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International Trade

Where Are Your Products From? The Importance and Challenges of Managing TAA Compliance for GSA Schedule Holders



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The Multiple Award Schedules administered by the General Services Administration (“GSA Schedule contracts”) can be a valuable tool for commercial companies looking to sell to the U.S. government. These long-term, government-wide contracts allow government customers to purchase commercial products and services at pre-negotiated prices under pre-negotiated, standard terms and conditions, thereby foregoing some of the onerous competition and administration requirements otherwise placed on government purchasers. Having a GSA Schedule contract can give companies an advantage in marketing and selling their commercial products and services to the government.

However, GSA Schedule holders must be aware of the special requirements that attach to the contract vehicle, including (but not limited to) the requirement that

each and every product offered on a GSA Schedule contract comply with the Trade Agreements Act (19 U.S.C. § 2501 *et seq.*) (“TAA”). The TAA, which implements various bilateral and multilateral free trade agreements to which the U.S. is a party, opens government procurement to products from “designated countries” (*i.e.*, those countries with which the U.S. has such trade agreements), while *prohibiting* procurement of products from non-designated countries. Therefore, products that are U.S. or designated-country origin are TAA-compliant, whereas products from non-designated countries, such as China, Malaysia, and India, are non-compliant.

GSA has determined that the TAA applies to all Schedule contracts and requires companies applying for a GSA Schedule contract to certify that products and services offered for sale on any resulting Schedule contract be TAA-compliant. In fact, GSA puts offerors on notice of the importance of TAA compliance in its “Read Me First” notice that accompanies the Schedule solicitation documents.

TAA compliance is particularly challenging in light of increasing economic pressures to move manufacturing processes to countries with lower costs and the reality of global and dynamic supply chains, where sources for parts and components can and do change frequently and with little notice or lead time. In this context, recent enforcement actions highlight the risks and challenges for GSA Schedule holders, and the importance of managing TAA compliance in a proactive and comprehensive manner.

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Recent TAA Enforcement Actions. There have been a number of cases against GSA Schedule holders in recent years, alleging that the contractors violated the TAA by including products on their Schedule contract that were not TAA-compliant. Specifically, the government has used the False Claims Act, 31 U.S.C. § 3729 *et seq.*, to bring enforcement actions against Schedule holders based on a failure to comply with the TAA. Similarly, whistleblowers have relied on the *qui tam* provisions in the False Claims Act, 31 U.S.C. § 3730(b), to file cases alleging that a Schedule contractor has violated the TAA by offering for sale on its Schedule contract TAA non-compliant products.

Recent examples of False Claims Act settlements involving allegations of TAA non-compliance by GSA Schedule holders include:

- August 19, 2014. Samsung Electronics America settled with the Department of Justice for \$2.3 million, in a case originally brought by a former employee, to resolve allegations that it submitted false certifications to its resellers that its products were TAA compliant, thereby causing its resellers to submit false claims for products sold on their GSA Schedule contracts in violation of the TAA.

- March 29, 2013. CDW-Government LLC agreed to settle with the Department of Justice for \$5.66 million, also in a case originally brought by a former employee, where it was alleged to have sold TAA non-compliant information technology, equipment, office supplies, and similar products to government agencies through its GSA Schedule contract.

- July 9, 2012. ADC Telecommunications Inc. paid \$1 million to the Department of Justice to settle a False Claims Act action resulting from the contractor's disclosure to GSA that it had sold TAA noncompliant telecommunication equipment to government agencies.

Because the products and services offered for sale by GSA Schedule holders are usually publicly available on GSA's website, and because it is often possible to determine the country of origin of a product from basic product information as well as independent research, False Claims Act whistleblower actions alleging TAA non-compliance are likely a higher risk for Schedule holders than whistleblower actions alleging other Schedule non-compliances.

Overview of TAA Compliance Requirements. GSA Schedule holders must certify that the offered products are of U.S. or designated-country origin, making it important to understand how origin is determined under the TAA. A country of origin evaluation begins with identification of the "end product," defined in the Federal Acquisition Regulations ("FAR") as "those articles, materials, and supplies to be acquired under the contract." FAR 52.225-5(a). For some products—in particular complex systems with multiple discrete components, and which require installation and assembly at the end user's location – determining what constitutes the "end product" can be a thorny issue. Similarly, spares and replacement parts can be a trap for the unwary; when sold separately, these items likely have to be evaluated independently as "end products."

Once the "end product" is identified, the next issue is how to determine the country of origin, where an article manufactured in one country contains parts or materials from another country, or where the manufacturing

steps take place in multiple countries. The TAA adopts the "substantial transformation" test *i.e.*, the country of origin is where the incorporated parts or material "have been substantially transformed into a new and different article of commerce with a name, character, or use distinct from that of" the parts or material. 19 U.S.C. § 2518(4)(B).

Principal authority for determining country of origin for purposes of the TAA is vested in the United States Customs and Border Protection ("Customs"), which has the statutory authority delegated by the Secretary of the Department of the Treasury to issue advisory opinions and final determinations on country of origin. See 19 U.S.C. § 2515(b)(1) and 19 C.F.R. Part 177, Subpart B. In making such determinations, Customs generally relies on its prior TAA rulings as well as the more substantial body of Customs rulings related to country of origin marking of products and packages entering the United States.

As a general rule, in determining country of origin under the substantial transformation test, Customs looks to the country where the product took its essential character and form, even if additional assembly or processing subsequently occurred elsewhere. Customs generally looks at a number of factors, including *inter alia*:

- the number of component parts to be assembled;
- origin of key components or completion of key components as part of the build process;
- the country where critical programming takes place;
- the independent functionality of the components;
- requirements for precision and specialized tools;
- the level of training and experience needed to perform the processing, manufacturing or assembly function; and
- costs attributed to components from a particular country or the value added as a result of processes performed in a particular country.

Customs has repeatedly emphasized that it must consider the totality of the circumstances and make such determinations on a case-by-case basis, making it difficult for GSA Schedule holders to apply the test to their own or third-party products, particularly where there is no sufficiently-analogous published determination.

Minimizing the Risks of TAA Compliance. There are several ways that GSA Schedule holders can minimize the risk of TAA non-compliance. Below are some general compliance considerations, though the specifics of implementation will vary depending on the products or services being offered, the industry, and the organization and processes of the business.

1. Know what is on your GSA Schedule contract. Contractors can add products to their GSA Schedule at any time, not just at the time of the initial offer or subsequent renewals of the contract. And, many companies are continuously adding products—their own or third-party product offerings—to meet customer demands, resulting in GSA Schedule contracts with hundreds and hundreds (and even thousands) of available items.

For this reason, it is critical to maintain a comprehensive and current list of all products currently offered on

the GSA Schedule contract, including parts or components that are available for sale as separate items (e.g., spares and replacements), throughout the life of the GSA Schedule contract.

2. Perform a country of origin review. It is important that GSA Schedule contract administrators and those charged with GSA Schedule contract compliance work with manufacturing operations and supply chain management to determine the country of origin of all items offered on the GSA Schedule contract. Notably, the test for country of origin under the TAA is *different* than the tests under the Buy American Act and other domestic preference regimes (e.g., the Department of Transportation’s various Buy America restrictions). Therefore, it is possible to have an item that is U.S.-origin under one test, but foreign-origin under another, and crucial to apply the correct test in evaluating the items.

Application of the substantial transformation test—determining whether specific operations “are minimal or simple, as opposed to complex or meaningful”—is itself difficult, with a large amount of gray area. Furthermore, application of the test, or contractors’ understanding of Customs’ approach, can evolve over time. For example, many companies, based on long-standing precedent that critical programming constitutes substantial transformation, have relied on software-loading to constitute substantial transformation of noncompliant hardware into a compliant end item.

More recently, Customs clarified that the types of critical programming operations that will effect a substantial transformation generally involve two elements: (1) the *development* of the software/firmware in question and (2) the *download and testing* of the software/firmware onto the manufactured item. Where the development, download and testing of the software all occur in the same country, Customs is likely to find that a substantial transformation in that country if these critical programming operations change or define the use of the device in question. By contrast, where the development of the software takes place in a *different* country than the download and testing of that software onto a manufactured item, Customs is unlikely to find a substantial transformation attributable to programming. This clarification has called into question those who relied on software-loading alone to constitute substantial transformation of non-compliant hardware articles.

GSA itself has acknowledged the challenge of applying the substantial transformation test (see MAS Desk Reference Section 3, p. 10), and advises that while responsibility for the determination rests solely with the

contractor, the contractor can seek a binding determination from Customs, or request an outside opinion. Given the high stakes associated with getting it wrong, where companies are unable to determine with confidence that their end products are U.S. or designated-country origin under the test, they should seek expert advice and, in the most difficult cases, seek a binding determination from Customs.

3. Keep your country of origin records current. Because changes in the supply chain can and do affect the country of origin (e.g., if a manufacturing facility changes location, or if the source for a key component moves from the U.S. or a designated country to a non-designated country like China), companies must remain vigilant, or they could find that they have been selling a product that was compliant when added to the GSA Schedule contract, but at some point became noncompliant. Methods for maintaining current and complete country-of-origin documentation include:

- Creating systematic triggers that alert the individual or department in charge of TAA compliance when changes to the manufacturing or supply chain occur, requiring a reevaluation of whether that change affects the country of origin;

- For end items or key components acquired from suppliers, obtaining country-of-origin certifications on a regular basis (e.g., annually), which put the burden on the supplier to affirmatively notify the GSA Schedule holder when and if the information in the current certification changes;

- Performing occasional audits to verify accurate and complete country-of-origin information for the items offered on the GSA Schedule contract.

Conclusion. Ensuring compliance with the TAA when performing a GSA Schedule contract is critical for reducing the risk of False Claims Act allegations or the need to make a mandatory disclosure to GSA. Before applying for a Schedule contract, companies should first understand the requirements of the TAA and determine whether the products they intend to offer for sale on a Schedule contract are TAA compliant. Once receiving a Schedule contract, companies should implement internal controls and processes to regularly confirm the origin of their products and take mitigating steps as necessary, whether that means deleting non-compliant products from the Schedule contract or making changes to the manufacturing processes, to ensure the products sold to the government are TAA compliant.