

## Chapter 9

# Federal Restrictions on Participation by Foreign Investors in Defense and Other Government Contracts

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### Research References

#### *West's Key Number Digest*

Admiralty ☞1.6; Aviation ☞7, 8; Commerce ☞3, 4, 14.5, 48, 54.5, 75, 80.10, 82.6, 82.20, 82.25, 82.30, 82.45, 82.50; Corporations ☞1.1(3), 632, 636, 675(5) to 657(7); Treaties ☞1 to 8; United States ☞5, 53(10), 59, 64, 64.15, 70, 70(6); War and National Emergency ☞15, 18, 48.1; Weapons ☞17

#### *Primary Authority*

46 U.S.C.A. App. Subpart V (construction-differential subsidy)  
10 U.S.C.A. § 2533 (determinations of public interest under the Buy American Act)  
10 U.S.C.A. § 2534 (miscellaneous limitations on the procurement of goods other than United States goods)  
19 U.S.C.A. §§ 2501 to 2518 (Trade Agreements Act of 1979 (the TAA))  
22 U.S.C.A. §§ 2751 to 2799aa (Arms Export Control Act)  
41 U.S.C.A. §§ 10a to 10d (Buy American Act)  
49 U.S.C.A. Ch. 401 (air commerce and safety-general provisions)  
50 U.S.C.A. §§ 1701 to 1706 (International Emergency Economic Powers Act)  
50 U.S.C.A. App. §§ 2401 to 2420 (Export Administration Act)  
15 C.F.R. Parts 730 to 774 (Export Administration Regulation (EAR))  
22 C.F.R. Parts 120 to 130 (Traffic in Arms Regulations (ITAR))  
31 C.F.R. Parts 500 to 597 (OFAC sanctions against certain countries)  
48 C.F.R. §§ 1 et seq. (Federal Acquisition Regulations System (FAR))

#### *A.L.R. Library*

Validity, Construction, and Application of State “Buy American” Acts, 107 A.L.R.5th 673  
Construction and Application of s 201 of Terrorism Risk Insurance Act of 2002, Public Law 107-297, sec. 201, 116 Stat. 2337, 190 A.L.R. Fed. 155

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## MANUAL OF FOREIGN INVESTMENT IN THE U.S.

Validity, Construction, and Operation of Buy American Act (41 U.S.C.A. s10A-10D), 185 A.L.R. Fed. 253

Validity, Construction, and Application of North American Free Trade Agreement and Implementing Statutes and Regulations, 183 A.L.R. Fed. 1

### *Legal Encyclopedias*

Am. Jur. 2d, Aliens and Citizens §§ 23, 1119; Aviation § 40; Commerce §§ 5, 17, 94, 106; Constitutional Law § 722; Contracts §§ 282 to 287; Customs Duties and Import Regulations §§ 12 to 22, 70, 76, 199, 265; Damages § 721; Federal Courts §§ 433, 435, 2277 to 2286; Foreign Corporations §§ 1 et seq.; Public Works and Contracts §§ 8 to 28

### *Treatises and Practice Aids*

Bruner & O'Connor on Construction Law § 7:51

Federal Procedure, L. Ed. § 37:1414

Federal Procedure, L. Ed. § 43:76

### *Forms*

Am. Jur. Legal Forms 2d, Public Works and Contracts § 216:131; United States § 254:7

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## **I. THE TRADITIONAL PREFERENCES FOR AMERICAN CONTRACTORS**

### **§ 9:1 The legal framework**

#### **Research References**

West's Key Number Digest, United States ⇄59

Validity, Construction, and Application of State "Buy American" Acts, 107 A.L.R.5th 673

Validity, Construction, and Operation of Buy American Act (41 U.S.C.A. s10A-10D), 185 A.L.R. Fed. 253

Validity, Construction, and Application of North American Free Trade Agreement and Implementing Statutes and Regulations, 183 A.L.R. Fed. 1

Federal Procedure, L. Ed. § 37:1414

Federal Procedure, L. Ed. § 43:76

Like most countries, the United States has traditionally favored United States companies when procuring goods and services for public use. In general, the restrictions on foreign participation in United States government procurement fall into two major categories. Relatively rare are restrictions on procurement from foreign nationals or United States entities controlled by foreign nationals or governments. More long-standing and common are restrictions

on procurement of foreign-origin supplies and materials. The latter category is exemplified by the Buy American Act (BAA)<sup>1</sup> and various restrictions in federal defense appropriation legislation which provide the principal statutory basis for preferential treatment of suppliers of United States products and services. The Federal Acquisition Regulation (FAR) and the various agency-specific supplementary regulations implement these statutory provisions.<sup>2</sup>

Until 1979, international law fully recognized and acknowledged such “buy national” preferences. In fact, the original General Agreement on Tariffs and Trade (GATT) expressly exempted government procurement from its anti-protectionist provisions. In 1979, however, a major change occurred with the adoption by 19 countries of the International Agreement on Government Procurement<sup>3</sup> under the GATT. The intent of this agreement was to open such countries’ government procurement, at least to some extent, to reciprocal international competition. At the conclusion of the Uruguay Round in 1994, however, the GATT was significantly modified and the World Trade Organization (WTO) was established.<sup>4</sup> This restructured international trade regime includes both multilateral agreements applicable to all WTO member countries and plurilateral agreements—such as the Agreement on Government Procurement (GPA)—applicable only to those WTO members that have expressly agreed to be bound by the terms of such agreement. The United States, the European Union (EU), and 26 countries (including most individual EU members) have acceded to the GPA which dramatically opens both central and subcentral government procurement of the member countries.

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**[Section 9:1]**

<sup>1</sup>41 U.S.C.A. §§ 10a to 10d.

<sup>2</sup>The FAR, a unified regulation applicable to procurement by all federal executive agencies is published under Title 48 of the Code of Federal Regulations (CFR). Numerous agencies have also published supplemental regulations specifically applicable to their procurements. These include, inter alia, the Department of Defense (DOD) FAR Supplement, the General Services Administration Acquisition Regulation (GSAR), the Department of Energy Acquisition Regulation (DEAR), the Department of Transportation Acquisition Regulation, the National Aeronautics and Space Administration (NASA) FAR Supplement, and, most recently, the Homeland Security Acquisition Regulation. Other agencies, including the Departments of State and the Environmental Protection Agency, as well as some sub-agencies, e.g., the military services and the Defense Logistics Agency, also publish supplementary acquisition regulations. Today, these supplemental regulations are generally available on-line through the agency’s website.

<sup>3</sup>For the text of the International Agreement on Government Procurement, see House Ways and Means Committee and Senate Finance Committee, *Multilateral Trade Negotiations: International Codes Agreed to in Geneva, Switzerland*, Apr 12, 1979, Cong, 1st Sess 96th 129 (Apr 23, 1979) (Joint Comm Print).

<sup>4</sup>The text of the WTO agreements are accessible on the WTO web site at [http://www.wto.org/english/docs\\_e/legal\\_e/legal\\_e.htm](http://www.wto.org/english/docs_e/legal_e/legal_e.htm).

In the United States, the GPA is implemented by the Trade Agreements Act of 1979 (the TAA),<sup>5</sup> the FAR, and the Department of Defense (DOD) FAR Supplement.<sup>6</sup> As a result of these provisions, the BAA and related restrictions have been rendered inapplicable to a substantial portion of a United States government procurement. Companies in countries that are signatories to the GPA may compete for the portion of the government procurement market covered by the GPA, without suffering the handicaps imposed by the traditional protectionist measures. The GPA has even opened some defense procurement to suppliers of foreign-origin goods and services, although not generally to procurement of sensitive military products and services.

This chapter describes the current status of the United States law restricting participation by foreign investors in defense and other United States government contracts. In addition, it discusses a variety of provisions that restrict participation by foreign investors in government contracts that require access to classified information and to unclassified, but controlled, technology.

## II. RESTRICTIONS ON GOVERNMENT PROCUREMENT FROM FOREIGN NATIONALS

### § 9:2 Companies controlled by certain foreign entities

#### Research References

West's Key Number Digest, Commerce ☞3, 4; Corporations ☞632, 636, 675(.5) to 657(7); United States ☞59

Although relatively rare, the United States government does impose some restrictions on contracting with companies controlled by certain foreign entities, particularly where the contracts implicate national security concerns. First, by statute, neither the Department of Defense (DOD) nor the Department of Energy (DOE) may contract for a national security program with a company “controlled” by a foreign government where performance of that contract would require access to “proscribed” information.<sup>1</sup> The phrase proscribed information generally includes the most sensitive types of classified information, such as top secret or special access program information.<sup>2</sup> A company is “controlled” by a foreign government where the foreign government has the power, either directly or

<sup>5</sup>19 U.S.C.A. §§ 2501 to 2518.

<sup>6</sup>FAR (48 C.F.R. Subpart 25.4), DOD FAR Supp. (48 C.F.R. Subpart 225.4).

#### [Section 9:2]

<sup>1</sup>10 U.S.C.A. § 2536.

<sup>2</sup>DOD FAR Supp. § 252.209–7002(a)(4) (48 C.F.R. § 252.209–7002(a)(4)); DEAR § 904.7101 (48 C.F.R. § 904.7101). See also the discussion in §§ 9:26 to 9:30 concerning performance of contracts requiring access to classified information.

indirectly, and whether exercised or exercisable to influence election of a majority of the board of directors or other controlling body, whether such power is obtained by contract or by operation of law.<sup>3</sup> Both DOD and DOE have statutory authority to waive this procurement prohibition either where it is in the national security interest of the United States or, in cases involving environmental remediation or restoration, where it would enhance those environmental objectives without harming the national security interest of the United States.<sup>4</sup>

A broader prohibition exists with respect to companies in which foreign governments that support international terrorism have a “significant interest.”<sup>5</sup> The Secretary of State, under the Export Administration Act of 1979, has responsibility for designating those foreign governments that “repeatedly provided support for acts of international terrorism.”<sup>6</sup> For purposes of this prohibition, a “significant interest” in a company may be substantially less than actual ownership or control. For example, a beneficial interest in 5% or more of the firm’s (or a subsidiary’s) securities is sufficient, as is ownership of 10% or more of the firm’s assets.<sup>7</sup> Again, DOD may waive the prohibition against contracting with companies in which terrorist-supporting foreign governments have a significant interest, but to do so requires a specific report to Congress identifying the contract, the foreign government’s interest, and the justification for award.<sup>8</sup> To enforce this provision, all contractors must disclose any such significant interest.<sup>9</sup>

Finally, Congress imposes on both DOD and DOE a requirement to collect and maintain a database of information concerning any companies controlled by “foreign persons” with whom either agency

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<sup>3</sup>DOD FAR Supp. § 252.209–7002(a)(1) (48 C.F.R. § 252.209–7002(a)(1)); DEAR § 904.7101 (48 C.F.R. § 904.7101).

<sup>4</sup>10 U.S.C.A. § 2536(b); DOD FAR Supp. § 209.104-1(e)(ii)(C) and (D) (48 C.F.R. § 209.104-1(e)(ii)(C) and (D)); DEAR § 904.7101(a) and (b) (48 C.F.R. § 904.7101(a) and (b)).

<sup>5</sup>10 U.S.C.A. § 2327.

<sup>6</sup>The countries currently designated by the Secretary of State include Cuba, Iran, Libya, North Korea, Sudan and Syria. By Presidential Determination No. 2004-52 dated September 24, 2004, 69 Fed. Reg. 58793 (Sept. 30, 2004), the President directed the Secretary of State to remove Iraq from the list of state supporters of terrorism. The DAR Council had already removed Iraq from the list in the implementing regulation on the basis of the President’s May 2003 Determination to lift sanctions against Iraq. See DOD FAR Supp. § 252.209-7001 (48 CFR § 252.209-7001), as amended by 69 Fed. Reg. 55992 (Sept. 17, 2004).

<sup>7</sup>DOD FAR Supp. § 252.209–7001(a)(3) (48 C.F.R. § 252.209–7001(a)(3)).

<sup>8</sup>10 U.S.C.A. § 2327(c).

<sup>9</sup>DOD FAR Supp. § 252.209–7001 (48 C.F.R. § 252.209–7001).

contracts.<sup>10</sup> Originally, this information collection provision applied to all contractors that were awarded contracts exceeding \$100,000 in a single year, but in 2002 Congress increased the threshold to \$10 million.<sup>11</sup> DOD has implemented this requirement by contract clause,<sup>12</sup> although contractor compliance remains irregular.<sup>13</sup>

The 2006 National Defense Authorization Act prohibits DOD from acquiring goods and services from a Communist Chinese military company if the goods or services are on the munitions list for the International Traffic in Arms Regulations. This prohibition may be waived for national security purposes.<sup>14</sup>

### § 9:3 The Bayh Amendment

#### Research References

West's Key Number Digest, Commerce ☞3, 4; Corporations ☞632, 636, 675(.5) to 657(7); United States ☞59; War and National Emergency ☞15

Section 744 of the 1973 Department of Defense Appropriation Act,<sup>1</sup> popularly known as the Bayh Amendment, prohibits the expenditure of funds appropriated to the DOD for military research and development contracts “with any foreign corporation, organization, person, or other entity” when an “equally competent” American contractor is willing to do the work at a lower cost. Although this provision is contained in the Appropriation Act for a particular fiscal year, the provision by its terms applies to “funds appropriated by this or any other Act”<sup>2</sup> and thus effectively restricts procurements in subsequent fiscal years as well. The Bayh Amendment is implemented by DOD FAR Supp. § 225.7016 (48 C.F.R. § 225.7016).

### § 9:4 International air transportation

#### Research References

West's Key Number Digest, Aviation ☞7, 8; Commerce ☞82.45; Corporations ☞1.1(3), 632

<sup>10</sup>10 U.S.C.A. § 2537.

<sup>11</sup>Pub. L. No. 107-314, § 1041(a)(16), 116 Stat. 2458, 2645 (2002).

<sup>12</sup>DOD FAR Supp. § 252.225-7003 (48 C.F.R. § 252.225-7003).

<sup>13</sup>See GAO Report 04-381, “Contract Management—DOD Needs Measures for Small Business Subcontracting Program and Better Data on Foreign Subcontracts” (April 2004)..

<sup>14</sup>Pub. L. No. 109-163, § 1211, 119 Stat. 3461; DOD FAR Supp. § 225.770 (48 C.F.R. § 225.770)

#### [Section 9:3]

<sup>1</sup>Pub. L. No. 92-570, § 744, 86 Stat. 1184, 1203 (1972).

<sup>2</sup>Pub. L. No. 92-570, § 744, 86 Stat. 1184, 1203 (1972).

Federal law limits most government contracts for international air transportation of persons and property to air carriers certified by the Department of Transportation, to the extent that service is “available” from such carriers.<sup>1</sup> Such an air carrier must be a United States citizen.<sup>2</sup> A corporation qualifies as a citizen only if it is “organized under the laws of the United States or a State, the District of Columbia, or a territory or possession of the United States,” no more than 25% of its voting interest is under foreign ownership or control and its president and two-third of its directors are United States citizens.<sup>3</sup>

### § 9:5 Maritime industry subsidies

#### Research References

West’s Key Number Digest, Admiralty ⚡1.6; Commerce ⚡82.30; Corporations ⚡1.1(3), 632; United States ⚡53(10)

Foreign participation in government subsidized construction, reconstruction, or reconditioning of ships to be used in foreign commerce, but suitable for defense or military use in time of war or national emergency, is restricted by the fact that the Maritime Administration’s construction differential subsidies are available only to “[a]ny proposed ship purchaser who is a citizen of the United States or any shipyard of the United States.”<sup>1</sup> Similarly, the Maritime Administration’s operating differential subsidies are limited to “any citizen of the United States.”<sup>2</sup>

For purposes of these programs, a corporation is deemed a United States citizen if Citizens of the United States own the controlling interest in the corporation; its chief executive officer, by whatever title, and the chairman of the board are United States citizens; a majority of a quorum of its directors are United States citizens (in the case of operating subsidies, however, all directors must be United States citizens); and the corporation is organized under the

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#### [Section 9:4]

<sup>1</sup>49 U.S.C.A. § 40118(a). This restriction applies to travel between a point within the United States and a point outside the United States as well as to travel between points outside the United States. 49 U.S.C.A. § 40118(a). This restriction is not applicable to employees of the State Department or the Agency for International Development when the transportation is between two points outside the United States. 49 U.S.C.A. § 40118(d).

<sup>2</sup>49 U.S.C.A. § 40102(a)(2).

<sup>3</sup>49 U.S.C.A. § 40102(a)(15)(C).

#### [Section 9:5]

<sup>1</sup>46 U.S.C.A. App. § 1151(a), (c).

<sup>2</sup>46 U.S.C.A. App. § 1171(a).

laws of “the United States or of a State, Territory, District, or possession thereof.”<sup>3</sup>

### III. RESTRICTIONS ON GOVERNMENT PROCUREMENT OF FOREIGN-ORIGIN MATERIALS

#### § 9:6 The Buy American Act

##### Research References

West’s Key Number Digest, Commerce ◊82.25; United States ◊59, 64  
Validity, Construction, and Application of State “Buy American” Acts, 107  
A.L.R.5th 673  
Validity, Construction, and Operation of Buy American Act (41 U.S.C.A.  
s10A-10D), 185 A.L.R. Fed. 253  
Bruner & O’Connor on Construction Law § 7:51  
Federal Procedure, L. Ed. § 37:1414  
Federal Procedure, L. Ed. § 43:76  
Proof That a Government Agency Was Liable For Improperly Granting a  
Bid Award to a Bid Applicant, 70 Am. Jur. Proof of Facts 3d 97  
Am. Jur. Legal Forms 2d, Public Works and Contracts § 216:131

The Buy American Act (BAA)<sup>1</sup> was enacted in 1933 and established the basic framework of restricting United States government procurement to domestic origin materials or supplies for public use inside the United States.<sup>2</sup> The Balance of Payments Program (BOPP)<sup>3</sup> established parallel restrictions on United States government procurement of materials for use abroad. The BAA is implemented primarily through the application of bid price evaluation factors which strongly favor selection of American products.

#### § 9:7 The Buy American Act—The general prohibition against procurement of foreign items

##### Research References

West’s Key Number Digest, Commerce ◊82.20, 82.25; United States ◊59, 64  
Bruner & O’Connor on Construction Law § 7:51  
Am. Jur. Legal Forms 2d, Public Works and Contracts § 216:131; United States § 254:7

As a general rule, the BAA provides that the government may

<sup>3</sup>46 U.S.C.A. App. §§ 802(a), 1244(c).

##### [Section 9:6]

<sup>1</sup>41 U.S.C.A. §§ 10a to 10d.

<sup>2</sup>Currently, the BAA is implemented in FAR Subparts 25.1 and 25.2 (48 C.F.R. Subparts 25.1 and 25.2). The rules applicable to military products are found in DOD FAR Supp. Subparts 225.1 and 225.2 (48 C.F.R. Subparts 225.1 and 225.2).

<sup>3</sup>DOD FAR Supp. Subpart 225.75 (48 C.F.R. Subpart 225.75). See also discussion at § 9:15.

procure for domestic public use: (a) unmanufactured articles only if such articles are mined or produced in the United States; and (b) manufactured articles only if they are domestically manufactured from components and material substantially all of which are mined, produced, or manufactured in the United States.<sup>1</sup> The phrase “substantially all” remains undefined in the statute, but the implementing regulations have traditionally interpreted this phrase as requiring that the cost of the domestic-source components of a domestically manufactured product to be at least 50% of the cost of all of its components.<sup>2</sup> A component is defined as “an article, material, or supply incorporated directly into an end product,” while an “end product” is defined as “those articles, materials, and supplies to be acquired for public use.”<sup>3</sup> Generally, an end product that satisfies this 50% requirement is designated a domestic end product. An end product that does not satisfy the 50% requirement is a foreign end product.<sup>4</sup> Importantly, under the DOD implementing regulations, the phrase domestic end product includes a product manufactured in the U.S. where the cost of both domestic U.S. components and any qualifying country components exceeds the 50% threshold.<sup>5</sup>

A product may still qualify as a domestic end product even though its components are 100% composed of foreign-source material. This occurs where all of the components (as well as the final product) were manufactured in the United States.<sup>6</sup> In other words, a supplier who subcontracts for the production of components need not require that the subcontractor use any U.S.-origin materials, provided that the location of the component’s manufacture is in the United States.

The term “manufacture” is undefined in either the statute or the implementing regulations, and its scope remains a matter of some

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**[Section 9:7]**

<sup>1</sup>41 U.S.C.A. § 10a.

<sup>2</sup>Exec. Order 10582, 2(a), 3 C.F.R. § 230; FAR § 25.101 (48 C.F.R. § 25.101). In determining the component costs, the manufacturer can include profit, overhead, and other indirect costs for components made by the manufacturer, but may not add such factors to the cost of purchased items. General Kinetics, B-243078.2, 92-1 CPD ¶ 95 (Jan 22, 1992).

In recent years, bills have regularly been introduced in Congress that would have the effect of statutorily mandating the so-called component test, while mandating a significantly higher percentage of domestic U.S. content (e.g., 75% U.S. components). See 2005 Cong. U.S. S. 395 (Feb. 16, 2005). So far, these legislative efforts have failed.

<sup>3</sup>FAR § 25.003 (48 C.F.R. § 25.003).

<sup>4</sup>FAR § 25.003 (48 C.F.R. § 25.003).

<sup>5</sup>DOD FAR Supp. §§ 225.003 and 225.7001 (48 C.F.R. §§ 225.003 and 225.7001). See discussion at § 9:11 for definition of “qualifying country.”

<sup>6</sup>See Hamilton Watch Co., Inc., 74-1 CPD ¶ 306, B-179939, 1974 WL 7807 (Comp. Gen. 1974).

confusion. The U.S. General Accounting Office (GAO) has ruled that “manufacturing” for purposes of the BAA must include “assembly. . . necessary for the product to meet the operational or performance requirements of the solicitation.”<sup>7</sup> Furthermore, operations on foreign sourced items, such as refurbishment, “which do not alter the essential nature of a component which is the core or essence of the end product being procured may not be used to circumvent the plain requirement of the [BAA] that the end product be manufactured ‘substantially all’ from domestic articles, material, or supplies.”<sup>8</sup> Where an end product is produced from a single component or material, GAO will examine the manufacturing process particularly closely to ensure first that it consists of two distinct phases: one which “manufactures” a domestic component from the foreign sourced material and one which then “manufactures” the end product distinguishable from the component. A significant factor is whether, as a result of these phases, the material has undergone substantial changes in physical character.<sup>8.25</sup> Labor is not considered to be a component of the end product because it is not an article, material, or supply incorporated directly into an end product.<sup>8.50</sup>

The regulations implementing the BAA on construction contracts are similar to those for supply contracts.<sup>9</sup> The regulations contain analogous definitions of domestic construction materials.<sup>10</sup> In the case of construction contracts, construction materials qualify as domestic construction materials only when the domestic components constitute at least 50% of the total cost of the construction material at the time and in the form it is delivered to the construction sites.<sup>11</sup> Unlike the regulations for supply contracts, the BAA explicitly requires construction “subcontractors, material men, or suppliers,” as well as prime contractors, to use domestic construction materials.<sup>12</sup>

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<sup>7</sup>TRS Research, 2000 CPD ¶ 128, B-285514, 2000 WL 1099965 (Comp. Gen. 2000).

<sup>8</sup>TRS Research, 2000 CPD ¶ 128, B-285514, 2000 WL 1099965 (Comp. Gen. 2000).

<sup>8.25</sup>*City Chemical LLC, B-2961352.05-1 CPD ¶ 120 (June 17, 2005).*

<sup>8.50</sup>*City Chemical LLC, B-2961352.05-1 CPD ¶ 120 (June 17, 2005).*

<sup>9</sup>FAR Subpart 25.2 (48 C.F.R. Subpart 25.2); DOD FAR Supp. Subpart 225.2 (48 C.F.R. Subpart 225.2).

<sup>10</sup>FAR § 25.003 (48 C.F.R. § 25.003).

<sup>11</sup>FAR § 25.003 (48 C.F.R. § 25.003).

<sup>12</sup>41 U.S.C.A. § 10b(a).

## § 9:8 The Buy American Act—Exceptions to the general prohibition

### Research References

West's Key Number Digest, Commerce ◊82.20, 82.25; United States ◊59, 64

Bruner & O'Connor on Construction Law § 7:51

Am. Jur. Legal Forms 2d, Public Works and Contracts § 216:131

Despite the general prohibition, the BAA contains a number of exceptions under which the government may procure foreign end products. First, the BAA restriction is inapplicable when the head of the procuring agency finds such application to be impracticable or inconsistent with the public interest.<sup>1</sup> A major application of the public interest exception—discussed in following sections—has been by the Secretary of Defense to exempt from the BAA countries which have committed, in Memoranda of Understanding, to reciprocal treatment in their defense related procurements.<sup>2</sup>

Second, the BAA restrictions do not apply when domestic end products or construction materials of the “class or kind to be used” are not found in “sufficient and reasonably available commercial quantities and of a satisfactory quality” in the United States.<sup>3</sup> Similarly, foreign components of the same class or kind of items found not to be reasonably available in the U.S. will be treated as domestic components for purposes of the 50% computation.<sup>4</sup> The FAR lists numerous items for which such determinations have been made, and agency specific supplemental regulations may add to this list.<sup>5</sup> Each agency head is authorized to make a determination of non-availability and contracting officers may make such a determination with respect to individual procurements.<sup>6</sup>

Third, and perhaps most importantly, the BAA restrictions do not apply when the contracting officer determines that the cost of the

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### [Section 9:8]

<sup>1</sup>41 U.S.C.A. § 10a; FAR §§ 25.103(a), 25.202(a)(1) (48 C.F.R. §§ 25.103(a), 25.202(a)(1)); DOD FAR Supp. § 225.103(a) (48 C.F.R. § 225.103(a)).

<sup>2</sup>See discussion §§ 9:10, 9:12.

<sup>3</sup>41 U.S.C.A. § 10a; FAR §§ 25.103(b), 25.202(a)(2) (48 C.F.R. §§ 25.103(b), 25.202(a)(2)). See also DOD FAR Supp. § 225.103(b) (48 C.F.R. § 225.103(b)).

<sup>4</sup>See FAR § 25.003 (48 C.F.R. § 25.003).

<sup>5</sup>FAR § 25.104(a) (48 C.F.R. § 25.104(a)). See also DOD FAR Supp. § 225.104(a) (48 C.F.R. § 225.104(a)). The determinations of non-availability listed at FAR § 25.104(a) do not apply “if the contracting officer learns before the time designated for receipt of bids in sealed bidding or final offers in negotiation that an article on the list is available domestically, in sufficient and reasonably available quantities of a satisfactory quality.” FAR § 25.104(b) (48 C.F.R. § 25.104(b)).

<sup>6</sup>FAR § 25.103(b)(2) (48 C.F.R. § 25.103(b)(2)).

domestic product or materials is unreasonable.<sup>7</sup> It is because of this exception that the implementing regulations do not prohibit the purchase of foreign origin items, but simply provide an evaluation preference for domestic end products. The regulations contain specific provisions for the evaluation of bids subject to the BAA.<sup>8</sup> Under these procedures, the offered prices for bids of foreign end products are adjusted upward—for evaluation purposes only—in accordance with a formula, and application of the BAA is deemed unreasonably costly when the evaluated price of the bid offering foreign end products is lower than all bids offering domestic end products.

The FAR formula requires generally that the bids for foreign end products, inclusive of duty, be adjusted upward by 6%.<sup>9</sup> When a domestic small business or labor surplus area bid is the competing bid, the FAR formula adjusts the offered price of the foreign end product upward by 12%.<sup>10</sup> The price of the domestic offer is reasonable if it does not exceed the evaluated price of the foreign bid after the upward adjustment.<sup>11</sup> In the case of construction contracts, unless the agency head specifies a higher percentage, the evaluated price is adjusted upward by “6 percent of the cost of any foreign construction materials.”<sup>12</sup>

For DOD procurements, the formula provides that a bid of a foreign end product, including duty, be adjusted upward by 50%.<sup>13</sup>

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<sup>7</sup>41 U.S.C.A. §§ 10a and 10d; FAR §§ 25.103(c), 25.202(a)(3) (48 C.F.R. §§ 25.103(c), 25.202(a)(3)), and DOD FAR Supp. § 225.103(c) (48 C.F.R. § 225.103(c)).

<sup>8</sup>FAR §§ 25.105, 25.204(b) and 25.504-1 (48 C.F.R. §§ 25.105, 25.204(b), and 25.504-1).

<sup>9</sup>FAR §§ 25.105(b)(1) and 25.204(b) (48 C.F.R. §§ 25.105(b)(1) and 25.204(b)). Note that the cost evaluation adjustment provisions do not apply if an acquisition of supplies is subject to a trade agreement under FAR subpart 25.4. FAR § 25.105(a)(2) (48 C.F.R. § 25.105(a)(2)). In the case of an acquisition which includes construction materials, the cost adjustment evaluation provisions do not apply to materials exempted by FAR clauses §§ 52.225-9(b)(2), 52.225-11(b)(3) (48 C.F.R. §§ 52.225-9(b)(2), 52.225-11(b)(3)), the Trade Agreements Act, or NAFTA. FAR § 25.204(a) (48 C.F.R. § 25.204(a)). See discussion at §§ 9:21 to 9:25.

<sup>10</sup>FAR § 25.105(b)(2) (48 C.F.R. § 25.105(b)(2)). The 12% adjustment for bids competing with domestic small businesses is only applicable to supply contracts.

<sup>11</sup>FAR § 25.105(c) (48 C.F.R. § 25.105(c)).

<sup>12</sup>FAR § 25.204 (48 C.F.R. § 25.204).

<sup>13</sup>DOD FAR Supp. §§ 225.105(b) and 225.502(c)(ii) (48 C.F.R. §§ 225.105(b) and 225.502(c)(ii)). This 50% evaluation factor is inapplicable to procurements in which no domestic offers are received. DOD FAR Supp. § 225.502(c)(ii)(B) (48 C.F.R. § 225.502(c)(ii)(B)). If the low offer is from a “qualifying country” (see discussion at § 9:11), then the contracting officer is directed to execute a determination and finding exempting that procurement from the BAA and the 50% evaluation factor would not apply. DOD FAR Supp. § 225.502(c)(ii)(C) (48 C.F.R. § 225.502(c)(ii)(C)).

**§ 9:9 Exception for commercial products****Research References**

West's Key Number Digest, Commerce ☞82.20, 82.25; United States ☞59, 64

Beginning in the mid-1990s, the United States has sought to encourage federal government agencies to rely more heavily on commercial products to satisfy government needs and, correspondingly, to remove barriers that inhibit commercial companies from doing business with the federal government. In 1994, Congress specifically amended the statutory factors the Secretary of Defense is required to consider in determining whether to grant a waiver of the BAA to include consideration of such additional factors as: (1) whether the waiver would enhance DOD's access to "advanced state-of-the-art commercial technology"; or (2) further the integration of the "military and commercial industrial base."<sup>1</sup>

In 2004, Congress went further and has expressly exempted commercial items that qualify as "information technology" from any application of the BAA.<sup>2</sup> Information technology subject to this statutory waiver includes any equipment or interconnected system for the acquisition, storage, manipulation, management, evaluation, etc. of federal agency data or information, including ancillary equipment such as software, firmware, and peripheral imaging equipment or other equipment controlled by the central processing unit of a computer.<sup>3</sup> A contrary trend, however, is evidenced by continued concern in Congress with potential vulnerability in information technology systems resulting from reliance on foreign origin computer hardware and software. For example, in Section 356 of the FY 2004 Intelligence Authorization Act,<sup>4</sup> Congress directed the Director of the Central Intelligence Agency to provide the relevant intelligence committees with a report "on the extent of United States dependence on computer hardware or software that is manufactured overseas." Within the past year, the National Security Agency has begun employing contract clauses (NSA FAR Supp 352.227-9005 and 352.227-9006) that require identification of (and permission to use) "foreign origin" software defined to include any software in which a non-U.S. citizen was involved in the "manufacture, development, maintenance or modification."

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**[Section 9:9]**

<sup>1</sup>FY 1995 DOD Authorization Act, Pub. L. No. 103-337, § 812(a), 108 Stat. 2815 (1994) amending 10 U.S.C.A. § 2533(a).

<sup>2</sup>Pub. L. No. 108-199, Div F, § 535, 118 Stat. 345 to 346 (2004); Pub. L. No. 108-477, Div H, § 517, 118 Stat. 2809 (2005); Pub. L. No. 109-115, Div A, § 717, 119 Stat. 2493 (2006), implemented by 71 Fed Reg 57378 (Sept. 28, 2006).

<sup>3</sup>40 U.S.C.A. § 11101(6).

<sup>4</sup>Pub. L. 108-177, 117 Stat. 2599, 2620 to 2621.

**§ 9:10 DOD exceptions under memoranda of understanding****Research References**

West's Key Number Digest, Commerce ☞82.20, 82.25; United States ☞59, 64

The Secretary of Defense has long exercised the “public interest” exception of the BAA to promote the purchase of U.S. defense articles and military interoperability with its allies by opening U.S. DOD procurements to countries that have executed reciprocal procurement agreements. The effect of these agreements is to free some of DOD procurements from the BAA and the Balance of Payments Program (BBOP)<sup>1</sup> restrictions. A 2002 amendment to the BAA, however, requires the Secretary of Defense, after consultation with the U.S. Trade Representative, to rescind any such blanket waiver of the BAA granted pursuant to a reciprocal defense procurement memorandum of understanding if the Secretary determines that the foreign country has violated the terms of such agreement by discriminating against U.S. products covered by the agreement.<sup>2</sup>

**§ 9:11 DOD exceptions under memoranda of understanding—The agreements****Research References**

West's Key Number Digest, Treaties ☞1 to 8; United States ☞5, 59, 64

The United States has executed the Memoranda of Understanding (MOU) with a number of its allies, which are referred to in the regulations as “qualifying countries.”<sup>1</sup> These agreements incorporate a determination that it is contrary to the public interest to apply the BAA/BOPP price differentials to various defense procurements from these sources.<sup>2</sup> As noted previously, components from qualify-

**[Section 9:10]**

<sup>1</sup>DOD FAR Supp § 225.003(9) (48 C.F.R. § 225.003(9)).

<sup>2</sup>41 U.S.C.A. § 10b-2.

**[Section 9:11]**

<sup>1</sup>The current list of “qualifying countries” with such MOUs are the following countries: Australia, Belgium, Canada, Denmark, Egypt, Federal Republic of Germany, France, Greece, Israel, Italy, Luxembourg, Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, and the United Kingdom. DOD FAR Supp. § 225.872-1(a) (48 C.F.R. § 225.872-1(a)). The United States also has somewhat more limited agreements with Austria and Finland. DOD FAR Supp. § 225.872-1(b) (48 C.F.R. § 225.872-1(b)).

<sup>2</sup>See DOD FAR Supp. § 225.872-1(a) (48 C.F.R. § 225.872-1(a)). For the countries with the more limited agreements under DOD FAR Supp. § 225.872-1(b) (48 C.F.R. § 225.872-1(b)), the determination of whether to waive the BAA/BOP

ing countries are treated the same as domestic components under DOD procurements for purposes of application of the BAA.<sup>3</sup>

### § 9:12 DOD exceptions under memoranda of understanding—Limitations of the agreements

#### Research References

West's Key Number Digest, Treaties ☞1 to 8; United States ☞5, 59, 64

Procurement from qualifying country sources is not automatic. Where the qualifying country product is the low eligible bid, the contracting officer must execute a Determination & Finding that it is in the public interest to award to the supplier of the qualifying country product.<sup>1</sup> Award is not permitted in some instances such as where the procurement of a domestic-source product is deemed necessary to maintain the defense mobilization base.<sup>2</sup> Furthermore, award may be limited by the restrictions of the United States National Disclosure Policy and the United States Industrial Security Program.<sup>3</sup> Finally, these MOUs do not generally exempt qualifying country goods from various appropriation acts and other specific statutory restrictions on DOD procurement,<sup>4</sup> although the regulations do provide relief in some areas such as specialty metals incorporated in a product from a qualifying country.<sup>5</sup>

### § 9:13 FMS contracts

#### Research References

West's Key Number Digest, Commerce ☞14.5, 48, 54.5, 75, 82.50

Under the Foreign Military Sales (FMS) program authorized by the Arms Export Control Act, the United States government purchases defense equipment from private contractors for sale to foreign governments.<sup>1</sup> Because these purchases are intended for export outside the United States, the BAA does not generally apply,

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price differential is done on a purchase by purchase basis. DOD FAR Supp. § 225.872-4(c) (48 C.F.R. § 225.872-4(c)).

<sup>3</sup>DOD FAR Supp. § 225.101 (48 C.F.R. § 225.101).

#### [Section 9:12]

<sup>1</sup>DOD FAR Supp. § 225.872-4 (48 C.F.R. § 225.872-4).

<sup>2</sup>DOD FAR Supp. § 225.872-2(a)(2) (48 C.F.R. § 225.872-2(a)(2)).

<sup>3</sup>DOD FAR Supp. §§ 225.872-2(a)(1) and 225.872-2(a)(4) (48 C.F.R. § 225.872-2(a)(2) and 225.872-2(a)(4)). See DOD Directive 5230.11 (National Disclosure Policy) and discussion at §§ 9:25 to 9:31 (Industrial Security Program).

<sup>4</sup>See discussion at §§ 9:16 to 9:18.

<sup>5</sup>DOD FAR Supp. § 252.225 (48 C.F.R. § 252.225).

#### [Section 9:13]

<sup>1</sup>22 U.S.C.A. § 2762.

and in any event, the majority of these procurements are made using the funds provided by the intended foreign government recipient. For this reason, DOD provides the foreign government substantial discretion in designating a particular prime contractor and/or subcontractor.<sup>2</sup> U.S. policy requires that DOD warn the foreign government purchaser of the contract risk in designating a particular supplier.<sup>3</sup>

Where, however, the foreign government is using “non-repayable credits” provided to the country under DOD’s Foreign Military Financing program,<sup>4</sup> different rules apply. Because these funds are essentially grants, DOD employs a “49 percent rule” restricting the items purchased from foreign sources to no more than 49 percent of the total procurement value. In addition, the pricing of such FMS contracts must be done on the same basis as if DOD were purchasing the items for itself.<sup>5</sup>

### § 9:14 Buy American Act enforcement

#### Research References

West’s Key Number Digest, United States ¶59, 64

Validity, Construction, and Application of State “Buy American” Acts, 107 A.L.R.5th 673

Validity, Construction, and Operation of Buy American Act (41 U.S.C.A. §10A-10D), 185 A.L.R. Fed. 253

Bruner & O’Connor on Construction Law § 7:51

Federal Procedure, L. Ed. § 37:1414

Federal Procedure, L. Ed. § 43:76

Proof That a Government Agency Was Liable For Improperly Granting a Bid Award to a Bid Applicant, 70 Am. Jur. Proof of Facts 3d 97

Am. Jur. Legal Forms 2d, Public Works and Contracts § 216:131

All bidders for contracts to which the BAA applies must submit a Buy American Certificate with their bid.<sup>1</sup> This certificate must set forth the foreign end products that will be supplied. The successful bidder is contractually bound to provide the domestic content of materials as represented in the certificate, and the failure to do so

<sup>2</sup>DOD FAR Supp. § 225.7304(a) (48 C.F.R. § 225.7304(a)).

<sup>3</sup>Security Assistance Management Manual, DOD 5105.38-M (Oct 2003) at ¶ C6.3.4.2.

<sup>4</sup>Under Section 23 of the Arms Export Control Act, 22 U.S.C.A. § 2763, the United States provides funds annually to certain countries—primarily Israel and Egypt—for the purchase of U.S. defense articles and services.

<sup>5</sup>DOD FAR Supp. § 225.7303-5 (48 C.F.R. § 225.7303-5).

#### [Section 9:14]

<sup>1</sup>FAR § 52.225-2 Buy American Act Certificate (June 2003); DOD FAR Supp. § 252.225-7000 (48 C.F.R. § 252.225-7000) Buy American Act—Balance of Payments Program Certificate (Apr 2003).

is a breach that can justify a default termination.<sup>2</sup> In construction contracts, the contracting officer will consider first requiring the contractor to remove and replace any foreign construction material. The contracting officer, by written determination that removal and replacement is impractical, may elect to retain the foreign construction material, but such election is without prejudice to other remedies, including a monetary adjustment.<sup>3</sup> Alternatively, the contracting officer has discretionary authority to require that the contractor replace foreign materials with domestic materials.<sup>4</sup> In addition, in cases of knowing submission of undisclosed foreign end products, the government may obtain treble damages and penalties under the civil False Claims Act.<sup>5</sup>

A construction contractor found to have violated the Act may be barred from further construction contracts for three years.<sup>6</sup> This severe penalty, however, has not been applied when the violation is unintentional or concerns only a small amount of foreign material.<sup>7</sup>

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<sup>2</sup>See *Integrated Systems Group, Inc. v. Social Sec. Admin.*, G.S.B.C.A. No. 14054 SSA, 98-2 B.C.A. (CCH) ¶ 29848, 1998 WL 377754 (Gen. Services Admin. B.C.A. 1998); *Appeal of Sunox Inc.*, 85-2 B.C.A. (CCH) ¶ 18077, 1985 WL 16553 (Armed Serv. B.C.A. 1985). See also *Law Enforcement Associates, Inc.*, 82-1 CPD ¶ 304, B-205024, B-205024 (1), 1982 WL 27938 (Comp. Gen. 1982) (noncompliance with BAA certificate is a matter of contract administration and does not affect the validity of the contract award).

<sup>3</sup>The monetary adjustment would at a minimum lower the contract price by the difference between the costs of the domestic and the foreign materials. See, e.g., *TFI Corporation*, 59 Comp. Gen. 405, 80-1 CPD ¶ 287, B-192879, 1980 WL 18008 (Comp. Gen. 1980); *Watkins, Effects of the Buy American Act on Federal Procurement*, 31 Fed. B.J. 191, 215 (1972). A contractor may also face the risk of default termination.

<sup>4</sup>See *Appeal of Kelfstad Engineering Co., Inc.*, 66-2 B.C.A. (CCH) ¶ 5987, 1966 WL 944 (Veterans Admin. B.C.A. 1966), reconsideration granted, decision vacated, V.A.B.C.A. No. 551, V.A.B.C.A. No. 67-1 6393, 1967 WL 813 (Veterans Admin. B.C.A. 1967); *Appeal of Two State Const. Co.*, 81-1 B.C.A. (CCH) ¶ 15149, 1981 WL 141303 (D.O.T. Cont. Adj. Bd. 1981).

<sup>5</sup>See *U.S. v. Rule Industries, Inc.*, 878 F.2d 535, 11 Int'l Trade Re. (BNA) 1634, 35 Cont. Cas. Fed. (CCH) ¶ 75678 (1st Cir. 1989) (upholding jury verdict and penalty of \$604,000 for knowingly furnishing foreign hacksaw blades in contravention of BAA certificate).

<sup>6</sup>41 U.S.C.A. § 10b(b). See also *Glazer Const. Co., Inc. v. U.S.*, 50 F. Supp. 2d 85, 185 A.L.R. Fed. 717 (D. Mass. 1999) (false and inconsistent statements about origin of construction material was sufficiently serious and compelling conduct to justify debarment).

<sup>7</sup>*J. McBride & T. Touhey, Government Contracts*, § 50.100 (1998). On BAA enforcement, see generally *J. Chierichella, The Buy American Act and the Use of Foreign Sources in Federal Procurement An Issues Analysis*, 9 Pub. Cont. L.J. 73, 74-75 (1977).

## § 9:15 The Balance of Payments Program

### Research References

West's Key Number Digest, United States ⇨64.15  
 Validity, Construction, and Operation of Buy American Act (41 U.S.C.A. s10A-10D), 185 A.L.R. Fed. 253

Similar to the BAA, the BOPP imposes a preference for the procurement of domestic supplies or construction materials in Department of Defense contracts, pursuant to which supplies will be used or construction will be performed outside the United States.<sup>1</sup> The program attempts to counter the unfavorable balance of trade effects resulting from United States overseas defense activities.

Like the BAA, the BOPP incorporates a general prohibition on the acquisition of foreign end products and foreign construction material subject, like the BAA, to availability of domestic or qualified country products or construction material at a reasonable price.<sup>2</sup> Accordingly, the same evaluation procedures (and 50% price evaluation factor) apply to procurements subject to the BOPP as apply to BAA.<sup>3</sup>

In addition to the evaluated price adjustment, the BOPP provides numerous other exceptions to the general prohibition against foreign source procurement. Such exceptions include procurements where it is relatively inconvenient or not feasible to use domestic source goods or materials (e.g., perishable substances, certain foods, certain bulk construction materials, and goods not available in the United States).<sup>4</sup> Finally, the BOPP domestic source preferences are also not used where such restrictions are prohibited by treaties or

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### [Section 9:15]

<sup>1</sup>DOD FAR Supp. Subpart 225.75 (48 C.F.R. Subpart 225.75).

<sup>2</sup>DOD FAR Supp. § 225.7501 (48 C.F.R. § 225.7501).

<sup>3</sup>See DOD FAR Supp. §§ 225.504 and 225.520(c)(ii) and (iii) (48 C.F.R. § 225.504 and 225.520(c)(ii) and (iii)).

<sup>4</sup>DOD FAR Supp. § 225.7501(a)(5) (48 C.F.R. § 225.7501(a)(5)) sets forth the conditions and exceptions under which DOD may acquire foreign end products or construction material for use outside the United States, including the catch-all where the head of the agency determines it is in the "public interest." Among the other specific exceptions are:

- The product or material is of a type (e.g. gravel, concrete masonry, ice, etc.) the nature or characteristics of which limit, as a practical matter, the geographic source;
- The product is a spare part for foreign manufactured equipment; or
- The estimated value of the acquisition is at or below the simplified acquisition threshold.

The BOPP restriction does not prohibit purchase of eligible products from "qualifying country" (discussed at § 9:11), or where the acquisition is subject to the Trade Agreements Act or other free trade agreement (discussed at § § 9:21 through 9:25).

executive agreements.<sup>5</sup> Finally, the agency head can waive the BOPP restrictions when it is in the public interest to do so.<sup>6</sup>

### § 9:16 Special DOD restrictions on procurement of foreign items

#### Research References

West's Key Number Digest, United States ⇨64.15

Apart from the BAA and BOPP, Congress has imposed some very specific restrictions on government (primarily DOD) procurement of certain foreign-source materials. Annual DOD Authorization and Appropriations Acts have added specific Buy American restrictions, which are also subject to various exceptions and waivers. Perhaps most long standing of these is the Berry Amendment, which has since been codified in the United States Code, but there are numerous other restrictions.

### § 9:17 Special DOD restrictions on procurement of foreign items—The Berry Amendment

#### Research References

West's Key Number Digest, United States ⇨64.15

For many years, the so-called Berry Amendment was routinely included in annual DOD Appropriations Acts to prohibit DOD's procurement of specific items containing foreign-source articles or material. This restriction was codified in 2001 and generally prohibits use of funds appropriated "or otherwise available to" DOD for procurement of food, clothing, various fabrics, hand or measuring tools, and specialty metals (e.g., certain steel and other metal alloys, titanium and titanium alloys, and zirconium and zirconium based alloys).<sup>1</sup>

There are a number of statutory and regulatory exceptions to the Berry Amendment restrictions including where there are inadequate U.S. sources or where the value of the acquisition is at or below the simplified acquisition threshold.<sup>2</sup> Some of the other significant exceptions are:

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<sup>5</sup>See DOD FAR Supp. § 225.7501(a)(3) (48 C.F.R. § 225.7501(a)(3)).

<sup>6</sup>DOD FAR Supp. § 225.7501(c) (48 C.F.R. § 225.7501(c)).

#### [Section 9:17]

<sup>1</sup>10 U.S.C.A. § 2533a. Specialty metals are listed at DOD FAR Supp. § 52.225-7014 (48 C.F.R. § 52.225-7014). Included are a variety of steels with specified alloy contents, as well as certain other metal alloys such as titanium.

<sup>2</sup>10 U.S.C.A. § 2533a(c) and (h); DOD FAR Supp. § 225.7002-2(a) and (b) (48 C.F.R. § 225.7002-2(a) and (b)).

- Acquisitions outside the United States in support of combat operations, as well as for various other emergency situations;<sup>3</sup>
- Certain acquisitions of fibers and yarns to be used in synthetic fabric (but not the fabric itself) provide the fabric will not be used in a “textile product”;<sup>4</sup>
- Purchases of specialty metals by subcontractors unless the acquisition involves such significant defense equipment as aircraft, missiles, ships, tanks, weapons or ammunition; and<sup>5</sup>
- Acquisition of specialty metals melted in a “qualifying country” (see discussion at § 9:11) or incorporated in an article manufactured in such country.<sup>6</sup>
- Acquisition of perishable food by or on behalf of activities located outside the United States.<sup>6,50</sup>

Failure to comply with the Berry Amendment restrictions may lead to both contractual as well as civil False Claims Act liability.<sup>7</sup>

### § 9:18 Special DOD restrictions on procurement of foreign items—Other specific restrictions

#### Research References

West’s Key Number Digest, United States ⇨64.15

There are a number of other restrictions that bar procurement, by certain agencies, of specific foreign-sourced products or services. Many of these restrictions are contained in annual appropriation acts, but some have been codified. The restrictions are generally of

<sup>3</sup>10 U.S.C.A. § 2533a(d)(1); DOD FAR Supp. § 225.7002-2(d) (48 C.F.R. § 225.7002-2(d)). See also 10 U.S.C.A. § 2533a(d)(2), (3) and (4); DOD FAR Supp. § 225.7002-2(e) (perishable foods), 225.7002-2(f) (contingency operations), 225.7002-2(g) (emergency acquisitions for activities outside the U.S.), and 225.7002-2(h) (vessels in foreign waters) (48 C.F.R. § 225.7002-2(e), (f), (g), and (h)).

<sup>4</sup>DOD FAR Supp. § 225.7002-2(o) (48 C.F.R. § 225.7002-2(o)).

<sup>5</sup>DOD FAR Supp. § 225.7002-2(m) (48 C.F.R. § 225.7002-2(m)).

<sup>6</sup>10 U.S.C.A. § 2533a(e); DOD FAR Supp. §§ 225.7002-2(n) and 252.225-7014(48 C.F.R. §§ 225.7002-2(n) and 252.225-7014).

<sup>6,50</sup>DOD FAR Supp. § 225.7002-2(e) (48 C.F.R. § 225.7002-2(e)).

<sup>7</sup>For example, in September 2004, Boeing agreed to pay the United States \$6 million and to furnish another \$1.4 million in spare aircraft parts to settle allegations that it had violated the False Claims Act by delivering aircraft to the Air Force and U.S. Navy that incorporated parts containing titanium (one of the designated “specialty metals”) melted in Russia. Press Release from the U.S. Attorney for the E.D. Missouri (Sept. 29, 2004). On June 1, 2006, DOD issued guidance allowing conditional acceptance of items that contain specialty metals that are not Berry Amendment compliant. The contracting officer is required to hold back the cost of the lowest auditable part that contains the noncompliant specialty metal and obtain a corrective action plan from the contractor. Memorandum from Under Secretary of Defense for Acquisition, Technology and Logistics re Berry Amendment Compliance for Specialty Metals (June 1, 2006).

two types. First, consideration of maintaining the defense industrial base has led to numerous special restrictions applicable to DOD procurements. Most of these originated in annual Defense Authorization or Appropriation Acts, although many have now been codified. Second, Congress frequently imposes Buy American type restrictions on what are essentially grant funds made available to states and some foreign governments. Each of these types of restrictions is discussed briefly below, identifying some of the products or programs covered.

The additional DOD restrictions are largely product specific and intended to protect a specific industry (and in some cases a particular company). Waivers are permitted under various circumstances, but are rare and for some restrictions require notification or certification to Congress of the circumstances justifying the waiver. Nonetheless, because the purpose of these restrictions is largely to protect the defense industrial base, Canadian sourced products are often exempt, and DOD has also waived application in some instances to products from the United Kingdom. What follows is an alphabetized list of the products, and in a few cases programs, currently identified in the applicable regulations. The grounds for waiver are generally found in DOD FAR Supp. § 225.7003,<sup>1</sup> but some products have specific criteria found in the cited implementing regulations.

- Anchor and mooring chain less than 4 inches in diameter.<sup>2</sup>
- Ball and roller bearings (except Canadian products; waived for UK products).<sup>3</sup>
- Buses (except Canadian products).<sup>4</sup>
- Carbon, alloy and armor steel plate for government-owned facilities (except Canadian products).<sup>5</sup>
- Chemical weapons antidotes (except Canadian products).<sup>6</sup>

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**[Section 9:18]**

<sup>1</sup>48 C.F.R. § 225.7003.

<sup>2</sup>10 U.S.C.A. § 2533(a)(3)(ii); DOD FAR Supp. § 225.7007 (48 C.F.R. § 225.7007).

<sup>3</sup>10 U.S.C.A. § 2533(a)(5); DOD FAR Supp. § 225.7009 (48 C.F.R. § 225.7009). The codified restriction is set to expire October 1, 2005 (see 10 U.S.C.A. § 2534(c)(3)), but annual appropriation acts continue to include a distinct restriction that may only be waived after certification to the Committees on Appropriation. See Pub. L. No. 108-87, § 8059, 117 Stat. 1085 (2003).

<sup>4</sup>10 U.S.C.A. § 2533(a)(1); DOD FAR Supp. § 225.7004 (48 C.F.R. § 225.7004).

<sup>5</sup>Pub. L. No. 108-87, § 8030, 117 Stat. 1079 (2003); 10 U.S.C.A. § 2533(a)(1); DOD FAR Supp. § 225.7004 (48 C.F.R. § 225.7004).

<sup>6</sup>10 U.S.C.A. § 2534(a)(2); DOD FAR Supp. § 225.7005 (48 C.F.R. § 225.7005).

- Forgings—ship propulsion shafts, periscope tubes and rings (> 120 inches in diameter) for bull gears.<sup>7</sup>
- Naval vessels—air circuit breakers (except Canadian products; waived for UK products).<sup>8</sup>
- Naval vessels—components uniquely for marine use including gyrocompasses, electronic navigation chart systems, steering controls, pumps, propulsion and machinery control systems, and totally enclosed lifeboats.<sup>9</sup>
- Naval vessels—construction, overhaul and repair.<sup>10</sup>
- Naval vessels—propellers (except Canadian products).<sup>11</sup>
- Polyacrylonitrile (PAN) carbon fibers.<sup>12</sup>
- Sonobuoys from certain countries.<sup>13</sup>
- Supercomputers.<sup>14</sup>

The restrictions on grant funds administered by DOD and other federal agencies reflect Congress' desire that U.S. companies and workers benefit from the government's largesse. Accordingly, many such programs have some Buy American restriction, although the applicable rules are usually much more rigid in insisting on solely

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<sup>7</sup>DOD FAR Supp. § 225.7102 (48 C.F.R. § 225.7102). This nonstatutory restriction may be waived at the Contracting Officer level. It does not apply to "qualifying country" sources (see discussion at § 9:11) when the quantities to be purchased exceed those necessary to maintain the defense mobilization base.

<sup>8</sup>10 U.S.C.A. § 2534(a)(3)(A)(i); DOD FAR Supp. § 225.7006 (48 C.F.R. § 225.7006).

<sup>9</sup>10 U.S.C.A. § 2534(a)(3)(B). The regulations have only implemented this restriction with respect to totally enclosed lifeboat survival systems from which Canadian products are exempted and application to the UK has been waived. DOD FAR Supp. § 225.7008-1(b) and 225.7008-3(b) (48 C.F.R. § 225.7008-1(b) and 225.7008-3(b)). A further restriction on totally enclosed lifeboat survival systems (and associated davits and winches)—form which Canadian products are not exempted—is mandated by the FY 1994 DOD Appropriation Act, Pub. L. 103-139. See DOD FAR Supp. § 225.7008-1(a) (48 C.F.R. § 225.7008-1(a)).

<sup>10</sup>10 U.S.C.A. § 7309 (known as the Burns-Tollefson Amendment); DOD FAR Supp. § 225.7013 (48 C.F.R. § 225.7013). This restriction includes a prohibition against award to a foreign shipyard of a contract to construct a vessel or a major component of the hull or superstructure of a vessel.

<sup>11</sup>DOD FAR Supp. § 225.7010 (48 C.F.R. § 225.7010). While the codified statutory authority for this provision expired February 10, 1998 (see 10 U.S.C.A. § 2534(c)(4)), Congress has subsequently included a similar restriction in annual appropriation acts. No such provision, however, was included in the most recent FY 2004 Defense Appropriation Act, Pub. L. No. 108-87, 117 Stat. 1054 (2003).

<sup>12</sup>DOD FAR Supp. § 225.7103 (48 C.F.R. § 225.7103). DOD intends to end this non-statutory restriction May 31, 2005.

<sup>13</sup>10 U.S.C.A. § 2534(e). DOD may not purchase sonobuoys manufactured in a country where U.S. manufacturers of sonobuoys are not permitted to compete on an equal basis.

<sup>14</sup>Pub. L. No. 108-87, § 8061, 117 Stat. 1086 (2003); DOD FAR Supp. § 225.7012 (48 C.F.R. § 225.7012).

U.S. content (even for components) than the BAA analysis discussed above (see § 9:7). Some of the major grant programs with Buy American restrictions are:

- Foreign Military Financing (FMF) Program. By policy, DOD requires that U.S. contractors providing defense articles or services to eligible foreign countries under this program identify all foreign content (including for components or material). It will only finance foreign content under a limited set of conditions.<sup>15</sup>
- U.S. Agency for International Development (US AID). In administering grants and contracts funded under the Foreign Assistance Act, US AID imposes rules that generally restrict the “source, origin and nationality” of goods and services to the United States and the recipient country.<sup>16</sup> In other words, generally the products must be purchased from a U.S. company (nationality), manufactured in the United States (origin), and shipped from the U.S. (source).
- Federal Aviation Funds. The Department of Transportation’s (DOT’s) Federal Aviation Administration (FAA) provides funding for airport improvement and other programs. Such funding is permitted “only if steel and manufactured goods used in the project are produced in the United States.”<sup>17</sup>
- Federal Highway Funds. Under the Surface Transportation Assistance Act of 1982, DOT’s Federal Highway Administration (FHWA) provides funds for the construction of highways. Federally-funded projects under that act must employ “steel, iron and manufactured products. . . [that] are produced in the United States.”<sup>18</sup> The FHWA requires that all manufacturing processes for steel or iron must occur in the United States (including post-production fabrication and processing).<sup>19</sup> It has used its waiver authority, however, to continue to exempt most manufactured products from this restriction, except those products manufactured predominately of steel or iron.<sup>20</sup>
- Federal Transit Funds. DOT’s Federal Transit Administration provides funding for various mass transit projects

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<sup>15</sup>There are no regulations governing the FMF program. The Defense Security Cooperation Agency, which has authority within DOD for administering the program, has published a set of “guidelines” which it enforces through a “Contractor’s Certification and Agreement with the Defense Security Cooperation Agency” that every contractor must sign. The guidelines and the certification are available from the agency at <http://www.dsca.mil>.

<sup>16</sup>22 U.S.C.A. § 2354; 22 C.F.R. Part 228.

<sup>17</sup>49 U.S.C.A. § 50101(a).

<sup>18</sup>Pub. L. No. 97-424, § 165(a), 96 Stat. 2136 to 2137 (1982).

<sup>19</sup>23 C.F.R. § 635.410(b).

<sup>20</sup>See 48 Fed. Reg. 53099 through 53104 (1983).

throughout the United States. By statute, such funds may only be used on projects where the “steel, iron and manufactured goods are produced in the United States.”<sup>21</sup> The steel and iron limitations apply to all construction material and require that, with limited exception, “all manufacturing processes” occur in the United States.<sup>22</sup> For “manufactured goods” to qualify, all manufacturing processes must occur in the United States and all components must be of U.S. origin.<sup>23</sup> A “component” is U.S. origin provided it is manufactured in the United States even if all subcomponents and material are foreign. Special rules apply to procurement of “rolling stock” (e.g., subway cars) which restrict use of foreign subcomponents.<sup>24</sup>

### § 9:19 Procurement from prohibited countries

#### Research References

West’s Key Number Digest, Commerce ◊75, 82.20

The United States maintains sanctions against various countries. Some of these are multilateral sanctions mandated by the United Nations, while others are unilateral restrictions that the United States has taken for foreign policy and national security reasons. The Office of Foreign Assets Controls (OFAC) within the U.S. Department of Treasury is primarily responsible for implementing the sanction programs.<sup>1</sup> These sanction regimes vary by country but frequently involve prohibitions with respect to financial transactions and/or restriction on purchase or importation of goods or services from the sanctioned country. The details of these sanction programs are beyond the scope of this chapter, but some of the broadest restrictions apply to transactions with Cuba,<sup>2</sup> North Korea,<sup>3</sup> Iran,<sup>4</sup> Libya,<sup>5</sup> Syria,<sup>6</sup> and Sudan.<sup>7</sup>

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<sup>21</sup>49 U.S.C.A. § 5323(j)(1).

<sup>22</sup>49 C.F.R. § 661.5(b) and (c).

<sup>23</sup>49 C.F.R. § 661.5(d).

<sup>24</sup>49 C.F.R. § 661.11.

#### [Section 9:19]

<sup>1</sup>See generally 31 C.F.R. Parts 500 to 597. A complete listing of the sanction programs and compliance guidance is available at the OFAC website: <http://www.treas.gov/offices/eotffc/ofac/>

<sup>2</sup>31 C.F.R. Part 515.

<sup>3</sup>On September 20, 2004, the President signed Executive Order 13357 which effectively lifted the sanctions on Libya. As such, on January 3, 2006, the FAR was revised to remove this designation. 69 Fed. Reg. 56665 (Sept. 22, 2004).

<sup>4</sup>31 C.F.R. Parts 535 and 560.

<sup>5</sup>31 C.F.R. Part 550. On February 26, 2004, OFAC provided a general license permitting U.S. persons to travel to Libya and engage in limited related

The FAR warns contractors and subcontractors that goods from various sanctioned countries may not lawfully be imported into the United States.<sup>8</sup> Accordingly, this regulation prohibits government contractors and their subcontractors from utilizing, in the performance of a government contract, supplies or services from sources originating from, or supplies that were located in, or were transported from or through certain prohibited countries. The list of these prohibited countries changes from time to time based on changes in United States foreign policy and the FAR refers contractors to OFAC for a list of countries and organizations subject to the sanctions.

### § 9:20 Restriction on contract performance outside the United States

#### Research References

West's Key Number Digest, United States ☞70

The BAA only applies to manufactured goods, agricultural products, or other material mined or grown which the federal government is procuring for use inside the United States. As the federal government has procured more and more services, and as political concerns have increased with the loss of service sector jobs abroad, Congress has contemplated limitations on the source of contract performance. Since 1992, Congress has required that firms submitting a bid or proposal or performing a DOD contract exceeding \$10 million must notify DOD of any intention of it or any of its first tier subcontractors to perform any part of the contract in excess of \$500,000 in value outside of the United States or Canada.<sup>1</sup> Various items such as petroleum products and commercial items are exempt from this notification requirement.

More recently, Congress has opened the door to restriction on the procurement of services to be performed outside the United States. In the FY 2004 Consolidated Appropriations Act, Congress prohibited, in the limited context of public-private competitions under OMB Circular A-76, award to contractors performing the services outside the United States, unless the United States had previ-

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transactions. 31 C.F.R. § 550.574. On April 23, 2004, the President further relaxed sanctions by permitting, under license, import from and export to Libya. See OFAC General License to be added to 31 C.F.R. § 550.575 and Bureau of Industry and Security regulations published at 69 Fed. Reg. 23626 (2004). Nonetheless, Libya remains designated as a country supporting terrorism.

<sup>6</sup>Exec. Order 13338, 69 FR 26751, 2004 WL 1062134.

<sup>7</sup>31 C.F.R. Part 538.

<sup>8</sup>FAR § 25.701 (48 C.F.R. § 25.701).

#### [Section 9:20]

<sup>1</sup>10 U.S.C.A. § 2410g.

ously performed those services outside the United States (e.g., services performed at overseas U.S. military bases).<sup>2</sup> It remains to be seen whether Congress will impose additional restrictions on contract performance outside the United States.

#### IV. ANTI-PROTECTIONIST MEASURES

##### § 9:21 International agreements opening U.S. government procurement

###### Research References

West's Key Number Digest, Commerce ☞4

As noted above, prior to 1979, countries remained free to restrict government procurement to local companies. These “buy national” restrictions were first addressed in 1979 under the old GATT regime and currently for certain specific countries that have signed the WTO's Agreement on Government Procurement (GPA) which became effective January 1, 1996. Since then, the United States, in particular, has negotiated various multilateral agreements that contain similar reciprocal concessions, such as the North American Free Trade Agreement (NAFTA) and the Dominican Republic-Central American Free Trade Agreement (DR-CAFTA). In addition, unsatisfied with the slow pace of further expansion of the WTO under the stalled Doha Round of negotiations, the United States continues to negotiate bilateral free trade agreements, e.g., with Singapore and Chile, that open government procurement by lowering the threshold at which the Buy American Act restrictions are waived for goods from those countries.

##### § 9:22 International agreements opening U.S. government procurement—The WTO agreement on government procurement

###### Research References

West's Key Number Digest, Commerce ☞4

The GPA establishes a framework of rights and obligations with respect to the laws, regulations, procedures, and practices applicable to government procurement by the countries that have acceded to the GPA's terms. The cornerstone of the GPA is non-discrimination. It incorporates both most-favored nation and national treatment obligations.<sup>1</sup> In order to ensure that the basic principle of non-discrimination is followed and that access to

<sup>2</sup>Pub. L. 108-199 Div. F § 647(e), 118 Stat. 362 (2004).

###### [Section 9:22]

<sup>1</sup>The GPA nonetheless permits parties to extend “special treatment” for goods and services from the least developed countries. GPA, Article V, ¶¶ 12-13.

procurement is available to foreign goods, services, and suppliers, the GPA prescribes procedures for providing transparency with respect to each signator government's laws, regulations, procedures, and practices regarding its procurement. The GPA provisions cover, inter alia, tendering procedures, qualification of suppliers, technical specifications, tender documentation, award of contracts, and bid challenge procedures.

Application of the GPA to a specific government procurement is determined by a series of factors. First, the governmental entity undertaking the procurement must have been listed by that government in its Appendix 1 (often divided into multiple annexes covering central, subcentral, and other quasi-governmental entities). Second, the procurement must be for the type of good or service set forth in that country's appendix. Third, the procurement must exceed the specified threshold that the government has made applicable for the type of procurement and particular agency.

In its Annex 1 to Appendix 1, the United States listed virtually all federal government agencies, including many that have recently been consolidated into the Department of Homeland Security. The United States' Annex 1 further lists the product categories that it has opened to foreign competition, which includes most commercial products such as computer equipment, software, furniture, and the like subject, however, to the general reservation contained in Article XXIII of the GPA. This reservation permits each party to the GPA to restrict procurement as necessary "for the protection of its essential security interests relating to the procurement of arms, ammunition or war materials, or to procurement indispensable for national security or national defence purposes." Thus, although the DOD is listed as an agency subject to the GPA, many of its procurements are in fact exempt, including all weapons and intelligence related programs. Similarly, the last sentence of this reservation was used by the United States to restrict procurements made in connection with its initial Iraq reconstruction contracts.

The United States agreed to a threshold of 130,000 Special Drawing Right units (SDRs)<sup>2</sup> for supplies and services and 5 million

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Under this authority, the United States has continued the special benefits it extends to certain countries under the Caribbean Basin Trade Initiative. See FAR § 25.404 (48 C.F.R. § 25.404).

<sup>2</sup>The SDR is an international reserve asset created by the International Monetary Fund (IMF). Valuation of the SDR is determined based upon a basket of currencies which the IMF reviews every five years to ensure that the currencies included are representative of those used in international transactions and that the weights assigned reflect their relative importance in the world's trading and financial systems. Following its five-year review for year 2000, the SDR basket continues to include the U.S. dollar, the Euro, the Japanese Yen, and the British

SDRs for construction of central government agencies.<sup>3</sup> Because the value of the SDR to the U.S. dollar fluctuates, by Executive Order,<sup>4</sup> the U.S. Trade Representative (USTR) determines, from time to time, the appropriate threshold for U.S. federal government procurement. Currently, the threshold is \$175,000 for supply and service contracts and \$6,725,000 for construction contracts.<sup>5</sup>

The United States has specifically reserved certain procurements. Thus, for example, in its notes to Annex 1, the United States makes clear that DOD procurements subject to the Berry Amendment<sup>6</sup> are not covered by its GPA commitments.<sup>7</sup> Moreover, the United States expressly excluded procurements that are set aside for a small or minority business<sup>8</sup> as well as grants and other forms of non-contractual financial assistance.<sup>9</sup> Unlike other signatories which generally use a “positive” list to identify the services covered by the GPA, the United States uses a negative list, excluding only those set forth in Appendix 1, including research and development as well as certain utility type services including telecommunications and automatic data processing (ADP).

If a contractor believes that a country such as the United States is not fulfilling its commitments under the GPA it has no direct recourse against the country involved. Rather, the WTO disputes process permits only the parties to bring complaints, and the remedy would be countervailing sanctions, not damages or a directed award. To date, only the United States has pursued such a formal complaint to a final decision. The United States unsuccessfully claimed that the Republic of Korea had violated its GPA commitments in connection with construction of the Incheon International Airport by requiring, *inter alia*, United States contractors to team with Korean companies.<sup>10</sup> Both the EU and Japan initiated claims against the United States based upon the State of Massachusetts unilateral sanctions against Burma (Myanmar), but did not pursue the case

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pound sterling. See IMF Completes Review of SDR Evaluation, press release no. 00/55 (IMF, Washington, DC, October 12, 2000).

<sup>3</sup>Different thresholds pertain for subcentral and other entities that the United States listed in its Appendix 1. See United States Appendix 1, Annexes 2 and 3.

<sup>4</sup>Exec. Order 12260 dated Dec. 31, 1980, § 1-104, 46 Fed. Reg. 1653 (1981).

<sup>5</sup>68 Fed. Reg. 70861 (2003). These thresholds have since been increased to \$193,000 for supply and service contracts and \$7,407,000 for construction contracts. 71 Fed. Reg. 9269 (Feb. 23, 2006) (interim rule); 71 Fed. Reg. 57375 (Sept. 28, 2006) (adopted as final without change).

<sup>6</sup>See discussion at § 9:17.

<sup>7</sup>United States Appendix 1, Annex 1.

<sup>8</sup>United States Appendix 1, Annex 1, General Note 1.

<sup>9</sup>United States Appendix 1, Annex 1, General Note 2.

<sup>10</sup>Korea—Measures Affecting Government Procurement, WT/DS163/R (May 1, 2000) (Doc. # 00-1679 obtainable from [www.wto.org](http://www.wto.org)). The panel did not address

once the state's action was successfully challenged and overturned by the U.S. Supreme Court.<sup>11</sup>

**§ 9:23 International agreements opening U.S. government procurement—North American Free Trade Agreement**

**Research References**

West's Key Number Digest, Commerce ◊4

Validity, Construction, and Application of North American Free Trade Agreement and Implementing Statutes and Regulations, 183 A.L.R. Fed. 1

In addition to the WTO's GPA, the United States has negotiated a number of bilateral and regional free trade agreements that include provisions opening government procurement between the parties. Most significant of these is the NAFTA between Canada, Mexico, and the United States. Chapter 10 of the NAFTA is similar to the GPA in that it commits the parties to most-favored nation and non-discrimination principles with respect to the "covered" procurements.<sup>1</sup> Furthermore, it mandates transparency with respect to tendering, specifications, and qualification of suppliers.<sup>2</sup> Each party also agreed to maintain bid challenge procedures.<sup>3</sup>

Like the GPA, the NAFTA specifies the agencies to which it is applicable at the central and subcentral levels. Each party also sets forth the general product and service groups that will be covered as well as the specific exclusions that will not be covered. Again, the United States has expressly listed those services that are not covered including all research and development as well as operation and maintenance of most government-owned research and other facilities.<sup>4</sup> With respect to supplies, the United States has excluded national defense related procurements as well as DOD

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the merits of the United States' claim because it accepted Korea's defense that the Incheon Airport procurement was not "covered" by the GPA.

<sup>11</sup>Crosby v. National Foreign Trade Council, 530 U.S. 363, 120 S. Ct. 2288, 147 L. Ed. 2d 352 (2000).

**[Section 9:23]**

<sup>1</sup>NAFTA Chapter 10, Article 1003.

<sup>2</sup>NAFTA Chapter 10, Articles 1007 to 1016.

<sup>3</sup>NAFTA Chapter 10, Article 1017.

<sup>4</sup>NAFTA Chapter 10, Annex 1001.1b-2, Section B, Schedule of the United States.

contracts subject to the Berry Amendment.<sup>5</sup> The United States also excludes procurements set aside for small business.<sup>6</sup>

Like the GPA, for the NAFTA to apply, the contract must exceed the specified threshold. Unlike the GPA, the NAFTA threshold is expressed in dollars (originally \$50,000) but subject to biennial inflation adjustment.<sup>7</sup> Currently, the general threshold is \$58,550 for supplies and services and \$7,611,532 for construction.<sup>8</sup> Because of a pre-existing agreement with Canada, however, the threshold is fixed at \$25,000 for supplies and services from Canada.<sup>9</sup>

### § 9:24 International agreements opening U.S. government procurement—Other free trade agreements

#### Research References

West's Key Number Digest, Commerce ⇌4

Other bilateral and regional Free Trade Agreements make similar concessions with respect to United States government procurement. One of the oldest is the Israeli Trade Agreement pursuant to which the United States exempted from the Buy American Act procurement by certain federal agencies (but not DOD, DOE or the Department of transportation) of Israeli products. This exemption applies to procurements of \$50,000 or more up to the threshold established under the GPA.<sup>1</sup>

The negotiation of such agreements has recently accelerated as the United States has become dissatisfied with the pace of the multilateral negotiations. In 2003, the United States concluded bilateral agreements with Singapore (also a signator to the GPA) and Chile, both of which agreements have been approved by Congress and implemented in the regulations.<sup>2</sup> Each of these agreements follows the same basic template as established under Chapter 10 of NAFTA. The agreement applies to those government entities listed, which for the United States includes most federal government agencies, including DOD. The United States has basically adopted the same exclusions as applicable to the GPA and NAFTA, although

<sup>5</sup>NAFTA Chapter 10, Annex 1001.1b-1 Schedule of the United States.

<sup>6</sup>NAFTA Chapter 10, Annex 1001.2b General Notes, United States Note 1.

<sup>7</sup>NAFTA Chapter 10, Annex 1001.1c, ¶ 1.

<sup>8</sup>FAR § 25.402(b) (48 C.F.R. § 25.402(b)).

<sup>9</sup>FAR § 25.402(b) (48 C.F.R. § 25.402(b)).

#### [Section 9:24]

<sup>1</sup>FAR § 25.406 (48 C.F.R. § 25.406).

<sup>2</sup>United States-Chile Free Trade Agreement Implementation Act, Pub. L. No. 108-77, 117 Stat. 909 (2003); United States-Singapore Free Trade Agreement Implementation Act, Pub. L. No. 108-78, 117 Stat. 948 (2003); 69 Fed. Reg. 1051 (2004).

the exclusion for telecommunications services for Singapore is different.<sup>3</sup> Like the NAFTA the thresholds are expressed in dollars (currently \$58,550 for supplies and services and \$6,725,000 for construction) subject to biennial inflation adjustment.

The United States has also entered into bilateral free trade agreements with Australia,<sup>4</sup> Morocco,<sup>5</sup> and a regional agreement known as the Central America Free Trade Agreement (CAFTA) with El Salvador, Honduras, and Nicaragua.<sup>6</sup> Other signatories to the CAFTA are Costa Rica, Dominican Republic, and Guatemala, however, the agreement has not yet taken effect for those countries. The CAFTA and Australian agreement adopt the same thresholds as the Singapore and Chile agreements, while the Morocco agreement adopts the WTO thresholds.

The United States continues its push to reach bilateral agreements with various countries. It has concluded, and Congress has implemented a free trade agreement with Morocco which essentially adopts the current thresholds under the GPA (\$175,000 for supplies and services and \$6,725,000 for construction) with adjustment based upon changes in the SDR.<sup>7</sup> On September 14, 2004, the United States executed a free trade agreement with Bahrain which, if implemented by Congress, would provide essentially the same benefits as the GPA with respect to the procurement of supplies and services, but construction is subject higher thresholds (\$7,611,532 as adjusted, but fixed at \$8,000,000 for Bahrain during the first two years of the agreement).<sup>8</sup> Negotiations continue with various countries such as Panama, and the Andean countries (Colombia, Peru, Ecuador and Bolivia).<sup>9</sup>

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<sup>3</sup>See FAR § 25.401(b)(3) (48 C.F.R. § 25.401(b)(3)).

<sup>4</sup>United States-Australia Free Trade Agreement Implementation Act, Pub. L. No. 108-286, 118 Stat. 919, 921 (2004); 70 Fed. Reg. 73152 (Dec. 9, 2005).

<sup>5</sup>United States-Morocco Free Trade Agreement Implementation Act, Pub. L. No. 108-302, 118 Stat. 1103, 1104 (2004); 71 Fed. Reg. 20306 (Apr. 19, 2006).

<sup>6</sup>US-Central American-Dominican Republic Free Trade Agreement Implementation Act, Pub. L. No. 109-53, 119 Stat. 462 (2003); 71 Fed. Reg. 36935 (June 28, 2006).

<sup>7</sup>United States-Morocco Free Trade Implementation Act, Pub. L. 108-302, 118 Stat. 302 (2004). Procurement is addressed in Chapter 9 and Annexes 9-A-1 through 9-G of the Agreement.

<sup>8</sup>The United States-Bahrain Free Trade Agreement text may be found at [http://www.ustr.gov/Trade\\_Agreements/Bilateral/Bahrain\\_FTA/final\\_texts/Section\\_Index.html](http://www.ustr.gov/Trade_Agreements/Bilateral/Bahrain_FTA/final_texts/Section_Index.html).

<sup>9</sup>Information on the status of these and other negotiations can be found at: [http://www.ustr.gov/Trade\\_Agreements/Bilateral/Section\\_Index.html](http://www.ustr.gov/Trade_Agreements/Bilateral/Section_Index.html). As of mid-2006, in addition to those listed above, the United States is pursuing free trade agreements with the Republic of Korea, Thailand, and Malaysia.

**§ 9:25 The Trade Agreements Act of 1979****Research References**

West's Key Number Digest, Commerce ⇌4

The Trade Agreements Act of 1979 (the TAA)<sup>1</sup> was originally enacted to implement the GATT Agreement on Government Procurement. The TAA authorized the President to designate foreign countries for which he waived protectionist measures regarding government procurement of eligible products.<sup>2</sup> The TAA has subsequently been amended to incorporate the WTO GPA as well as the NAFTA. As such, signatories of such countries have become known as “designated countries” for which Buy American restrictions are waived on procurements covered by the GPA and the NAFTA. In addition, the TAA provides authority to waive BAA restrictions on products from least-developed countries, which the President has done for Caribbean Basin countries, and certain African countries.<sup>3</sup> The TAA, however, expressly does not authorize the President to waive laws or regulations providing preferences to a small or minority business, which explains why this limitation is included in the U.S. accession to the GPA as well as in its bilateral and regional free trade agreements.<sup>4</sup>

Unlike the BAA, however, in enacting the TAA Congress expressly prohibited the purchase of products or services from non-designated countries in procurements covered by the Act (i.e. above the applicable thresholds).<sup>5</sup> The purpose was to encourage additional countries to provide reciprocal government procurement opportunities. Hence, for procurements subject to the TAA, the United States must buy on a non-discriminatory basis but only from among the products and services from the United States or “designated countries.”

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**[Section 9:25]**

<sup>1</sup>19 U.S.C.A. §§ 2501 to 2518.

<sup>2</sup>In Executive Order 12260, § 1-201 (Dec. 31, 1980), the President delegated this authority to the United States Trade Representative (USTR). The Office of the USTR is the agency within the Executive Office of the President that is charged with setting and administering overall trade policy. The USTR has principal authority for representing the United States at the WTO as well as negotiating the bilateral and regional free trade agreements discussed above.

<sup>3</sup>19 U.S.C.A. § 2511(b)(4); FAR § 25.003 (48 C.F.R. § 25.003).

<sup>4</sup>19 U.S.C.A. § 2511(f).

<sup>5</sup>19 U.S.C.A. § 2512(a). The prohibition may still be waived on a case-by-case basis if a non-signatory country has in place protections “equivalent to those in the Agreement” and “maintains and enforces effective prohibitions on bribery and other corrupt practices” or “when in the national interest” to do so or pursuant to a reciprocal procurement agreement with the Department of Defense. 19 U.S.C.A. § 2512(b).

FAR Subpart 25.4 implements the TAA. The regulations set forth the applicable thresholds—as determined by the USTR—for the GPA and other free trade agreement covered procurements.<sup>6</sup> One significant exception is that the TAA does not apply to the “acquisitions of arms, ammunition, or war materials, or purchases indispensable for national security or for national defense purposes.”<sup>6.50</sup> The regulations also specify those acquisitions that are exempt from the TAA (and other free trade agreements), including significantly which services are exempted from which of the growing list of free trade agreements.<sup>7</sup> Finally, the regulations make clear that for procurements covered by the GPA (but not for those covered by free trade agreements), the procurement is limited to U.S. origin products and services or those from a designated country.<sup>8</sup> Thus, products from such growing markets as China and India are ineligible.

Another significant difference between the TAA and the traditional Buy American analysis is the manner for determining the country of origin for a particular offered product. As discussed above, under the BAA, a component test is employed. The TAA adopts the traditional customs rule of origin:

An article is a product of a country or instrumentality only if (i) it is wholly the growth, product, or manufacture of that country or instrumentality, or (ii) in the case of an article which consists in whole or part of materials from another country or instrumentality, it has been substantially transformed into a new and different article of commerce with a name, character, or use distinct from that of the article or articles from which it was so transformed.<sup>9</sup>

This substantial transformation test looks to the country in which the product took its essential character and form. The oft espoused, but nonetheless vague, rule is that a “substantial transformation” occurs where the production processes are “complex and meaning-

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<sup>6</sup>FAR § 25.402(b) (48 C.F.R. § 25.402(b)) provides a matrix that identifies the current thresholds by agreement and by type of procurement (supply, service, or construction).

<sup>6.50</sup>See FAR § 25.401(a)(2). Accordingly, the General Service Administration (GSA) could not prohibit a potential contractor from offering under a GSA Schedule contract Vietnamese manufactured goods such as protective vests, holsters, and Kevlar gloves that are usable for both military and civilian law enforcement personnel. *Blackhawk Industries Products Group Unlimited, LLC. v. U.S. General Services Admin.*, 348 F. Supp. 2d 662 (E.D. Va. 2004).

<sup>7</sup>See FAR § 25.401 (48 C.F.R. § 25.401).

<sup>8</sup>Compare FAR §§ 25.403(c) and 25.405(b) and 25.406 (48 C.F.R. §§ 25.403(c) and 25.405(b) and 25.406).

<sup>9</sup>19 U.S.C.A. § 2518(4)(B).

ful,” but not where they are “minimal or simple.”<sup>10</sup> Companies seeking to move production facilities to such nondesignated country locations as China, India, and Malaysia have used these final determinations to verify that the final manufacturing steps that continue to occur in a designated country are sufficient to qualify as “substantial transformation.”<sup>10,50</sup>

Because of the uncertainty in application of this test when dealing with complex products and systems with components and materials from both designated and non-designated countries, the TAA requires the Bureau of Customs and Border Protection (Customs) to provide final and advisory country-of-origin determinations for products to be offered in government procurement subject to the TAA.<sup>11</sup> The procedures for seeking such final or advisory determinations is set forth in regulations published by Customs.<sup>12</sup> “Final” rulings represent a binding Customs decision, subject to judicial review by the request or any “party-at-interest” which includes domestic manufacturers of like products.<sup>13</sup> An advisory ruling simply provides non-binding, written information based on general principles of law and well-established legal interpretations regarding the particular country of origin.<sup>14</sup>

Bidders for contracts covered by the TAA must submit certified information regarding the sources of their products.<sup>15</sup> A bidder making a fraudulent misrepresentation in order to qualify for the waiver or to avoid a prohibition, “[i]n addition to any other provisions of law which may be applicable,” may be criminally liable under the

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<sup>10</sup>See, e.g., Customs Ruling Letter 560677 - Dell Laptops, 67 Fed. Reg. 59332, 59334 (2002).

<sup>10,50</sup>See, e.g., Customs Ruling Letter 563236 - Avaya, Inc., 70 Fed. Reg. 39779-85 (2005) (multi-line telephone sets assembled in Mexico from Malaysian, Chinese, and US parts and subassemblies); Customs Ruling Letter 563294 - Eastman Kodak Company, 70 Fed. Reg. 54563-66 (2005) (desktop scanners manufactured in United States from parts and subassemblies from China and other locations).

<sup>11</sup>19 U.S.C.A. 2515(b)(1). The TAA actually specifies that the Secretary of Treasury is responsible for these determinations, but this responsibility has been delegated to Customs which is now part of the Department of Homeland Security.

<sup>12</sup>19 C.F.R. §§ 177.21 to 177.31.

<sup>13</sup>19 C.F.R. § 177.22(c) and (d).

<sup>14</sup>19 C.F.R. § 177.22(b).

<sup>15</sup>See FAR §§ 52.225-1, 52.225-6 (48 C.F.R. §§ 52.225-1, 52.225-6). To alleviate some of the confusion surrounding reliance on blank or incomplete BAA/BBOP certificates (see Designware, Inc., 86-1 CPD ¶ 181, B-221423, 1986 WL 63206 (Comp. Gen. 1986); Spectrum Leasing Corporation, 86-2 CPD ¶ 56, B-218323, B-218323.3, B-218785, B-218785.2, 1986 WL 63708 (Comp. Gen. 1986)), the General Services Administration (GSA) and Department of Defense (DOD) published a notice stipulating that “[f]irms which are competing for Government contracts must list all foreign end products on the certificate[.]” 51 Fed. Reg. 32944 (1986).

False Statements Act, 18 U.S.C.A. § 1001.<sup>16</sup> Offering or selling products from nondesignated countries under TAA-covered contracts—such as virtual all GSA Schedule contracts—may also result in treble damages and penalties under the civil False Claims Act.<sup>17</sup>

## V. RESTRICTIONS ON ACCESS TO CLASSIFIED INFORMATION

### § 9:26 Introduction

#### Research References

West's Key Number Digest, United States ⇨70(6); War and National Emergency ⇨48.1

Performance of United States government contracts involving the national defense, intelligence activities, or nuclear weapons production or nuclear power generation frequently requires access to information that has been “classified” by the United States to limit its releasability or dissemination even to U.S. citizens.<sup>1</sup> Where the U.S. contractor is foreign-owned or where non-U.S. citizens are part of the senior management team or work at the facility involved in contract performance, an elaborate regulatory scheme establishes the “mitigation” steps that must be taken to ensure that the classified information remains protected. Accordingly, foreign investors in businesses engaged in these areas must understand the limitations these regulations place on their control and management of the investment.

### § 9:27 National Industrial Security Program

#### Research References

West's Key Number Digest, United States ⇨70(6); War and National Emergency ⇨48.1

<sup>16</sup>19 U.S.C.A. § 2515(b)(2).

<sup>17</sup>See, e.g. *United States ex rel. Safina Office Products v. Office Depot, Civ. No. 1:03cv0003 (D.D.C.)*. In this case, a company brought a qui tam case under the False Claims Act alleging a number of competing office supply contractors were offering under a GSA Schedule contract office supplies from such nondesignated countries as Thailand, Taiwan, and China. Among the companies settling these allegations are: (a) OfficeMax, Inc. (\$9.8 million settlement); (b) Office Depot (\$4.75 million settlement); and (c) Staples (\$7.4 million settlement). From these settlement amounts, Safina (and the other relators bringing the lawsuit on the U.S.'s behalf) received more than \$3.29 million.

#### [Section 9:26]

<sup>1</sup>The President authorizes the classification of information pursuant to his constitutional authority as well as pursuant to specific Congressional grants of authority contained in such statutes as the Atomic Energy Act of 1954, as amended, and the National Security Act of 1947, as amended. The classification of “national security information” is currently governed by Exec. Order 13292 dated March 25, 2003, 68 Fed. Reg. 15313 (2003).

The National Industrial Security Program (NISP) was established by Executive Order 12829, dated January 6, 1993, for the purpose of establishing “a single, integrated, cohesive industrial security program to protect classified information and to preserve [United States] economic and technological interests.”<sup>1</sup> The President gave the Information Security Oversight Office (ISOO) overall responsibility for implementing and monitoring the NISP, while designating DOD as the “Executive Agent” for determining eligibility for access to classified information by contractors and their employees.<sup>2</sup> The major goal of the NISP was to achieve uniformity in security policies and procedures across the various federal agencies possessing classified information as well as eliminating duplicative or unnecessary requirements. Previously, each agency had authority for its own classification procedures.

The Executive Order also vested in DOD authority for preparing the National Industrial Security Program Operating Manual (NISPOM).<sup>3</sup> This manual establishes uniform procedures for the release of classified information to industry, including obtaining and maintaining appropriate clearances. It provides guidance on the applicable safeguards industry must establish and maintain to protect classified information entrusted to it. Cognizance over what information is to be classified remains the principal responsibility of the “cognizant security agencies” (“CSA”) which include DOD, the Central Intelligence Agency, DOE, and the Nuclear Regulatory Commission.

The NISPOM is applicable to all government contractors that perform contracts which require in their performance access to classified information by the contractor or its employees. Any contract performance of which may involve access to classified information must contain a clause requiring the contractor to execute a security agreement and commit to following the procedures set forth in the NISPOM.<sup>4</sup> Similarly, subcontractors under federal government prime contracts that require access to classified information are also bound by the NISPOM.

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**[Section 9:27]**

<sup>1</sup>Exec. Order 12829, 58 Fed. Reg. 3478 (1993).

<sup>2</sup>Exec. Order 12829, 58 Fed. Reg. 3878 (1993), §§ 102 and 202.

<sup>3</sup>The NISPOM was first published in January 1995 and replaced implementing policies at various agencies such as DOD’s Industrial Security Manual. The NISPOM was amended and republished on February 28, 2006. DOD, however, has not revoked or amended its Industrial Security Regulation (ISR), DOD 5220.22-R (Dec. 4, 1985), which establishes the internal requirements for DOD’s industrial security program.

<sup>4</sup>FAR §§ 4.404(a) and 52.204-2 (48 C.F.R. §§ 4.404(a) and 52.204-2).

**§ 9:28 Obtaining and performing classified contracts****Research References**

West's Key Number Digest, United States ⇨70(6); War and National Emergency ⇨48.1

Central to the National Industrial Security Program (NISP) scheme is the provision that no classified information may be disclosed to any contractor unless the contractor's facility<sup>1</sup> has been granted a facility security clearance at a level appropriate for the particular classified information to be accessed or possessed.<sup>2</sup> A facility clearance represents an administrative determination that the facility is eligible for access to classified information or award of a classified contract.<sup>3</sup> Facility security clearances are issued by the CSA and are available only to facilities that are located in the United States or its possessions.<sup>4</sup> Moreover, to qualify for a facility clearance, the contractor must be organized and existing under the laws of one of the 50 states, the District of Columbia, or Puerto Rico.<sup>5</sup>

A subsidiary organization generally may not obtain a facility clearance unless its parent also obtains a facility clearance of at least the same level.<sup>6</sup> As a result, a foreign parent corporation cannot obtain a facility clearance for its contracting activity merely by acting through an American subsidiary. To qualify for a facility clearance, steps must be taken to insulate that subsidiary's facility from foreign ownership, control, or influence (FOCI).

**§ 9:29 Obtaining and performing classified contracts—  
Foreign ownership, control, or influence****Research References**

West's Key Number Digest, Corporations ⇨632

The NISP concept of “foreign ownership, control, or influence”

**[Section 9:28]**

<sup>1</sup>NISPOM Appendix C defines facility as:

[a] plant, laboratory, office, college, university or commercial structure with associated warehouses, storage areas, utilities and components, which, when related by function and location, form an operating entity. (A business or educational organization may consist of one or more facilities as defined herein.) For purposes of industrial security, the term does not include Government installations.

<sup>2</sup>NISPOM § 2-100.

<sup>3</sup>NISPOM § 2-100.

<sup>4</sup>NISPOM §§ 2-102 and 2-103.

<sup>5</sup>NISPOM § 2-102.

<sup>6</sup>NISPOM § 2-109.

(FOCI) presents the largest obstacle to participation by foreign companies in classified United States government contracts or even day-to-day management of investments, only a portion of which may be devoted to classified work. The general rule is that a facility found to be under FOCI is ineligible for a facility clearance.<sup>1</sup> Nonetheless, recognizing that “[f]oreign investment can play an important role in maintaining the viability of the U.S. industrial base,” the NISP permits facility clearances where the FOCI can be adequately mitigated.<sup>2</sup>

The determination of whether a domestic organization is subject to FOCI is made on a case-by-case basis. In general, FOCI exists “whenever a foreign interest has the power, direct or indirect, whether or not exercised, and whether or not exercisable, through ownership. . . , by contractual arrangements or other means, to direct or decide matters affecting management or operations of that company in a manner which may result in unauthorized access to classified information or may affect adversely the performance of classified contracts.”<sup>3</sup> In evaluating FOCI, the Department of Defense will consider the company, the foreign interest (i.e., its parent), and the government of the foreign interest. It reviews such factors as: (a) the record of economic espionage against U.S. targets; (b) the record of enforcement and/or engagement in unauthorized technology transfers (i.e., export control violations); (c) the nature and sensitivity of the information to be accessed; (d) the extent of foreign government ownership or control; and (e) any foreign ownership interest greater than 5% ownership or 10% of voting interests.<sup>4</sup> In evaluating foreign ownership or control, DOD evaluates numerous economic and personnel issues, like whether a significant amount of the company’s income is derived from foreign sources; whether foreign persons can control or influence the company’s policies and procedures; and whether there is significant indebtedness to foreign sources.<sup>4,50</sup>

The NISP provides a number of different methods for mitigating FOCI concerns depending on the extent and character of the FOCI. First, the United States can grant a facility clearance when the facility is under the FOCI of a company from a country with which the United States has a reciprocal industrial security agreement and the foreign government issues a security assurance for the firm

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**[Section 9:29]**

<sup>1</sup>NISPOM §§ 2-102.d

<sup>2</sup>NISPOM § 2-300.

<sup>3</sup>NISPOM § 2-300.a.

<sup>4</sup>NISPOM § 2-301.

<sup>4,50</sup>This information is among the information required to be submitted under the Standard Form 328 *Certificate Pertaining to Foreign Interests* (July 2004).

in question.<sup>5</sup> Access to classified information under these circumstances is often limited and must conform to limitations set forth in the U.S. National Disclosure Policy.<sup>6</sup>

Second, a facility under FOCI may be effectively insulated from the foreign interest by means of a voting trust agreement or proxy agreement. Under such an arrangement, legal title in the foreign interest's stock is transferred to trustees or proxy holders who are United States citizens, completely disinterested, and who possess personnel security clearances permitting access to the classified information. The trustees or proxy holders must be given "all prerogatives of ownership" and must exercise them "in such a way as to ensure that the foreign stockholders [with certain exceptions] shall be insulated from the cleared company."<sup>7</sup> The foreign beneficiaries may only retain authority over such significant corporate transactions, inter alia, as mergers, sale, or disposal of a substantial portion of assets or filing of bankruptcy.

Third, but perhaps most common,<sup>8</sup> FOCI may be effectively mitigated by a special security agreement (SSA) or security control agreement (SCA) among the United States firm, the foreign interest, and the DOD.<sup>9</sup> The principal difference between the SSA or SCA and the voting trust or proxy arrangement discussed above is that the foreign parent or investor is permitted involvement—through the Board of Directors—in the management of the cleared company.<sup>10</sup> Such foreign directors are excluded, however, from access to, or involvement in, any classified contracts. Furthermore, under the Defense Security Service's standard template for SSAs and SCAs, the access restrictions are extended beyond classified information to "controlled unclassified information."<sup>11</sup> A foreign-owned or controlled company cleared under an SSA may only be cleared to the level of Secret, and generally may not have access to more sensitive classified information such as COMSEC or specially compartmented information unless the agency issues a National Interest Determination (NID). Such NIDs may be issued for an entire program, project or just for an individual contract.<sup>12</sup> An SCA does not entail the same information access limitations, but is only avail-

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<sup>5</sup>NISPOM § 2-309.

<sup>6</sup>NISPOM § 2-309.a.(2).

<sup>7</sup>NISPOM § 2-303.b.

<sup>8</sup>See GAO Report 96-64 "Defense Industrial Security—Weaknesses in U.S. Security Arrangements with Foreign-Owned Defense Contractors," Feb. 20, 1996.

<sup>9</sup>NISPOM § 2-303.c.

<sup>10</sup>NISPOM § 2-303.c.

<sup>11</sup>"Controlled unclassified information" is essentially unclassified technology or technical data that is nonetheless controlled under any of the various export control regimes discussed at §§ 9:31 to 9:35.

<sup>12</sup>NISPOM § 2-303.c(2)(a).

able where the FOCI concern is limited to “influence” and the company is “not effectively owned or controlled by a foreign person.”<sup>13</sup>

Finally, where the foreign person’s ownership interest does not include a right to representation on the Board of Directors, the FOCI may normally be adequately mitigated by a Board Resolution effectively excluding the foreign shareholder from access to classified or controlled unclassified information or any position that might allow influence over the performance of classified work.

### **§ 9:30 Obtaining and performing classified contracts— Foreign officers and directors**

#### **Research References**

West’s Key Number Digest, Corporations ¶632

Personnel security clearances are generally available only for employees of companies with facility clearances. At the same time, for a facility clearance to be granted, the senior management official at the facility as well as those who occupy positions that would “enable the person to adversely affect the organization’s policies and practices in the performance of classified contracts” must always be cleared to the level of the facility clearance.<sup>1</sup> Furthermore, as a general rule, only U.S. citizens are eligible for security clearances.<sup>2</sup>

Non-U.S. citizen company personnel that do not occupy positions in which they might affect performance of classified contracts may be excluded by Board resolution. Such a resolution must bar such individuals from access to classified information as well as from positions from which they might influence performance of classified contracts.<sup>3</sup>

In some instances, even U.S. citizens may be denied personnel security clearances, even though there is otherwise no question concerning their honesty or integrity. Representatives of foreign interest (RFI) are defined as a citizen or national of the United States who is acting as or representing a “foreign interest,” a term which includes foreign nationals or businesses incorporated under

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<sup>13</sup>NISPOM §§ 2-303.c(1).

#### **[Section 9:30]**

<sup>1</sup>NISPOM §§ 2-104 and 2-106.a.

<sup>2</sup>NISPOM § 2-209. A limited exception is available where “compelling reasons” exist to grant access to an immigrant alien or foreign national. Usually, such a person must have unique, urgently needed skills, and even then the level of classified information that may be disclosed to such individuals is limited. NISPOM §§ 2-209 and 2-210.

<sup>3</sup>NISPOM § 2-106.a.

laws other than the United States and its territories.<sup>4</sup> While not automatically disqualifying, the RFI must explain in detail the connection with the foreign interest. As a practical matter, since 2001, the United States has become increasingly stringent and has even denied security clearances to dual citizens, particularly when they have other foreign ties.<sup>5</sup>

## VI. RESTRICTIONS ON ACCESS TO CONTROLLED UNCLASSIFIED TECHNOLOGY

### § 9:31 Introduction

#### Research References

West's Key Number Digest, Commerce ☞3, 4, 75; War and National Emergency ☞18

United States law and regulation controls foreign person access to information and technology even beyond strictly classified information. Moreover, violation of these export control restrictions may result in substantial civil or even criminal liability. Accordingly, foreign investors must be aware of these various control regimes which may have a significant impact on the information to which they may need access as well as the manner and extent to which they may integrate U.S. and foreign operations.

There are a number of regulatory regimes that control unclassified U.S. technology and data. Some, like information concerning nuclear reactors, are very specific, but two have fairly broad application. First, the Arms Export Control Act<sup>1</sup> and the associated International Traffic in Arms Regulation (ITAR)<sup>2</sup> control the export of defense articles and services and associated technical data that has potential military applications. Second, the Export Administration Regulations (EAR)<sup>3</sup> controls the export of dual use technical data. The ITAR is administered by the Directorate of Defense Trade Controls (DDTC) within the U.S. Department of State. The EAR is administered by the Bureau of Industry and Security (BIS) within the U.S. Department of Commerce.

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<sup>4</sup>NISPOM Appendix C, Definition of "Foreign Interest."

<sup>5</sup>See 32 C.F.R. Part 154, Appendix H *Adjudication Policy*, as amended by an interim final rule published August 30, 2006. 71 Fed. Reg. 51474 (2006). Appendix H sets forth criteria (disqualifying and mitigating) for determining eligibility for personal security clearances.

#### [Section 9:31]

<sup>1</sup>22 U.S.C.A. §§ 2751 to 2799aa-2.

<sup>2</sup>22 C.F.R. Parts 120 to 130.

<sup>3</sup>15 C.F.R. Parts 730 to 774.

## § 9:32 The International Traffic in Arms Regulations

### Research References

West's Key Number Digest, Commerce ☞3, 4, 75; War and National Emergency ☞18; Weapons ☞17

Section 38 of the Arms Export Control Act<sup>1</sup> grants broad powers to the President to control the export of defense articles, services, and related technical data. Pursuant to this grant of authority, the DDTC has promulgated the International Traffic in Arms Regulations (ITAR). The regulations contain the “Munitions List” which identifies the defense articles and technical data that are subject to control under the ITAR. Despite its name, the Munitions List does not itemize the specific products that the President (through DDTC) has concluded are “defense articles,” but rather describes 20 broad categories of military related products, e.g., military electronics (Category XI) and spacecraft systems (Category XV).<sup>2</sup> Components, parts, and technical data associated with such products are also generally controlled. Furthermore, the Munitions List includes articles not necessarily captured by the identified categories, but which nonetheless have a “substantial military applicability” and which have been “specifically designed or modified for military purposes.”<sup>3</sup>

DDTC applies a functional test for determining whether a particular article or service should be included on the Munitions List. This test considers whether a particular article or service:

- (a) is specifically designed, developed, configured, adopted, or modified for a military application, and;
  - (i) does not have predominant civil applications, and;
  - (ii) does not have performance equivalent (defined by form, fit and function) to those of an article or service used for civil applications; or
- (b) is specifically designed, developed, configured, adapted or modified for a military application, and has significant military or intelligence applicability such that control under this subchapter is necessary.<sup>4</sup>

The actual intended use of the article or service by the export recipient is irrelevant in determining whether it is subject to control

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#### [Section 9:32]

<sup>1</sup>22 U.S.C.A. § 2778.

<sup>2</sup>22 C.F.R. § 121.1.

<sup>3</sup>22 C.F.R. § 121.1. Category XXI.

<sup>4</sup>22 C.F.R. § 120.3.

as a defense article or service.<sup>5</sup> Rather, the DDTC focuses on the nature, characteristics and capabilities of the article or service in determining to exercise jurisdiction over the commodity.<sup>6</sup> By statute, the President's determination (through DDTC) to include an article on the Munitions List is not judicially reviewable.<sup>7</sup>

All U.S. manufacturers or exporters of defense articles and all providers of defense services must register with DDTC.<sup>8</sup> The registration does not itself confer any benefit or provide export authorization, but is merely a prerequisite to obtaining a license or other approval to engage in controlled export activities.<sup>9</sup> Only companies incorporated in the United States may register and they must reveal whether they are owned or controlled by a "foreign person." For these purposes, "control" means that more than 50% of the voting securities are held by one or more foreign persons while a presumption of control arises when 25% of the voting securities are held by foreign persons and no U.S. person holds an equal or larger percentage.<sup>10</sup> For already registered companies, the ITAR requires a 60 day advance notification "of any intended sale or transfer to a foreign person of ownership or control. . . ."<sup>11</sup>

Compliance with the ITAR requires serious and considered attention. Violation of the ITAR can result in substantial civil penalties, and where the violation is "willful," criminal penalties.<sup>12</sup> A company convicted of violating the ITAR (and certain other designated statutes) is subject to mandatory debarment from exporting,<sup>13</sup> and civil violations may result in suspension or debarment of export privileges.<sup>14</sup> An individual or entity may attempt to mitigate any such penalty by voluntarily disclosing any such violations to DDTC's Office of Defense Trade Controls Compliance.<sup>15</sup> The ITAR provides for an administrative proceeding in front of an administrative law judge prior to the imposition of civil penalties or debarment,<sup>16</sup> although given DDTC's significant discretion in issuing licenses, no company has pursued such a challenge to conclusion.

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<sup>5</sup>22 C.F.R. § 120.3.

<sup>6</sup>22 C.F.R. §§ 120.3 and 120.4.

<sup>7</sup>22 U.S.C.A. § 2778(h).

<sup>8</sup>22 C.F.R. § 122.1.

<sup>9</sup>22 C.F.R. § 122.1(c).

<sup>10</sup>22 C.F.R. § 122.2(c).

<sup>11</sup>22 C.F.R. § 122.4(b).

<sup>12</sup>22 U.S.C.A. § 2778(c) and (e).

<sup>13</sup>22 U.S.C.A. § 2778(g)(4).

<sup>14</sup>22 C.F.R. § 127.7.

<sup>15</sup>22 C.F.R. § 127.12

<sup>16</sup>22 C.F.R. Part 128.

### § 9:33 The International Traffic in Arms Regulation—ITAR controlled technology and technical data

#### Research References

West's Key Number Digest, Commerce ⇌3, 4, 75

The ITAR controls the export of defense articles, defense services, and related technical data. For foreign investors—and even many domestic companies—the breadth of these terms, and accordingly the controls that the ITAR imposes, is surprising. First, the concept of export encompasses transfers—whether of technical data or defense services—to any foreign person regardless of where the transfer occurs.<sup>1</sup> In other words, disclosing controlled technical data to a foreign person is an export even if it occurs in a facility within the United States. A foreign person is anyone who is neither a U.S. citizen nor an alien admitted for lawful permanent residency.<sup>2</sup> Accordingly, a domestic subsidiary of a foreign investor may need express export authorization to release certain controlled technical information to its foreign parent.

Apart from the actual items that fall within the Munitions List, the ITAR controls export of certain kinds of information; that which is defined as “technical data” and that which is provided in the context of performing a “defense service.” Technical data is basically:

Information, other than software. . . which is required for the design, development, production, manufacture, assembly, operation, repair, testing, maintenance or modification of defense articles. This includes information in the form of blueprints, drawings, photographs, plans, instructions and documentation.<sup>3</sup>

Although the word “required” might be construed to limit the reach of what is “technical data,” DDTC generally considers any information that relates to the development, design, manufacture, etc., of a defense article to be controlled technical data.

There are, however, some express exclusions from the definition of technical data. Some of the principal exclusions are: “basic marketing information” and “information in the public domain.”<sup>4</sup>

Basic marketing information is limited to top level information on function or purpose or general system descriptions of defense

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#### [Section 9:33]

<sup>1</sup>22 C.F.R. § 120.17(4) and (5).

<sup>2</sup>22 C.F.R. § 120.16. Accordingly, U.S. green card holders qualify as U.S. persons, but foreign nationals admitted under any of the various temporary work visas remain “foreign persons” for purposes of these regulations.

<sup>3</sup>22 C.F.R. § 120.10. Also controlled as technical data is classified information and information subject to an invention secrecy order.

<sup>4</sup>22 C.F.R. §§ 120.10 and 120.11.

articles such as one might find in a published brochure. The ITAR provides an extensive list of the kinds of information that is deemed to be in the public domain;<sup>5</sup> e.g., information in public libraries, but questions will often arise as to whether the precise information that the domestic U.S. company would like to release can be found in the public domain.

Further complicating release considerations is the ITAR's concept of defense service. A defense service is generally the "furnishing of assistance (including training) to foreign persons, whether in the United States or abroad" in connection with design, manufacture, repair, use, etc., of a defense article.<sup>6</sup> The regulations suggest, however, that a defense service can occur even if "all the information relied upon by the U.S. person in performing the defense service is in the public domain or is otherwise exempt from the licensing requirements. . . ."<sup>7</sup> In other words, communications between a domestic U.S. subsidiary and its foreign parent may constitute a defense service even though no controlled technical data is released. Moreover, DDTC has asserted the position that even where the technology is actually coming from the foreign party to the U.S. person, questions about the technology from the U.S. person may educate the foreign person and thus constitute a defense service.

Generally, the export of technical data or performance of a defense service requires a license or other approval from DDTC. For technical data, the general requirement is for a permanent export license (Form DSP-5).<sup>8</sup> For defense services, this requires DDTC approval of a technical assistance agreement or manufacturing license agreement unless some exemption exists.<sup>9</sup> There are, however, very few exemptions available for defense services. There are a number of exemptions available to export technical data, including the return of technical data to its original source.<sup>10</sup> In addition, DDTC recently added a special comprehensive license available in connection with potential acquisitions, mergers, teaming arrangements, and joint ventures that permits U.S. companies to release "a broadly defined set of technical data to qualifying well established foreign defense firms in NATO countries, Australia, Japan or Sweden" to facilitate consideration of the proposed transaction.<sup>11</sup>

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<sup>5</sup>22 C.F.R. § 120.11.

<sup>6</sup>22 C.F.R. § 120.9.

<sup>7</sup>22 C.F.R. § 124.1(a).

<sup>8</sup>22 C.F.R. § 125.2.

<sup>9</sup>22 C.F.R. Part 124.

<sup>10</sup>See generally 22 C.F.R. § 125.4(b).

<sup>11</sup>22 C.F.R. § 126.14(a)(4).

**§ 9:34 The International Traffic in Arms Regulations—ITAR brokering regulation****Research References**

West's Key Number Digest, Commerce ◊3, 4, 75

Another concern for foreign investors are the ITAR brokering regulations.<sup>1</sup> Unlike the export controls—which apply only to U.S. defense articles and services—the brokering rules apply to transactions involving any defense article or service, regardless of the country of origin. Under the rules, any person who engages in brokering activities must register with DDTC.<sup>2</sup> This registration includes “a foreign person located in the United States or otherwise subject to the jurisdiction of the United States.<sup>3</sup> Brokering activities is broadly defined to include virtually any activity that facilitates a transaction involving defense articles or services, including financing, transporting, and more traditional brokering activities such as acting as an agent.<sup>4</sup> No person may engage in brokering activities without prior notification or prior approval as required under the regulations.<sup>5</sup>

Accordingly, a number of transactions between a domestic U.S. subsidiary and its foreign parent may implicate the brokering regulations. If the U.S. subsidiary assists its foreign parent's efforts to sell the parent's defense articles or services, it may well be brokering. Since brokering is precluded for certain embargoed countries,<sup>6</sup> the domestic U.S. subsidiary may actually be precluded from participating. Conversely, if the foreign parent has a presence in the United States sufficient to make it subject to U.S. jurisdiction, it may need to register as a broker if it assists the U.S. subsidiary's sales efforts. DDTC has suggested that a foreign person's (such as an affiliated company's) assistance in the sale or export of U.S.-origin defense articles or services is alone sufficient to make such foreign person subject to U.S. jurisdiction for the purpose of requiring registration as a broker and being subject to the brokering notification and approval regulations.<sup>7</sup>

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**[Section 9:34]**

<sup>1</sup>22 C.F.R. Part 129.

<sup>2</sup>22 C.F.R. § 129.3.

<sup>3</sup>22 C.F.R. § 129.3.

<sup>4</sup>22 C.F.R. § 129.2(b).

<sup>5</sup>22 C.F.R. §§ 129.7 and 129.8.

<sup>6</sup>22 C.F.R. § 129.5.

<sup>7</sup>The United States sought to preserve this position in *U.S. v. Yakou*, 428 F.3d 241 (D.C. Cir. 2005) where on a motion to clarify the original opinion the court added language making clear that the United States had not argued Yakou

## § 9:35 The Export Administration Regulations

### Research References

West's Key Number Digest, Commerce ¶¶3, 4, 75, 80.10, 82.6  
Construction and Application of s 201 of Terrorism Risk Insurance Act of 2002, Public Law 107-297, sec. 201, 116 Stat. 2337, 190 A.L.R. Fed. 155

The Export Administration Act (EAA)<sup>1</sup> authorized the President to restrict exports of dual use items, including associated technology and technical data on the grounds of national security, foreign policy, or domestic short supply. Pursuant to that statute, the Department of Commerce, Bureau of Industry and Security (BIS) promulgated the Export Administration Regulations (EAR).<sup>2</sup> As with the International Traffic in Arms Regulations (ITAR), violations of the EAR can result in criminal or civil penalties. In fact, penalties under the EAR can arise where an action is taken with the intent to evade a requirement of the EAR.<sup>3</sup> Criminal sanctions may include fines of up to five times the value of the exports, or \$50,000, whichever is greater, and/or up to five years in prison.<sup>4</sup> Under the EAA, criminal sanctions may include fines of up to five times the value of the exports, or \$50,000, whichever is greater, and/or up to five years in prison.<sup>5</sup> The EAA criminal sanctions, when in effect, are significantly increased for willful violations or where the exporter has knowledge that items will unlawfully be used for military or intelligence gathering purposes.<sup>6</sup> Civil penalties, under the EAA, are generally \$10,000 per violation (\$100,000

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was "otherwise subject to U.S. jurisdiction." The court upheld the dismissal of an indictment of Yakou for violating the brokering regulations in connection with obtaining naval patrol boats for Iraq because Yakou had abandoned his lawful permanent resident status in the United States before the activities in question. The boats at issue were from Malaysia and not U.S. defense articles.

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<sup>1</sup>50 U.S.C.A. App §§ 2401 to 2420. The Export Administration Act (EAA) expired on August 20, 1994. Except for a brief period during which the EAA was reauthorized (see, Pub. L. No. 106-508 (2000)), the President's authority under that Act has since been extended Executive Order pursuant to the International Emergency Economic Powers Act, 50 U.S.C.A. §§ 1701 to 1706. See, e.g., Exec. Order 13222, 66 Fed. Reg. 44025 (2001) most recently renewed for another year on August 7, 2003, 68 Fed. Reg. 47833 (2003).

<sup>2</sup>15 C.F.R. Parts 730 to 774.

<sup>3</sup>15 C.F.R. § 764.2.

<sup>4</sup>15 C.F.R. § 764.3(b)(1).

<sup>5</sup>15 C.F.R. § 764.3(b)(1). During periods when the EAA is not in effect, courts look to the penalties provided under International Emergency Economic Powers Act (IEEPA) which provide for a \$50,000 fine, but as of March 9, 2006, provide for prison terms up to 20 years. 50 U.S.C.A. § 1705, as amended by Section 402 of the USA PATRIOT Act Improvement and Reauthorization Act of 2005, Pub. L. 109-177, 120 Stat. 243 (2006).

<sup>6</sup>15 C.F.R. § 764.3(b)(2).

if the violation involves national security controlled items) and suspension or debarment of export privileges.<sup>7</sup>

The structure of the EAR is very different from the ITAR. Essentially, the Commerce Control List (CCL) divides the universe of possible dual use items and technologies into ten categories identified by a single digit numeral:

- 0 - Nuclear materials, facilities & equipment, and Miscellaneous
- 1 - Materials, Chemicals, Microorganisms and Toxins
- 2 - Materials Processing
- 3 - Electronics
- 4 - Computers
- 5 - Telecommunications & Information Security
- 6 - Lasers & Sensors
- 7 - Navigation & Avionics
- 8 - Marine
- 9 - Propulsion Systems, Space Vehicles and related equipment<sup>8</sup>

Within each of these categories, items are arranged in one of five groups identified by a letter:

- A - Equipment, Assemblies & Components
- B - Test, Inspection & Production Equipment
- C - Materials
- D - Software
- E - Technology<sup>9</sup>

Each item listed on the CCL<sup>10</sup> has a five digit Export Control Classification Number (ECCN) which begins with the category, then the group designation, and finally with three numeric digits that identify the reasons for control. EAR99 refers to items that are not specifically listed on the CCL but are nonetheless “subject to the EAR,”<sup>11</sup> meaning that restrictions such as end use and end user limitations apply.

The EAR controls the export and re-export of all items subject to the EAR. Re-export refers to the shipment or transmission of items or activities subject to the EAR from one foreign country to another

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<sup>7</sup>15 C.F.R. § 764.3(a)(1) and (2). During times, such as now, when the EAA has not been reauthorized, the civil penalties are those specified in IEEPA. Section 402 of the USA PATRIOT Act Improvement and Reauthorization Act of 2005, Pub. L. 109-177, 120 Stat. 243 increased the civil penalty to \$50,000 per violation, effective March 9, 2006. See 71 Fed. Reg. 44189 (2006).

<sup>8</sup>15 C.F.R. § 738.2(a).

<sup>9</sup>15 C.F.R. § 738.2(b).

<sup>10</sup>15 C.F.R. Part 774.

<sup>11</sup>15 C.F.R. § 734.2(a) describes generally the concept of “subject to the EAR.”

foreign country.<sup>12</sup> Whether a license is needed for a particular transfer involves first determining the ECCN for the item or technology, consulting the CCL to determine the reason(s) for the control (e.g., national security, anti-terrorism, missile technology, etc.), reviewing the Country Chart, and checking to see whether any exemption pertains.<sup>13</sup>

As with the ITAR, the principal concern for foreign investors arises from the controls the EAR places on disclosures of technology and technical data to foreign persons and on use of U.S.-origin components or technology in foreign produced goods. The EAR contains the same deemed export rule found in the ITAR. Any release of controlled technology or source code to a foreign person—whether in the United States or abroad—is thus an export.<sup>14</sup>

The EAR defines technology as “specific information necessary for the ‘development,’ ‘production,’ or ‘use’ of a product.” The referenced information takes the form of ‘technical data’ or ‘technical assistance.’<sup>15</sup> The definitions of technical assistance and technical data are defined by way of examples. Technical assistance “may take forms, such as instruction, skills training, working knowledge, consulting services.”<sup>16</sup> Technical data “may take forms such as blueprints, plans, diagrams, models, formulae, tables, engineering designs and specifications, manuals and instructions written or recorded on other media or devices such as disk, tape, read-only memories.”<sup>17</sup> Software is defined in the regulation as “a collection of one or more ‘programs’ or ‘microprograms’ fixed in any tangible medium of expression.”<sup>18</sup>

For foreign persons to have access to controlled dual use U.S. technology even in the U.S. requires assessment of whether a license is needed which depends, in part, on the citizenship of the specific foreign person. Technology or software expressly not subject

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<sup>12</sup>15 C.F.R. § 734.2(b)(4).

<sup>13</sup>See 15 C.F.R. Part 732 which actually identifies 27 steps for compliance with the EAR requirements and provides a decision flow diagram to assist in determining whether a transaction is subject to the EAR and what the license requirements are, if any.

<sup>14</sup>15 C.F.R. § 734.2(b)(2).

<sup>15</sup>15 C.F.R. § 772.1.

<sup>16</sup>15 C.F.R. § 772.1. The regulations also note that technical assistance may involve transfer of technical data.

<sup>17</sup>15 C.F.R. § 772.1.

<sup>18</sup>15 C.F.R. § 772.1. A program, for the purposes of this definition, is “a sequence of instructions to carry out a process in, or convertible into, a form executable by an electronic computer;” while a microprogram is defined as “a sequence of elementary instructions, maintained in a special storage, the execution of which is initiated by the introduction of its reference instruction into an instruction register.”

to the EAR, include: (1) items subject to the jurisdiction of another federal agency; (2) publicly available technology or software; (3) certain commercial publications, recordings, and motion pictures; and (4) foreign-made items incorporating a de minimis level of U.S. content.<sup>19</sup>

In addition, the EAR continues to control U.S. goods, technology, and foreign goods manufactured from U.S. technology or goods, unless the amount of the U.S. content is de minimis. The United States thus asserts control over a foreign-made commodity in which incorporated controlled U.S. commodities represent more than 25% of the total value of the foreign-made commodity.<sup>20</sup> In certain limited circumstances, the United States even controls foreign manufactured commodities that are the “direct product” of U.S. technology or software.<sup>21</sup>

If an export or re-export is subject to the EAR, and no exception applies, then a license must be obtained from the BIS. Only the exporter may apply for a license.<sup>22</sup> The exporter is “[t]he person in the United States who has the authority of a principal party in interest to determine and control the sending of items out of the United States.”<sup>23</sup> The license application must disclose the names and addresses of the parties to the transaction. Such licenses may include situations where the domestic U.S. company is seeking to employ foreign persons, i.e., not U.S. citizens or lawful permanent residents of the United States. Such licenses may also cover technology sharing between the U.S. subsidiary and its foreign affiliates.

## VII. CONCLUSION

### § 9:36 Summary

#### Research References

West’s Key Number Digest, Commerce ◊3, 4; United States ◊70

The various treaties and agreements have greatly expanded the ability of participation of foreign companies in United States government procurement. Other than companies from certain prohibited countries, most foreign companies can compete for substantial majority of U.S. government contracts. However, there are numerous prohibitions and restrictions for such foreign participant. Foreign companies must pay particular attention to such rules as they not only limit a company’s ability to participate in a

<sup>19</sup>15 C.F.R. § 734.3(b).

<sup>20</sup>15 C.F.R. § 734.4(d). These thresholds are reduced to 10% if the destination of the re-export is an embargoed country.

<sup>21</sup>15 C.F.R. §§ 734.3(a)(4) and 736.2(b)(3).

<sup>22</sup>15 C.F.R. § 748.4(a)(1).

<sup>23</sup>15 C.F.R. § 772.1.

given procurement, but also because violation of the applicable rules and regulations could result in the imposition of substantial civil and criminal penalties.

