclosure for the product were manufactured in Germany. Items numbered 2, 4, 5, and perhaps 6 (the darker colored items) – essentially the motor, a valve and pulleys – were attached in the United States. With regard to the foreign-made blower component, the contractor's literature states that the German state-of-the-art heavy manufacturing process had resulted in a "durable design that includes rigid casings, cast bearing supports, and one-piece rotors" – with "precision machined, case-hardened, spur-type timing gears and oversized cylindrical roller bearings" along with "piston-ring seals." The literature also discusses the sophisticated instrumentation, controls and sensors that are part of the device.

Applying the established test and the ARRA-related regulations to the blower component, leads to a conclusion that there has not been a true change in use or character. First, the identifying characteristics of the blower component were not "lost" so that "an identifiable new and different product" emerged. The heavily manufactured German blower component was never manufactured into something new during the assembly process in the United States; the "essence" of the final blower product remained "intact" after assembly. Second, the "use" or "character" of the complex component did not change because the assembly process in the

United States was not a complex enough process to have created a new product with a new use or character.[1] Third, from the standpoint of the rigorous ARRA-related regulations, there was no evidence that the German blower component had been "substantially transformed in the United States into a new and different manufactured good distinct from the materials from which it was transformed" or created into "a material that has different properties than the properties of the individual raw materials." In short, the use or character of the foreign-made blower component was not substantially modified in the United States. The identity of the complex German component which was the "essence" of the final product was left "intact." Therefore, we are concerned that there is non-compliance with the Buy American provision of ARRA. In addition to our report regarding the City of Ottawa, we discussed almost identical concerns about the same or similar products in three other audit reports issued to Region 5. Details related to the audit reports are in Attachment 2.

Conclusion

In its August 15, 2012 memorandum, OW stated that it would be "imprudent" to change its guidance at this late date. We do not agree. As long as the guidance in question is available for use by other divisions of EPA or other agencies, the potential for additional incorrect decisions exists. The prudent step, we believe, is to modify the guidance so as to mitigate further potential risk to the Agency.

Beyond our position regarding the specific German blower component as discussed in the City of Ottawa audit report, this is more fundamentally a question of whether the OW test is a legally sufficient, stand-alone method for accurately assessing substantial transformation. Our position is that an assessment of such factors as increased value or time used – the focus of the OW test – does not, without more, ensure that the foreign component was 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 transformed." Nor does the OW alternative test, in line with ARRA-related regulations, ensure that a foreign-made good has been "substantially transformed

[1] OGC, at our March meeting and in its informal opinion – though not in its legal opinion – seemed to suggest that the addition of a motor to the German component caused the component to become fully functional and thus would have constituted a substantial change in use or character – the established test. (A change in function is not part of the OW alternative test.) OGC cited to a case involving an extruder, Customs letter, HQ 558919 (Mar. 20, 1995). An extruder is a machine tool which forms metal or plastic components by "extruding" – that is by pushing the materials through a die with force. In this case, an extruder subassembly was made abroad and then combined with what appears to be the majority of major components in the United States; the added components included a drive unit, an electrical control panel and the extruder screw. Customs determined that the foreign-made extruder subassembly was substantially transformed in the United States. Customs, in making its decision, applied the established test. It determined that the assembly processes involving the addition and total integration of a number of major components to the extruder subassemblies in the United States resulted in a substantial change in use or character because of the "the extent of operations performed" **and** the fact that the imported component "[lost] its identity and [became] an integral part of the new article." Specifically, Customs stated "the DC motor, power unit and belt drive; the electrical control cabinet or panel which incorporates solid-state temperature controllers, screw-speed indicator, drive ammeter, pilot light on-off controls, and wiring necessary to operate the extruder; and the extruder screw which mixes and moves the material to be extruded through the die" were all critical and complex additions to the foreign-made assembly.

The facts here stand in contrast to the Ottawa blower situation where the sole, major component of the final blower product was imported and the assembly in the United States was not so complex as to cause the major foreign component to lose its identity and become an integral part of a new product. The German blower component remained "intact," and was the "essence" of the final product after the assembly process in the United States.

in the United States into a new and different manufactured good distinct from the materials from which it was transformed." As a consequence, the OW alternative test may have led to and can continue to lead to wrong decisions. These unjustified determinations may serve to undercut the goal of ARRA.

In accordance with EPA's Audit Management Process Manual, 2750 CHG 2 (Dec. 3, 1998), we will forward this memorandum and related materials to the Agency Follow-Up Official. If you have any questions regarding this memorandum, please contact Melissa Heist, Assistant Inspector General for Audit, at (202) 566-0899 (Heist.Melissa@epa.gov); or Robert Adachi, Product Line Director, at (415) 947-4537 (Adachi.Robert@epa.gov).

Arthur A. Elkins, Jr.

cc: Principal Deputy Assistant Administrator, Office of Water
Scott Fulton, General Counsel
Deputy General Counsel
Deputy Associate General Counsel for Civil Rights and Finance Law
Director, Office of Ground Water and Drinking Water, Office of Water
Director, Office of Wastewater Management, Office of Water
Deputy Regional Administrator, Region 5
Audit Follow-up Coordinator, Region 5
Director, Water Division, Region 5
Chief, State and Tribal Programs Branch, Region 5

Attachments

UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

OCT 17 2012

THE INSPECTOR GENERAL

MEMORANDUM

SUBJECT: Resolution of OIG Report No. 11-R-0700, *American Recovery and Reinvestment Act Site Visit of Wastewater Treatment Plant—Phase II Improvements Project, City of Ottawa, Illinois*, September 23, 2011

TO: Barbara Bennett
Chief Financial Officer

As the Agency Follow-Up Official for the audit resolution process, we are notifying you that we have reached an impasse with the Office of Water (OW) concerning its position on guidance directly affecting Region 5's proposed management decision on the subject audit report. On March 15, 2012, we notified Region 5 and OW (see attachment 1) that we disagreed with the January 27, 2012, proposed management decision (see attachment 2) that the equipment questioned in the audit report complied with the Buy American requirements of Section 1605 of the American Recovery and Reinvestment Act of 2009 (Recovery Act). Specifically, applying a test set out in guidance[1] prepared by OW, the region determined that products that were discussed in the audit had in fact met the substantial transformation test and were in compliance with the Buy American requirements of the Recovery Act.

We disagreed with the proposed management decision because we believe that the OW guidance on which that decision is based is significantly flawed. The OW guidance includes legal definitions of substantial transformation, but then employs a test for use in assessing substantial transformation that seemingly is not based on those legal definitions. We recommended that OW modify its guidance so that the definitions of substantial transformation are implemented in the OW guidance, and we recommended that the region apply the legally sound test to the questioned equipment items in the Ottawa report. We believe that the result will be that the Region will determine that the equipment is not in compliance with the Buy American provisions of the Recovery Act.

On August 15, 2012, the Acting Assistant Administrator for OW notified our office that it disagreed with our rejection of Region 5's proposed management decision and our recommendation to amend the existing Buy American guidance (see attachment 3). OW based its decision on legal analysis from the Office of General Counsel (OGC) that the guidance for

[1] DETERMININIG WHETHER "SUBSTANTIAL TRANSFORMATION" OF COMPONENTS INTO A "MANUFACTURED GOOD" HAS OCCURRED IN THE U.S.: ANALYSIS, ROLES, AND RESPONSIBILITIES, October 22, 2009

analyzing substantial transformation is consistent with relevant legal authority. In addition, OW did not think it prudent to amend the guidance at such a late date. Therefore, OW determined that the recommended guidance modification was not necessary.

We reviewed OW's decision and the attached OGC legal analysis, dated August 7, 2012, (see attachment 4). On September 28, 2012, we notified Region 5 and OW (see attachment 5) that in our opinion the legal analysis does not offer adequate support for the position that OW's substantial transformation test is based in law. We continue to believe that the test developed by OW for the purpose of assessing substantial transformation is not consistent with legal precedent.

This matter is unresolved. The resolution of the Ottawa report is past the 180-day period specified in OMB Circular A-50, *Audit Followup*. If you have any questions regarding this memorandum, please contact Melissa Heist, Assistant Inspector General for Audit, at (202) 566-0899 or heist.melissa@epa.gov; or Robert Adachi, Product Line Director, at (415) 947-4537 or adachi.robert@epa.gov.

Arthur A. Elkins Jr.

Attachments

cc: Scott Fulton, General Counsel
Acting Assistant Administrator, Office of Water
Principal Deputy Assistant Administrator, Office of Water
Regional Administrator, Region 5
Deputy Regional Administrator, Region 5
Deputy General Counsel
Deputy Associate General Counsel for Civil Rights and Finance Law
Acting Director, Office of Ground Water and Drinking Water, Office of Water
Acting Director, Office of Wastewater Management, Office of Water
Audit Follow-up Coordinator, Region 5
Director, Water Division, Region 5
Chief, State and Tribal Programs Branch, Region 5

Proposed Resolution to the Substantial Transformation Audit

Audit Title: American Recovery Act and Reinvestment Act (ARRA) Site Visit of Wastewater Treatment Plant – Phase II Improvements Project, City of Ottawa, Illinois

Issue: The Office of Inspector General (OIG) has asserted that Guidance from the Office of Water (OW) contains an incorrect articulation of the substantial transformation test intended to implement the "Buy American" requirement under ARRA. OIG believes that the Guidance's articulation of the substantial transformation test pertaining to assembly of manufactured goods potentially resulted in the use of some non-compliant goods. OIG recommended that OW amend the Guidance to explicitly require that a good primarily manufactured through assembly in the U.S. be changed in character or use from its foreign components to comply.

Proposed Solution: OW proposes specific clarifications to the Guidance, shown below, to address the OIG's concern without elevation in the audit resolution process. The language clarifies and confirms that a good manufactured through assembly in the U.S. must be changed in character and or use from its foreign components and that the subparts of the "complex and meaningful" test are critical factors.

Status: The 2009 OW Guidance, "Determining Whether 'Substantial Transformation' of Components into a 'Manufactured Good' Has Occurred in the U.S.," was designed to assist recipients in implementing the requirements of the Buy American provision (Section 1605) of ARRA. OMB regulations implementing ARRA define a "manufactured good" as one "that has been processed into a specific form and shape, or combined with other raw material to create a material that has different properties than the properties of the individual raw materials." 2 CFR §176.140.

In the course of its audit, the OIG found that the City of Ottawa could not provide sufficient documentation in four instances to assure compliance with the Buy American requirements of ARRA for the installation of blowers used in the audited project. OIG, OW and Region 5 were unable to come to a mutually satisfactory resolution of this issue at the early stages, so in its September 28, 2012 Memorandum OIG forwarded this matter to the OCFO Agency Follow-Up Official.

Proposed Agency Amendment: To address the OIG's concerns, OW offers to amend the Guidance to read as follows:

> Question 3 generally addresses situations where the most significant of the potentially transformative work is assembly. Because assembly is in most cases further down the spectrum towards non-transformative work, a more demanding standard is appropriate. Thus, to answer "yes" to Question 3, a manufacturer must answer "yes" to the initial question as evidenced presumptively by answering "yes" to at least two of sub-questions 3a, 3b, 3c, 3d, or 3e. Manufacturers who wish to establish beyond a doubt that their product has been substantially transformed in the U.S. via answers to Question 3 will want to provide descriptions of their process(es) that support affirmative answers to as

many of the subquestions as are applicable, to increase the likelihood that the answers to at least two of the questions are sufficient.

3. Was(/were) the process(es) performed in the U.S. (including but not limited to assembly) complex and meaningful such that the resulting manufactured good, as a whole, is changed in character or use from its pre-assembly components?

a. Did the process(es) take a substantial amount of time?
b. Was(/were) the process(es) costly?
c. Did the process(es) require particular high level skills?
d. Did the process(es) require a number of different operations?
e. Was substantial value added in the process(es)?

As in the current guidance, Question 3 and two of the five sub-questions would have to be answered in the affirmative to determine that a good was manufactured in the U.S.

Background: The Guidance explains the concept of substantial transformation and restates OMB regulations requiring a manufactured good to have different properties than those of the its individual raw materials. The Guidance then identifies questions that should be answered affirmatively to find that a good has been manufactured in the United States. With respect to goods that are primarily manufactured through assembly, the Guidance identifies a question and five sub-questions, at least two of which should be answered in the affirmative for an item to be considered to be made in the U.S. The current text reads:

> Question 3 generally addresses situations where the most significant of the potentially transformative work is assembly. Because assembly is in most cases further down the spectrum towards non-transformative work, a more demanding standard is appropriate. Thus, if the answer to at least two of 3a, 3b, 3c, 3d, or 3e is "yes", then the answer to Question 3 is "yes". Manufacturers who wish to establish beyond a doubt that their product has been substantially transformed in the U.S. via answers to Question 3 will want to provide descriptions of their process(es) that support affirmative answers to as many of the subquestions as are applicable, to increase the likelihood that the answers to at least two of the questions are sufficient.
>
> 3. Was(/were) the process(es) performed in the U.S. (including but not limited to assembly) complex and meaningful?
>
> a. Did the process(es) take a substantial amount of time?
> b. Was(/were) the process(es) costly?
> c. Did the process(es) require particular high level skills?
> d. Did the process(es) require a number of different operations?
> e. Was substantial value added in the process(es)?

OW interprets Question 3 and its sub-questions, in the context of the entire guidance, to contemplate a change in character or use consistent with the concept of substantial transformation. The sub-questions establish reasonable, practical indicia for identifying when

assembly will result in a good that has different properties from those of the individual raw materials, as required in the Guidance. Under the Guidance, "complex and meaningful" assembly operations, such as heavy machining and welding involving high value labor and sophisticated equipment, are required to produce a material that has different properties from the individual raw materials and establish substantial transformation. By contrast, work that is minimal, simple, or cosmetic in nature cannot amount to the complex and meaningful process needed to change a good's character or use and establish substantial transformation.

The OIG objected to Question 3 in the OW guidance because it views the five sub-questions as replacing the "change in character or use" test. OIG advised that subsidiary questions like the Question 3 sub-questions could be used as a cross-check or additional factor when assessing change in character or use, but not as a replacement for the "change in character or use" test.

UNITED STATES ENVIRONMENTAL PROTECTION AGENCY

JAN 17 2013

MEMORANDUM

SUBJECT: Resolution of OIG Report No. 11-R-0700, *American Recovery and Reinvestment Act Site Visit of Wastewater Treatment Plant – Phase II Improvements Project, City of Ottawa, Illinois*, September 23, 2011

TO: Barbara Bennett
Chief Financial Officer

We are notifying you, as the Agency Follow-Up Official for the audit resolution process, that efforts to resolve issues concerning the Office of Water's (OW) "substantial transformation" test have not led to an end of the ongoing impasse. Therefore, we request that you proceed with the next appropriate step in the resolution process under EPA Manual 2750.

Below, we will summarize our position previously set out in Attachment 5 to our October 17, 2012, memorandum to you, and discuss the Agency's December 15, 2012, written proposal for resolving our concerns. (Both documents are attached.)

Section 4(a)(2) of the Inspector General Act of 1978, as amended, requires the IG to review existing and proposed legislation and regulations relating to the programs and operations of the Agency. We have reviewed the American Recovery and Reinvestment Act and its implementing regulation in this and related Recovery Act audits. In Attachment 5, we described in detail the risks resulting from Region 5's application of a new, alternative substantial transformation test created by OW. Region 5 used OW's alternative test to determine that products that were discussed in the audit had been substantially transformed and therefore were in compliance with the Buy American requirements of the Recovery Act. However, as articulated in Attachment 5, it is our position that OW failed to show that its alternative test for substantial transformation is based in statutory, regulatory, or case law definitions. Consequently, the application of this test means that foreign products that were allowed to be used in Recovery Act projects because they passed (rather easily) the OW alternative test may well have been wrongfully purchased with American dollars.

We further stated that the established test for assessing whether a foreign product is substantially transformed in the United States is the change in character or use test. This test is found in statute (19 U.S.C. § 2518(4)(B)), regulation (19 C.F.R. § 177.22(a)), and in virtually all case law cited by OW and the Office of General Counsel. The test is used regardless of whether the transformation in the United States involves assembly or any other process. Under the rigorous change in character or use test, there must be ultimate proof that a foreign component is not just

subjected to treatment, labor, and manipulation in the United States, but rather that it ultimately is truly transformed into a new and different article with a wholly distinctive character or use.

By contrast to the established change in character or use test, the OW alternative test for substantial transformation (embodied in question three of the OW substantial transformation questionnaire) has no apparent legal basis. The OW test in question requires an "answer" to two out of five factors. Those five factors are: a substantial amount of time for manufacture, a costly process, a high level of skill is required for manufacture, the manufacture process involves different operations, and substantial value was added by the manufacturing process. The source of these factors is not identified, nor is it clear why an answer to two factors suffices to evidence substantial transformation.

The Agency, in its response on December 15, 2012, suggested a solution to the concerns set out in Attachment 5. It proposed that question three (OW's alternative test) in the substantial transformation questionnaire be modified so it is clear to users that by providing answers to two out of five factors it necessarily follows that the character or use test would be satisfied. In short, OW is suggesting that the factors in question three represent operational definitions of the established change in character or use test. However, as we noted in Attachment 5, there is no legal support for the claim that the items in question three can be used to establish change in character or use. Spending time or money on a foreign component in no way ensures that it has been significantly transformed as to use or character. Merely stating that question three is a legitimate method of assessing change in use or character does not make it so. Therefore, the proposal does not solve the problems related to OW's alternative test and the potential risk for incorrect decisions still exists.

For that reason, OIG continues to conclude that the prudent action going forward is for the Agency to modify its guidance as we propose, in order to mitigate risk. We propose that the cleanest resolution of the issue would be to eliminate question three from OW's substantial transformation questionnaire. In our view, question three is not a legally supportable test for determining substantial transformation. Removing question three would mitigate further potential risk to the Agency through incorrect application of the Buy American provision of the Recovery Act. If the Agency ultimately concludes that it does not need to or wish to mitigate the risk, it can so declare. It simply goes forward without mitigating the risk.

If you have any questions regarding this memorandum or any related materials, please contact Melissa Heist, Assistant Inspector General for Audit, at (202) 566-0899 or Heist.Melissa@epa.gov; or Robert Adachi, Product Line Director, at (415) 947-4537 or Adachi.Robert@epa.gov.

Arthur A. Elkins Jr.

Attachments

cc: Acting Assistant Administrator, Office of Water
Principal Deputy Assistant Administrator, Office of Water

EPA Audit Resolution Submission Form

Action Office: OW/R5 **Report #:** 11-R-0700

Date: 1/29/13

Audit Title: *American Recovery and Reinvestment Act Site Visit of Wastewater Treatment Plant – Phase II Improvements Project, City of Ottawa, Illinois*

Current Status of Audit: Management position disputed

Brief Description of Audit: The purpose of the site visit was to determine whether the City of Ottawa, Illinois, complied with selected requirements of the American Recovery and Reinvestment Act of 2009 (Recovery Act), P.L. 111-5, pertaining to the wastewater treatment plant project jointly funded by the Recovery Act and the Illinois Water Pollution Control Loan Program. Among other findings no longer at issue, the Office of Inspector General (OIG) found that the city could not provide sufficient documentation in four instances to assure compliance with the Buy American requirements of the Recovery Act for the installation of blowers used in the project. Region 5 disagreed with the findings and proposed a management plan asserting that the blowers met Buy American requirements because the blowers were substantially transformed in the United States in accordance with a test articulated by the Office of Water (OW) in guidance issued in 2009. The OW 2009 guidance, "Determining Whether 'Substantial Transformation' of Components into a 'Manufactured Good' Has Occurred in the U.S.," (the Guidance) which is the subject of the OIG's September 28, 2012, memo, was designed to assist recipients in implementing the Buy American requirements of the Recovery Act. OIG's response to the Region 5 management plan – directed to both Region 5 and OW – reflected the OIG's stated belief that the substantial transformation test articulated in the Guidance for situations involving the assembly of manufactured goods was not consistent with the existing law associated with substantial transformation. OIG contends that the OW articulation of the substantial transformation test potentially resulted in some manufactured goods that were used in SRF projects being non-compliant with the Buy American requirements of the Recovery Act. OIG recommended that OW amend the Guidance. OW and Region 5 disagree with OIG's findings related to the Guidance, and more specifically, based on technical and engineering review, OW and Region 5 believe that the blowers at issue in the Ottawa, Illinois project were "substantially transformed" and comply with the Buy American requirement.

Issue(s) Under Dispute: Application of the substantial transformation test as articulated in the Guidance in determining whether a manufactured good is made in the US. And, whether the blowers used in the Ottawa Illinois project satisfied the Buy American requirement of the Recovery Act.

Recommendation: OIG recommends that OW modify the Guidance to conform to what OIG believes is the appropriate test for substantial transformation.

Detailed Description of Dispute

Agency Position:

The Recovery Act included a Buy American provision (Section 1605) that requires, with limited exceptions, that funds awarded may only be used for a project if the "manufactured goods used in the project are produced in the United States." Neither the Recovery Act nor OMB guidance prescribed a particular test for determining whether a "manufactured good" was produced in the United States. OW exercised its discretion to develop reasonable guidance for recipients who were going to make determinations regarding the origin of diverse manufactured goods. OW issued the Guidance on October 22, 2009. The Guidance adopted the concept of "substantial transformation" as a means of complying with the Buy American provisions of the Recovery Act, and provided 3 questions (each to address different fact situations) to further assist recipients. The current Guidance satisfies the legal requirements of the Recovery Act and is not contrary to OMB ARRA guidance. Were EPA to follow the OIG's recommendation, it would have significant implications for states, communities, contractors, suppliers and manufacturers. The recommendation could result in EPA requiring states to review over 3300 projects, 3 years after all projects were statutorily required to be under contract or construction and where applicable, apply a different BA testing threshold to determine compliance. This could lead to contract disputes, litigation and economic hardship that would be harmful to States, ARRA recipients, contractors and suppliers Further, ARRA funds are 97% outlayed and the majority of projects have been completed for over a year.

OIG Position:

This dispute involves Region 5's proposed management decision, that by applying a test of its own creation, EPA correctly ensured that this project funded by the American Recovery and Reinvestment Act of 2009 (Recovery Act) complied with Section 1605 (the 'Buy American' provision) of that Act. The region determined that in applying an alternative substantial transformation test set out in guidance prepared by the Office of Water, a number of products that were discussed in the audit had in fact met the test. The Office of Inspector General disagreed with the proposed management decision because it believed that the OW guidance on which that decision was based is significantly flawed and therefore led to approvals of products that in fact do not comply with the Buy American requirements of the Recovery Act. The OW guidance includes legal definitions of substantial transformation, but then employs an alternative test for use in assessing substantial transformation that seemingly does not comport with those legal definitions.

In materials sent to the Agency Follow-Up Official on October 17, 2012, and January 17, 2013, the OIG described in detail concerns relating to Region 5's application of the alternative substantial transformation test created by OW. As articulated in these materials, the OIG concluded that OW failed to show that its alternative test for substantial

transformation was based in statutory, regulatory, or case law definitions. Consequently, the application of this test means that foreign products that were allowed to be used in Recovery Act projects because they passed (rather easily) the OW alternative test may well have been wrongfully purchased with American dollars.

The OIG further stated that the established test for assessing whether a foreign product is substantially transformed in the United States is the change in character or use test. This test is found in statute (19 U.S.C. § 2518(4)(B)), regulation (19 C.F.R. § 177.22(a)), and virtually all case law cited by OW and the Office of General Counsel. The test is used regardless of whether the transformation in the United States involves assembly or any other process. Under the rigorous change in character or use test, there must be ultimate proof that a foreign component is not just subjected to treatment, labor, and manipulation in the United States, but rather that it ultimately is truly transformed into a new and different article with a wholly distinctive character or use.

Because the OW alternative test for assessing substantial transformation is seemingly not based in law, the relevant guidance should be modified to focus solely and effectively on the appropriate test. By doing so, the Agency would mitigate further potential risk through incorrect application of the Buy American provision of the Recovery Act.

Proposed Agency Alternative:
The use of the "substantial transformation" test as articulated in the OW guidance to satisfy the Buy American provision in the Recovery Act is a question of policy.

OMB regulations implementing the Recovery Act define a "manufactured good" as one "that has been processed into a specific form and shape, or combined with other raw material to create a material that has different properties than the properties of the individual raw materials." 2 CFR §176.140. It further states that "There is no requirement 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." 2 CFR § 176.70(a)(2)(ii). The Guidance restates this OMB definition that a "manufactured good" must have different properties than those of the individual raw materials. OW believes, therefore, that the Guidance effectively requires a manufactured good made in the U.S. to be changed in character or use from its foreign components.

Neither the Recovery Act nor OMB guidance prescribed a particular test applicable to OW's State Revolving Fund Programs for determining whether a "manufactured good" was produced in the United States. Without statutory language that defines "manufactured good" or OMB guidance that required a particular test for determining whether a manufactured good was assembled in the United States, OW had the authority to develop reasonable guidance. OW concluded that the "substantial transformation" concept adopted by OMB for international agreements provided a useful framework for analysis. The OW guidance explains the concept of substantial transformation and identifies three questions, any one of which should be answered affirmatively to find that a good has been manufactured in the United States.

With respect to goods that are primarily manufactured through assembly, Question 3 in the Guidance applied. The Guidance identified that question and five sub-questions, at least two of which should be answered in the affirmative for an item to be considered to be made in the U.S.:

> "Question 3 generally addresses situations where the most significant of the potentially transformative work is assembly. Because assembly is in most cases further down the spectrum towards non-transformative work, a more demanding standard is appropriate. Thus, if the answer to at least two of 3a, 3b, 3c, 3d, or 3e is "yes", then the answer to Question 3 is "yes". Manufacturers who wish to establish beyond a doubt that their product has been substantially transformed in the U.S. via answers to Question 3 will want to provide descriptions of their process(es) that support affirmative answers to as many of the subquestions as are applicable, to increase the likelihood that the answers to at least two of the questions are sufficient.
>
> "3. Was(/were) the process(es) performed in the U.S. (including but not limited to assembly) complex and meaningful?

a. Did the process(es) take a substantial amount of time?
b. Was(/were) the process(es) costly?
c. Did the process(es) require particular high level skills?
d. Did the process(es) require a number of different operations?
e. Was substantial value added in the process(es)?"

OW interprets Question 3 and its sub-questions, in the context of the entire guidance, to contemplate a change in character or use consistent with the concept of substantial transformation. The sub-questions establish reasonable, practical indicia for identifying when assembly will result in a good that has different properties from those of the individual raw materials, as required in the Guidance. Under the Guidance, "complex and meaningful" assembly operations, such as heavy machining involving high value labor and sophisticated equipment, are required to produce a material that has different properties from the individual raw materials and establish substantial transformation. By contrast, work that is minimal, simple, or cosmetic in nature cannot amount to the complex and meaningful process needed to change a good's character or use and establish substantial transformation.

Nonetheless, the OIG objects to Question 3 in the OW guidance because it views the five sub-questions as replacing the "change in character or use" test. OIG advises that Question 3 should be removed from the Guidance.

Despite the fact that most of the nearly 3,300 projects funded by the SRFs under the ARRA are completed and that 97 percent of the funds have been expended, OW offered to address OIG's concerns by amending the Guidance to clarify and confirm that a good manufactured through assembly in the U.S. must be changed in character and or use from its foreign components and that the sub-questions are critical factors. In the proposed amendment, as in the current guidance, Question 3 and two of the five sub-questions would have to be answered in the affirmative to determine that a good was manufactured in the U.S. The proposed change was rejected by the OIG.

As indicated above, this is a dispute about a policy choice, not a legal requirement. Substantial transformation is not required to satisfy the Buy American provision in the Recovery Act. In fact, when the Federal Acquisition Regulations (FAR) were eventually amended to address the Buy American provision of ARRA in June 2010, the "substantial transformation" test was not adopted. Instead, the FAR applied a test that essentially looked to the last place of assembly to determine the location of manufacture. Therefore, the OW Guidance does not pose a substantial risk of violation of the Buy American provision of the Recovery Act. Indeed, the best resolution is for the Agency to maintain the current language in the Guidance and address any concerns about compliance with the Buy American provision in the Recovery Act based on technical and engineering review on a case-by-case basis

UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

MAR 2 1 2013

THE INSPECTOR GENERAL

MEMORANDUM

SUBJECT: Resolution of Office of Inspector General Report No. 11-R-0700, *American Recovery and Reinvestment Act Site Visit of Wastewater Treatment Plant—Phase II Improvements Project, City of Ottawa, Illinois,* September 23, 2011

FROM : Arthur A. Elkins Jr.

TO: Robert Perciasepe
Deputy Administrator

In accordance with guidelines set out in the Environmental Protection Agency Manual 2750, the Office of Inspector General and agency representatives met with the EPA Chief Financial Officer on February 28, 2013, in an effort to resolve the above-referenced audit matter. (*See* Exhibit 2, OIG Report 11-R-0700; and Exhibit 3, Region 5's response to the final report.) The meeting did not result in an audit resolution, so we are presenting the dispute to you as the EPA's Deputy Administrator and final agency arbiter of audit resolution cases. Office of Water Deputy Assistant Administrator Michael Shapiro agreed via email that this next step is warranted.

The OIG is asking for a prompt resolution of this matter, given the lengthy, and sometimes inexplicable, delays to date in moving towards an outcome.[1] The Office of Management and Budget Circular A-50, *Audit Followup*, specifies a 180-day period for the resolution of audits, and it is now approximately 1 year past this time period.

A series of meetings between the agency and the OIG relating to the subject audit report have yielded no agreement. The OIG therefore respectfully requests that you make a decision for the agency based on the written record. Following is a concise summary of the highlights of the dispute. The summary includes references to the attached, relevant materials. In particular, we direct your attention to OIG legal memoranda dated March 15, 2012 (Exhibit 4) and September 28, 2012 (Exhibit 7); and to the EPA Office of General Counsel legal opinion dated August 7, 2012 (Exhibit 5). These documents provide the majority of relevant information.

[1] For example, one unexplained delay occurred during the time period between October 2012 and January 2013. The OIG submitted a request to the CFO for assistance in the audit resolution process on October 17, 2012. (*See* Exhibit 8.) The agency, however, did not provide materials required by EPA Manual 2750, and there was no response of any sort from the Office of the Chief Financial Officer. The OIG was compelled to repeat the request on January 17, 2013. (*See* Exhibit 9.) A meeting was finally held with the CFO and agency representatives on February 28, 2013.

SUMMARY

The subject City of Ottawa audit, and three related Region 5 audits, were initiated by OIG hotline complaints. The complaint related to the Ottawa City project alleged that certain products being used in the EPA's American Reinvestment and Recovery Act of 2009 project were not in compliance with Section 1605 of the Recovery Act—the Buy American provisions. Those provisions require that products used in Recovery Act projects must be "produced" in the United States. Congressional intent behind these provisions is clear. In the purpose statement, Congress stated that the first goal of the Recovery Act was "[t]o preserve and create jobs and promote economic recovery." A major step in achieving that purpose was supposed to be the Buy American provisions. Agencies had an obligation to rigorously monitor use of foreign components in Recovery Act projects so as to eliminate imports that would negatively affect American jobs and the American economy.

The OIG concluded that Region 5 had wrongfully determined that certain equipment used in the Ottawa City project (and three similar projects resulting in three additional Region 5 audits) was procured in compliance with the Buy American provisions. (*See* Exhibit 2.) Further, the OIG concluded that the incorrect determinations by Region 5 were mostly the result of flawed OW guidance. (The OW guidance in question is included at Exhibit 1.) We state "mostly the result," because Region 5 played a role in the outcome when it failed to follow certain guidelines in the OW guidance. The OIG March 2012 memorandum at Exhibit 4 includes details about the region's actions.

In an effort to ensure compliance with the Buy American provisions, the OW determined that substantial transformation analysis should be employed when components of products used in Recovery Act projects are manufactured overseas. (*See* Exhibit 1.) Generally, the question is whether those components are transformed enough within the United States so as to be able to conclude that they are actually produced in the United States. The EPA generally required a Recovery Act contractor with a product that was partially composed of a foreign component(s) to evidence that the component had been substantially transformed in the United States.

The established test for determining substantial transformation is the change in character or use test. This test for substantial transformation is based in statute (19 U.S.C. § 2518(4)(B)), regulation (19 C.F.R. § 177.22(a)), and is employed in virtually all case law cited by OGC and OW. The test was referenced in Recovery Act-related OMB regulations, which in turn are cited in the OW guidance. The essence of the rigorous established test is that in order for a foreign component to be considered manufactured in the United States, it must be substantially transformed into a new and different article of commerce with a character or use distinct from the article or articles from which it was transformed. This test is discussed in detail in the attached OIG legal memoranda. (*See* Exhibits 4 and 7.)

For its Recovery Act-related guidance, OW created a questionnaire with three questions to be used for assessing substantial transformation. (*See* Exhibit 1.) Each question is a stand-alone test. The second question in the questionnaire is the established change in character or use test. The third question, however, is a new, alternative test created by OW. The OW alternative test simply requires evidence of such factors as time or money spent on the domestic process to show substantial transformation. Importantly, there is no ultimate evidentiary requirement in the alternative test that the foreign component was transformed into a "new and different article." The OW alternative test was widely used by the agency (including Region 5), in part because it does not require a rigorous assessment of change in use or character. Because of the lack of rigor in the alternative test, there is a very high risk that there can be a lack of compliance with the letter and intent of the Buy American provisions. We believe that

this was in fact the result for the acquisition that was the subject of this audit report, as well as for acquisitions referenced in the three related reports. In short, it strongly appears that certain Recovery Act funds were spent in violation of the requirements of the Act.

The OGC asserted in its legal opinion that there is legal support for the alternative test. (*See* Exhibit 5.) However, despite the fact that there are many hundreds of legal cases that focus on a substantial transformation test, the OGC only cited to two cases in support of the alternative test. One is a federal case, which actually supported the OIG position that the established test must be used to assess substantial transformation. The second case is a U.S. Customs Service Notice; it dealt with a fact pattern that is entirely unrelated to the fact patterns reviewed by the OIG. These two cases do not constitute legal support for the OW alternative test.

AGENCY ARGUMENTS

During the course of the last year, OW has generated seven arguments to justify its alternative test. Many of these arguments have been addressed in OIG legal memoranda. (*See* Exhibits 4 and 7.) Summaries of the arguments and OIG responses are presented below.

First argument. OW contends that it would be imprudent to address a problem related to Recovery Act guidance at this late date because the stimulus funds have mostly been spent. (*See* Exhibit 6.) But with regard to the subject audit, and the three related Region 5 audits, OW noted at the February meeting that Recovery Act funds related to the audit(s) have not yet been spent. Thus, there is still a chance here to apply correct guidance in at least a few instances. Finally, the significantly flawed OW alternative test sits prominently in the public domain (if one inputs "substantial transformation test" into Google, the second entry is the OW alternative test guidance), and so the test may be used going forward by the EPA or other agencies to wrongly assess substantial transformation in other instances involving federal funds, especially if additional stimulus monies are appropriated.

Second argument. OW argues that it did not have much time to prepare the guidance and so any error that may have slipped through is justifiable. This is not persuasive. One of the cases cited in OW's own substantial transformation guidance is *Customs Ruling* HQ 734097 (November 25, 1991). This case included a test that is an effective blend of the established test and the alternative test. The referenced test required evidence of both complex manufacture **and** that the components "[lost] their identity and [became] an integral part of a new article." Application of this test, that was known by OW when preparing its guidance, would have been simple and appropriate.

Third argument. OW proposed a possible solution to the OIG concerns by suggesting that the words "change in character or use" (the established test) be added to the question component of the alternative test. Unfortunately, the suggested change would not require the user of the test to show evidence of actual change in character or use. Put another way, the proposal would not add a new criterion about change in use or character to the test. Hence, the proposed modification would not result in any improvement and no reduction in the risk that the agency was violating the Act.

Fourth argument. OW raised a concern that it would be unworkable to revisit thousands of past Recovery Act decisions to assess whether mistakes were made regarding foreign components because of flawed guidance. However, at the February 28, 2013, meeting, the OW agreed that a waiver might be a feasible option to address the mistakes without having to revisit each previous payment. Ultimately it is for the agency to decide how best to remedy the concerns raised here, but difficulty in correcting an error is not a defense to a conclusion that there is an error.

Fifth argument. At the February 28, 2013, meeting with the CFO, the OGC raised the argument that OW intended to ensure that the alternative test required evidence of a change in character or use, but the wording was a bit "inartful." Because of the "inartfulness," however, the established test was not employed in the subject audited project, nor in the three related audited projects, and probably not used in many other substantial transformation decisions in EPA Recovery Act projects. This might be an acceptable argument when large amounts of Recovery Act funds are not at stake, but here the size and importance of the multibillion-dollar stakes demanded and still demands artfulness and accuracy.

Sixth argument. In the requisite 2750 form that was submitted to the CFO in February 2013 (Exhibit 10), OW asserted for the first time in writing that the Federal Acquisition Regulation in 2010 "applied a test that essentially looked to the last place of assembly to determine the location of manufacture." The section of the FAR in question is located at 75 Fed. Reg. 53,153, 53,156 (August 30, 2010). (*See* Exhibit 11.) OW seems to be arguing that the FAR "test" is similar to the OW alternative test, so there is no risk of having violated the Buy American provisions. This is the OIG's first opportunity to respond in writing to this argument. OW's novel argument about the FAR fails for a few reasons. First, the FAR merely stated that there is a record of interpreting "manufacture" in connection with the Buy American Act (which is significantly different than the Buy American provisions of the Recovery Act), and then elaborated on the simple assertion by referencing a General Accounting Office opinion letter (B-175633 dated November 3, 1975 (Exhibit 12)). The GAO case discussed an Army regulation that required in its two-part Buy American Act test that at least 50 percent of the value of the end product must be of domestic origin. That is significantly more rigorous than the OW sole focus on "assembly." Thus, contrary to OW's assertion, the two tests are not comparable. Second, the other part of the Army test focused on the last place of manufacture—not last place of assembly. (The FAR also discussed last place of manufacture and not last place of assembly.) In the GAO opinion, "manufacture" included a number of steps in addition to assembly. More importantly, the GAO was left unsure about whether those manufacturing steps were sufficient to satisfy the intent behind the Buy American Act requirement regarding manufacture in the United States, so GAO recommended that the Secretary of Defense better define and clarify the meaning of "manufactured in the United States." (*See* Exhibit 12 at 4.) The FAR and the referenced GAO case simply do not apply an established test about the last place of assembly that is somehow similar to OW's alternative test. The recent FAR argument does not save OW's alternative test.

Seventh argument. The agency stated at the February meeting with the CFO that it was not required to use the substantial transformation concept to assess whether foreign components were in compliance with the Buy American provisions. Apparently, this means that the agency should not now be held responsible for applying a methodology that it did not have to use in the first place. We agree that OW was not required to employ the concept of substantial transformation. However, it did so, and it justified that decision in its guidance by stating that the concept is "well-established" and that "EPA is not aware of an alternative standard " that could be used in the context of the Buy American provisions to determine whether or not a manufactured good is U.S.-produced. (*See* Exhibit 1 at 2.) We believe OW made the correct choice to focus on substantial transformation; but having selected substantial transformation as the operative basis for determining whether Recovery Act funds were being properly spent, OW was then required to apply the correct substantial transformation test. OW failed to do so and thus the intent behind the Buy American provisions was not satisfied and Recovery Act funds were likely spent in violation of the Act.

CONCLUSION

Based on the discussion above and the attached supporting documentation, we request that the agency's final audit resolution decision require appropriate modification of OW substantial transformation guidance and application of the revised guidance to the proposed management decisions referenced in the subject audit, as well as in the three related Region 5 audits. Also, if the agency chooses to further mitigate the risk of violation of the Recovery Act, it should address prior relevant decisions that are possibly incorrect, as well as make appropriate changes to the guidance in question so that it will not be improperly used in the future.

If you have any questions regarding this memorandum, please contact Melissa Heist, assistant inspector general for the Office of Audit, at (202) 566-0899 or (Heist.Melissa@epa.gov); or Robert Adachi, product line director, at (415) 947-4537 or (Adachi.Robert@epa.gov).

Attachments (12)

cc: Acting Assistant Administrator, Office of Water
Principal Deputy Assistant Administrator, Office of Water
Regional Administrator, Region 5
Deputy Regional Administrator, Region 5
General Counsel
Deputy General Counsel
Chief Financial Officer
Deputy Chief Financial Officer
Deputy Associate General Counsel for Civil Rights and Finance Law
Director, Office of Ground Water and Drinking Water, Office of Water
Acting Director, Office of Wastewater Management, Office of Water
Audit Follow-up Coordinator, Region 5
Director, Water Division, Region 5
Chief, State and Tribal Programs Branch, Region 5

EPA AUDIT RESOLUTION: American Recovery and Reinvestment Act (ARRA) Site Visit of Wastewater Treatment Plant---Phase II Improvements Project, City of Ottawa, IL

Submitted by Nancy Stoner, Assistant Administrator, Office of Water

- ARRA included a Buy American provision (Section 1605) that required, with limited exceptions, projects to use manufactured goods produced in the United States.
- Neither ARRA nor OMB guidance prescribed a particular test for determining whether a manufactured good was produced in the United States. Neither ARRA nor OMB required that all components of a manufactured good be produced in the US.
- OW exercised its discretion to develop reasonable guidance for recipients and sub-recipients who were going to make a determination regarding diverse manufactured goods used in water treatment projects, and adopted the concept of "substantial transformation" as a means of complying with the Buy American provisions of the ARRA. OW issued the guidance on October 22, 2009.
- Generally, substantial transformation requires a determination of whether a "change in the character or use" of components has occurred in creating a manufactured good.
- The guidance provided three questions (each to address different fact situations) to be answered to further assist recipients. The Guidance's third test for assembled goods requires that the processes performed in the U.S. are "complex and meaningful" and involve at least two of the following: substantial time, cost, value added, skill, and a number of different operations.
- OW maintains that complex and meaningful processes performed in the US result in a change of character or use of the components of a manufactured good. For example, a car chassis will still appear to be a "car," but will not effectively be a car unless an engine and electronics are attached. The complex processes involved will change the character and use of the component, though the chassis is unchanged.
- The Office of Inspector General (OIG) conducted a site visit of a wastewater treatment plant in Ottawa, IL. It asserts that a blower that was installed there did not comply with the Buy American provision of the ARRA. The OIG believes that while the processing of the blower that occurred in the US may have met the OW test for complex and meaningful assembly it did not result in a substantially transformed manufactured good. OW disagrees. The blower does comply with ARRA requirement.
- The OIG believes that the OW guidance must be changed. OW disagrees. The current OW guidance satisfies the legal requirements of ARRA and complies with OMB ARRA guidance.
- OW had policy discretion to choose or develop any reasonable test to determine "made in the U.S." It was not required to adopt the precise test preferred by OIG or used in other contexts. OW could, and did, develop its own test. The Federal Acquisition Regulations (FAR) for direct federal contracting under ARRA adopted a different, less rigorous test of "manufacture", which essentially looks to the site of last assembly.

Region 5 and OW/OIG Audit Dispute Resolution Request:
"American Recovery and Reinvestment Act Site Visit of Wastewater Treatment Plant—Phase II Improvements Project, City of Ottawa, IL, September 23, 2011

Briefing for the Acting Administrator
Monday, April 1, 2013

Purpose

In accordance with EPA's Manual 2750, *Audit Management Procedures*, the Acting Administrator will meet with the Inspector General, Acting Chief Financial Officer, AA for OW, and RA for Region 5 to discuss and resolve a disputed OIG audit recommendation related to substantial transformation requirements in accordance with the Buy American Act on ARRA awards

Participants

Bob Perciascepe, Acting Administrator/Deputy Administrator; Maryann Froehlich, Acting Chief Financial Officer; Nancy Stoner, Assistant Administrator, OW; Susan Hedman, Regional Administrator, Region 5; Brenda Mallory, Acting General Counsel

AGENDA

I. Introduction/Review of New Audit Dispute Resolution Process (Maryann Froehlich)
(Refer to "Resolution Process for Audits of Assistance Agreements")
- First audit to be elevated to the Deputy Administrator for resolution under the new audit dispute resolution process established by the agency's revised audit management policy, Manual 2750
- Disputed recommendation: "Employ the procedures set out in 2 CFR §176.130 to resolve the noncompliance on the Ottawa project. In the event that the region makes a determination to retain foreign-manufactured goods in the Ottawa project under 2 CFR§176.130 (c)(3), the region should either "reduce the amount of the award by the cost steel, iron, or manufactured goods that are used in the project or . . . take enforcement or termination action in accordance with the agency's grants management regulations."
- This issue affects 3 additional Region 5 audits

II. OIG Position (Arthur Elkins)
(Refer to jointly prepared agency-OIG "Audit Dispute Resolution Request Form" and)

III. Agency Position (Nancy Stoner, Brenda Mallory)
(Refer to jointly prepared agency-OIG "Audit Dispute Resolution Request Form" and)

IV. Discussion/Questions and Answers (Bob Perciascepe)

V. Next Steps (Maryann Froehlich)

New Manual 2750 Audit Dispute Resolution Process: Assistance Agreement Audits

2750 Procedure for Assistance Agreement Audits			Audit Under Dispute OIG Report 11-R-0700, American Recovery and Reinvestment Act Site Visit of Wastewater Treatment Plant—Phase II Improvement Project, City of Ottawa, IL, September 23, 2011
Step	Process[1]	Time Frame	
1	The Assistant Inspector General meets with the Program Manager to resolve disagreements in developing the Management Decision	20 days	• 1-27-12—Region 5 proposes Management Decision • 3/15/12—OIG memo to Region 5 and OW disagreeing with proposal • 3/20/12—OGC "informal legal discussion" in support of OW alternative test • 4/5/12—OIG response to OGC informal opinion • 8/7/12—OGC legal opinion • 8/15/12—OW disagrees with OIG based on OGC legal opinion
2	When resolution is unsuccessful, the Action Official (Assistant or Regional Administrator for regions; Office of Grants and Debarment for HQ) elevates to the Chief Financial Officer via *Agency Audit Dispute Resolution Request*. The Chief Financial Officer meets with the Action Official and the Inspector General to resolve the issues.	20 days	• 10/11/12—OW takes lead for preparing Dispute Resolution Request • 10/17/12—OIG memo to CFO • 12/15/12—OGC sends agency proposal to OIG for resolving issue • Jan 2013—OIG and OGC discuss proposal; no agreement • 1/17/13—IG memo to CFO requesting initiation of audit dispute resolution process • **2/21/13—OW submits Audit Dispute Resolution Request** • **2/28/13—Meeting of CFO, IG, OW, Region 5, OGC; no resolution**
3	When resolution is unsuccessful, the Chief Financial Officer, Action Official, and Inspector General meet with the Deputy Administrator and present the issue template for resolution. The Deputy Administrator's decision will be considered final.	20 days	• 3/27/13—Meeting with Deputy Administrator

[1] At any point during the resolution process, it may be necessary for the Office of General Counsel to develop a formal legal opinion on an issue or use outside technical assistance to provide additional professional advice on the merits of arguments presented in cases.

EPA Audit Dispute Resolution Request Form

Action Office: OW/R5 **Report #:** 11-R-0700 **Date:** 1/29/13[1]

Audit Title: *American Recovery and Reinvestment Act Site Visit of Wastewater Treatment Plant – Phase II Improvements Project, City of Ottawa, Illinois*

Current Status of Audit: Management position disputed

Brief Description of Audit: The purpose of the site visit was to determine whether the City of Ottawa, Illinois, complied with selected requirements of the American Recovery and Reinvestment Act of 2009 (Recovery Act), P.L. 111-5, pertaining to the wastewater treatment plant project jointly funded by the Recovery Act and the Illinois Water Pollution Control Loan Program. Among other findings no longer at issue, the Office of Inspector General (OIG) found that the city could not provide sufficient documentation in four instances to assure compliance with the Buy American requirements of the Recovery Act for the installation of blowers used in the project. Region 5 disagreed with the findings and proposed a management plan asserting that the blowers met Buy American requirements because the blowers were substantially transformed in the United States in accordance with a test articulated by the Office of Water (OW) in guidance issued in 2009. The OW 2009 guidance, "Determining Whether 'Substantial Transformation' of Components into a 'Manufactured Good' Has Occurred in the U.S.," (the Guidance) which is the subject of the OIG's September 28, 2012, memo, was designed to assist recipients in implementing the Buy American requirements of the Recovery Act. OIG's response to the Region 5 management plan – directed to both Region 5 and OW – reflected the OIG's stated belief that the substantial transformation test articulated in the Guidance for situations involving the assembly of manufactured goods was not consistent with the existing law associated with substantial transformation. OIG contends that the OW articulation of the substantial transformation test potentially resulted in some manufactured goods that were used in SRF projects being non-compliant with the Buy American requirements of the Recovery Act. OIG recommended that OW amend the Guidance. OW and Region 5 disagree with OIG's findings related to the Guidance, and more specifically, based on technical and engineering review, OW and Region 5 believe that the blowers at issue in the Ottawa, Illinois project were "substantially transformed" and comply with the Buy American requirement.

Issue(s) Under Dispute: Application of the substantial transformation test as articulated in the Guidance in determining whether a manufactured good is made in the US. And, whether the blowers used in the Ottawa Illinois project satisfied the Buy American requirement of the Recovery Act.

Recommendation: OIG recommends that OW modify the Guidance to conform to what OIG believes is the appropriate test for substantial transformation.

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[1] Submitted by OW to OCFO February 21, 2013

Agency Position:
The Recovery Act included a Buy American provision (Section 1605) that requires, with limited exceptions, that funds awarded may only be used for a project if the "manufactured goods used in the project are produced in the United States." Neither the Recovery Act nor OMB guidance prescribed a particular test for determining whether a "manufactured good" was produced in the United States. OW exercised its discretion to develop reasonable guidance for recipients who were going to make determinations regarding the origin of diverse manufactured goods. OW issued the Guidance on October 22, 2009. The Guidance adopted the concept of "substantial transformation" as a means of complying with the Buy American provisions of the Recovery Act, and provided 3 questions (each to address different fact situations) to further assist recipients. The current Guidance satisfies the legal requirements of the Recovery Act and is not contrary to OMB ARRA guidance. Were EPA to follow the OIG's recommendation, it would have significant implications for states, communities, contractors, suppliers and manufacturers. The recommendation could result in EPA requiring states to review over 3300 projects, 3 years after all projects were statutorily required to be under contract or construction and where applicable, apply a different BA testing threshold to determine compliance. This could lead to contract disputes, litigation and economic hardship that would be harmful to States, ARRA recipients, contractors and suppliers Further, ARRA funds are 97% outlayed and the majority of projects have been completed for over a year.

OIG Position:
This dispute involves Region 5's proposed management decision, that by applying a test of its own creation, EPA correctly ensured that this project funded by the American Recovery and Reinvestment Act of 2009 (Recovery Act) complied with Section 1605 (the 'Buy American' provision) of that Act. The region determined that in applying an alternative substantial transformation test set out in guidance prepared by the Office of Water, a number of products that were discussed in the audit had in fact met the test. The Office of Inspector General disagreed with the proposed management decision because it believed that the OW guidance on which that decision was based is significantly flawed and therefore led to approvals of products that in fact do not comply with the Buy American requirements of the Recovery Act. The OW guidance includes legal definitions of substantial transformation, but then employs an alternative test for use in assessing substantial transformation that seemingly does not comport with those legal definitions.

In materials sent to the Agency Follow-Up Official on October 17, 2012, and January 17, 2013, the OIG described in detail concerns relating to Region 5's application of the alternative substantial transformation test created by OW. As articulated in these materials, the OIG concluded that OW failed to show that its alternative test for substantial transformation was based in statutory, regulatory, or case law definitions. Consequently, the application of this test means that foreign products that were allowed to be used in Recovery Act projects because they passed (rather easily) the OW alternative test may well have been wrongfully purchased with American dollars.

The OIG further stated that the established test for assessing whether a foreign product is substantially transformed in the United States is the change in character or use test. This test is found in statute (19 U.S.C. § 2518(4)(B)), regulation (19 C.F.R. § 177.22(a)), and virtually all case law cited by OW and the Office of General Counsel. The test is used regardless of whether the transformation in the United States involves assembly or any other process. Under the rigorous change in character or use test, there must be ultimate proof that a foreign component is not just subjected to treatment, labor, and manipulation in the United States, but rather that it ultimately is truly transformed into a new and different article with a wholly distinctive character or use.

Because the OW alternative test for assessing substantial transformation is seemingly not based in law, the relevant guidance should be modified to focus solely and effectively on the appropriate test. By doing so, the Agency would mitigate further potential risk through incorrect application of the Buy American provision of the Recovery Act.

Proposed Agency Alternative:
The use of the "substantial transformation" test as articulated in the OW guidance to satisfy the Buy American provision in the Recovery Act is a question of policy.

OMB regulations implementing the Recovery Act define a "manufactured good" as one "that has been processed into a specific form and shape, or combined with other raw material to create a material that has different properties than the properties of the individual raw materials." 2 CFR §176.140. It further states that "There is no requirement 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." 2 CFR § 176.70(a)(2)(ii). The Guidance restates this OMB definition that a "manufactured good" must have different properties than those of the individual raw materials. OW believes, therefore, that the Guidance effectively requires a manufactured good made in the U.S. to be changed in character or use from its foreign components.

Neither the Recovery Act nor OMB guidance prescribed a particular test applicable to OW's State Revolving Fund Programs for determining whether a "manufactured good" was produced in the United States. Without statutory language that defines "manufactured good" or OMB guidance that required a particular test for determining whether a manufactured good was assembled in the United States, OW had the authority to develop reasonable guidance. OW concluded that the "substantial transformation" concept adopted by OMB for international agreements provided a useful framework for analysis. The OW guidance explains the concept of substantial transformation and identifies three questions, any one of which should be answered affirmatively to find that a good has been manufactured in the United States.

With respect to goods that are primarily manufactured through assembly, Question 3 in the Guidance applied. The Guidance identified that question and five sub-questions, at least two of which should be answered in the affirmative for an item to be considered to be made in the U.S.:

"Question 3 generally addresses situations where the most significant of the potentially transformative work is assembly. Because assembly is in most cases further down the spectrum towards non-transformative work, a more demanding standard is appropriate. Thus, if the answer to at least two of 3a, 3b, 3c, 3d, or 3e is "yes", then the answer to Question 3 is "yes". Manufacturers who wish to establish beyond a doubt that their product has been substantially transformed in the U.S. via answers to Question 3 will want to provide descriptions of their process(es) that support affirmative answers to as many of the subquestions as are applicable, to increase the likelihood that the answers to at least two of the questions are sufficient.

"3. Was(/were) the process(es) performed in the U.S. (including but not limited to assembly) complex and meaningful?

a. Did the process(es) take a substantial amount of time?
b. Was(/were) the process(es) costly?
c. Did the process(es) require particular high level skills?
d. Did the process(es) require a number of different operations?
e. Was substantial value added in the process(es)?"

OW interprets Question 3 and its sub-questions, in the context of the entire guidance, to contemplate a change in character or use consistent with the concept of substantial transformation. The sub-questions establish reasonable, practical indicia for identifying when assembly will result in a good that has different properties from those of the individual raw materials, as required in the Guidance. Under the Guidance, "complex and meaningful" assembly operations, such as heavy machining involving high value labor and sophisticated equipment, are required to produce a material that has different properties from the individual raw materials and establish substantial transformation. By contrast, work that is minimal, simple, or cosmetic in nature cannot amount to the complex and meaningful process needed to change a good's character or use and establish substantial transformation.

Nonetheless, the OIG objects to Question 3 in the OW guidance because it views the five sub-questions as replacing the "change in character or use" test. OIG advises that Question 3 should be removed from the Guidance.

Despite the fact that most of the nearly 3,300 projects funded by the SRFs under the ARRA are completed and that 97 percent of the funds have been expended, OW offered to address OIG's concerns by amending the Guidance to clarify and confirm that a good manufactured through assembly in the U.S. must be changed in character and or use from its foreign components and that the sub-questions are critical factors. In the proposed amendment, as in the current guidance, Question 3 and two of the five sub-questions would have to be answered in the affirmative to determine that a good was manufactured in the U.S. The proposed change was rejected by the OIG.

As indicated above, this is a dispute about a policy choice, not a legal requirement. Substantial transformation is not required to satisfy the Buy American provision in the Recovery Act. In

fact, when the Federal Acquisition Regulations (FAR) were eventually amended to address the Buy American provision of ARRA in June 2010, the "substantial transformation" test was not adopted. Instead, the FAR applied a test that essentially looked to the last place of assembly to determine the location of manufacture. Therefore, the OW Guidance does not pose a substantial risk of violation of the Buy American provision of the Recovery Act. Indeed, the best resolution is for the Agency to maintain the current language in the Guidance and address any concerns about compliance with the Buy American provision in the Recovery Act based on technical and engineering review on a case-by-case basis.

d. Internal Agency Audit Dispute Resolution Process

The Action Official and OIG will work together to attempt to resolve their disagreement(s). When the Action Official or OIG believe that efforts to reach agreement on audit issues are at an impasse, either party should immediately refer the issue(s) to the CFO to implement resolution.

Step 1 – The Assistant IG will meet with the Program Manager to resolve disagreements in developing the Management Decision.

Step 2 – When resolution is unsuccessful, the AO elevates to the CFO via an Agency Audit Dispute Resolution Request. CFO meets with the AO (AA/RA for Regional audits, OGD Director for Headquarters audits) and the IG to resolve the issues.

Step 3 – When resolution is unsuccessful, the CFO, AA/RA and the IG meet with DA and present the issue template for resolution. The DA decision will be considered final.

Each step of this process will have 20 days for Assistance Agreement audits.

**At any point during the resolution process, it may be necessary for the OGC to develop a formal legal opinion on an issue or use outside technical assistance to provide additional professional advice on the merits of arguments presented in cases.*

e. Assistance Agreement/Single Audit Appeals Process

This Subpart prescribes the procedures and responsibilities for resolving a financial assistance audit appeal and request for review of the appeal decision. Failure to provide a timely resolution may suspend the recovery of funds potentially owed to the federal government and may delay the implementation of identified corrective actions. As a result, this Subpart provides a uniform process, including appropriate timelines and tracking requirements, to hold responsible officials accountable for the efficient, effective and timely resolution of financial assistance audit appeals.

This Subpart will become effective upon issuance of amendments to the EPA's assistance agreement dispute regulations at 40 CFR §§ 30.63 and 31.70.

Definitions, for purposes of this Subpart:

- *Disputes Decision Official* is the designated agency official responsible for issuing a decision resolving a financial assistance audit appeal.

  - The DDO for a Headquarters financial assistance audit appeal is the Director of the Grants and Interagency Agreement Management Division. To help provide a fair and impartial review, the Headquarters DDO may not serve as the Action Official for the challenged Management Decision or as the Review Official for the appeal decision

  - The DDO for a Regional financial assistance audit appeal is the official designated by the Regional Administrator to issue the written decision resolving the appeal. To help provide a fair and impartial review, the designated Regional DDO may not serve as the Action Official for the challenged Management Decision or as the Review Official for the appeal decision.

- *Financial Assistance Audit Appeal* (or "Appeal") is the letter a recipient submits to the DDO disputing an agency Management Decision resolving the final findings and recommendations contained in an OIG financial assistance audit report or the final report for an audit conducted under the Single Audit Act, as amended, and OMB Circular A-133.

- *Request for Review* is the letter a recipient submits to the designated Review Official to challenge the propriety of the DDO's Appeal decision.

- *Review Official* is the EPA official responsible for issuing a decision resolving a recipient's request for review of a DDO's Appeal decision.

  - For a Headquarters DDO Appeal decision, the Review Official is the Director of the Office of Grants and Debarment.

  - For a Regional DDO Appeal decision, the Review Official is the Regional Administrator.

- *Action Official* is the EPA official who authors the Management Decision to the recipient in response to a financial assistance audit or single audit review.

- *Management Decision* is the agency's initial determination by the AO to a recipient in response to findings and recommendations reported in an OIG financial assistance or OIG single audit review. The Management Decision also informs a recipient of their right to appeal the decision to the DDO.