An Analysis of "Buy America" Provisions
In ADF Group Inc. v. United States under Chapter 11 of the NAFTA

Rahna Epting, IELP Law Clerk
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In *ADF Group Inc. v. United* States, an investment tribunal established under Chapter 11 of the NAFTA clarified several important aspects concerning the applicability of the NAFTA to government procurement and "Buy America" requirements.[1] In doing so, the Tribunal's decision makes clear that "Buy America" and other statutes that impose requirements on investors to buy domestic products and services as part of government procurement are not actionable by investors under Chapter 11 of the NAFTA in many circumstances. Its findings also clarify when a NAFTA Party, as opposed to a private investor, may challenge "Buy America" provisions under the NAFTA's government procurement provisions. In *ADF Group Inc*., the Tribunal found that federal "Buy America" provisions, when implemented by an agency of the state of Virginia, were exempt from the provisions of Chapter 11. Further, even if Chapter 11 did apply, the "Buy America" provisions did not violate Chapter 11's requirement to treat foreign investments "no less favorably" than domestic investments.

The Dispute

This dispute arises out of the construction of the Springfield Interchange Project (SIP) by the Virginia Department of Transportation (VDOT), which received federal funding for the SIP from the Federal Highway Administration (FHWA). Shirley Contracting Corporation (Shirley) was awarded the main contract and sub-contracted with ADF International for the supply and delivery of the structural steel components for nine bridges. Because of the federal funding, ADF International, like Shirley, was required to adhere to U.S. "Buy America" laws,[2] which require that steel and other products be purchased and manufactured in the United States.

To meet VDOT technical specifications, ADF International proposed to ship U.S.-purchased steel to its facilities in Canada, which are owned by its parent company ADF Group, in order to further process and manufacture steel girders. The finished product would then be shipped to the construction site and used in the SIP. VDOT and the FHWA advised that ADF International's proposal violated Buy America provisions, because the fabrication of the girders in Canada prevented the material from qualifying as "domestic."

ADF International sought a waiver of the Buy America requirements, alleging that its U.S. fabrication facilities were inadequate for the job and that all other potential facilities were "fully loaded."[3] VDOT denied the request for a waiver, stating that the request had "no basis" as

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[1] *ADF Group Inc. v. United States*, ICSID Case No. ARB(AF)/00/1, 9 January 2003.
[2] *Id.* The Buy America Act requirements are specifically listed in the main contract between VDOT and Shirley and incorporated by reference into the sub-contract between ADF International and Shirley. It includes provisions from § 165(a) and (b) of the Surface Transportation Assistance Act (STAA) of 1982, 23 U.S.C § 101, and 23 C.F.R. § 635.410 for the implementation of § 165.
[3] *ADF Group Inc. v. United States, supra* note 1, at para 53.

dozens of facilities in the United States could fabricate steel girders.[4] As a result, ADF International used its own Florida facility as well as other U.S. facilities to fabricate the girders. Although the project was completed on time, ADF International and Shirley claimed lost profits resulting from the manufacture of the steel girders in the United States as opposed to ADF Group's Canadian facilities. As a result, ADF Group, as the foreign investor, challenged the "Buy America" provisions as infringing on its investment rights provided for in Chapter 11 of the NAFTA.

NAFTA's Legal Framework

Chapter 10 of the NAFTA establishes rules for tendering procedures for use by governments when they procure goods and services. For example, when a government seeks bids for the construction of a building or for other government goods and services, it must ensure that its tendering procedures do not discriminate against other NAFTA Parties or their businesses. In addition, when selecting a bid, a NAFTA Party cannot discriminate against suppliers from other NAFTA Parties. As described more fully below, whether Chapter 10 applies depends on whether the procuring government is a local, state or federal government and whether governments choose to be bound by the provisions of Chapter 10. Only governments may bring claims alleging violations of Chapter 10.

Chapter 11 of the NAFTA includes protections for foreign investors from government actions that may discriminate or expropriate their investments. For example, Article 1102 of the NAFTA prohibits a NAFTA Party from taxing or regulating foreign investors differently from domestic investors in like circumstances. Article 1110 prohibits a NAFTA Party from expropriating investments of an investor of another NAFTA Party. In addition, Article 1106 prohibits a NAFTA Party from imposing certain "performance requirements" on investors, such as requirements that investors export a certain level of goods or services or achieve a specified level of domestic content (e.g., a requirement that investors use domestically produced inputs in the production of goods). Article 1106 also prohibits a Party from imposing requirements to use or accord a preference to goods and services produced in its territory. As described below, there are exceptions to some of these rules. Unlike Chapter 10, Chapter 11 allows foreign investors to bring suit alleging violations of Chapter 11 before an international tribunal. [5]

The Tribunal's Decision

Regarding NAFTA's government procurement provisions, the Tribunal determined that Chapter 10's government procurement requirements did not cover this dispute. First, federal and state agencies become bound to the government procurement provisions of the NAFTA only if they are "listed" under NAFTA Annex 1001.1a-3 in accordance with Article 1024. With respect to the SIP, VDOT was the controlling entity, was not a listed entity, and was therefore not required to adhere to Chapter 10. In fact, no state government or its agencies are required to adhere to NAFTA Chapter 10 as of May 1, 2005 because none are listed. Moreover, Chapter 10 does not

[4] *Id.* at para 54.
[5] For more information on Chapters 10 and 11 of the NAFTA, *see* IELP's *Citizen's Guide To Trade Law* forthcoming 2005).

apply at all to local governments. In other words, the potential scope of Chapter 10 is limited to federal and state governments.

To overcome these legal obstacles, ADF Group alleged that the FHWA, as the funder of the SIP, was the controlling entity. The Tribunal, however, concluded that the provision of funds by FHWA did not constitute procurement. Instead, the Commonwealth of Virginia, through VDOT, engaged in procurement.[6] Second, only NAFTA Parties may bring claims under Chapter 10; investors may bring claims only under Chapter 11.

Regarding Chapter 11, the Tribunal first concluded that ADF International's purchase of steel constituted an "investment" within the meaning of Chapter 11 either as (1) "other property, "tangible or intangible, acquired in the expectation or used for the purpose of economic benefit" or (2) an "interest[] arising from the commitment of capital or other resources in the territory of a Party to economic activity in such territory, such as under (i) contracts involving the presence of an investor's property in the territory of the Party, including … construction contracts."[7] In addition, the Canadian ADF Group qualified as a Chapter 11 "investor" because it is the parent company of ADF International, which purchased steel in the United States for the SIP.

Despite meeting these threshold jurisdictional requirements, the Tribunal rejected ADF Group's substantive claims. ADF Group claimed that VDOT violated Article 1102's national treatment obligation by requiring ADF Group to manufacture the steel girders in the United States and preventing it from performing the work at its Canadian facilities. ADF Group also claimed that the requirements to use U.S. steel constituted a requirement to achieve a specified level of domestic content in violation of Article 1106's prohibition against certain performance requirements.

The Tribunal ruled that Article 1108 exempts procurements that are also investments from certain Chapter 11 requirements, including Article 1102 and requirements to achieve specified domestic content under Article 1106. Article 1108(7) exempts investments resulting from government procurement from the requirements of Article 1102 (as well as other provisions of Chapter 11).[8] In addition, Article 1108(8) exempts measures designed to achieve a specified level of domestic content. Thus, the Tribunal concluded that the Buy America provisions did not conflict with Chapter 11's national treatment obligations and prohibition against achieving a specified level of domestic content.

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[6] The Tribunal noted, however, that VDOT was engaged in "procurement" as defined in Article 1001(5) of the NAFTA and if it were in fact a listed entity under NAFTA Article 1024 it would have to adhere to Chapter 10 requirements. Although FHWA provided federal funds for the construction of the SIP, the Tribunal found that the FHWA was not involved in government procurement and that VDOT was the government entity engaged in procurement of steel in this case; Article 1003 National Treatment and Non-discrimination, Article 1004 Rules of Origin, Article 1007 Technical Specifications and more.

[7] *ADF Group Inc. v. United States*, *supra* note 1, at para. 152 (quoting *North American Free Trade Agreement*, Article 1139, 1 January 1994, http://www.nafta-sec-alena.org/DefaultSite/index_e.aspx?DetailID=78).

[8] Article 1108(7) also exempts investments resulting from government procurement from the most favored nation obligation (which requires a NAFTA Party to treat all foreign investments and investors equally) and from requirements that investors appoint persons of a particular nationality to certain management positions.

Despite this ruling, the Tribunal also concluded that the Buy America requirements would not violate Chapter 11's national treatment obligation if it applied. Article 1102 of the NAFTA requires each Party to provide to investors of another Party and investments of investors of another Party "treatment no less favorable than that it accords, in like circumstances," to its own investors and investments of its own investors.

The Tribunal disagreed because the requirements placed upon the Canadian investor (ADF Group) were no different from requirements that would have been placed on a domestic investor: both foreign and U.S. investors were required to buy and fabricate steel in the United States. Moreover, ADF Group was unable to identify any U.S. company that had been exempted from Buy America requirements.[9] Because Canadian and U.S. investors are treated the same, VDOT had not violated any national treatment obligation.[10]

The Tribunal also made important substantive findings concerning the obligation in Article 1105 of the NAFTA for Parties to provide the "Minimum Standard of Treatment" to foreign investors, an obligation from which investments resulting from government procurement are not exempted. The meaning of this obligation has been the subject of numerous disputes and its exact contours are not fully known. In the most general sense, it prohibits governments from treating aliens, including foreign investors, in unacceptable ways as defined by customary international law.

What constitutes "minimum standard of treatment" is difficult to say, because the requirement is not "frozen in time;" it is evolving and should be considered "as it exists today."[11] However, the *ADF* Tribunal concluded that the *Neer* test, which derived from the treatment of an individual in a foreign country, did not apply to investments. [Paul Neer was a U.S. national murdered in Mexico, where he was the superintendent of a mine]. That test would find a violation of the minimum standard of treatment where "treatment of an alien … amount[ed] to an outrage, to bad faith, to willful neglect of duty, or to an insufficiency of government action so far short of international standards that every reasonable and impartial man would readily recognize its insufficiency."[12] The Tribunal in *ADF Group, Inc.* stated that "[t]here appears no logical necessity and no concordant state practice to support the view that the *Neer* formulation is automatically extendible to the contemporary context of treatment of foreign investors and their investments by a host or recipient State."[13]

In the NAFTA investment context, the minimum standard of treatment references "fair and equitable treatment" and "full protection and security." ADF Group alleged that the Buy America requirements violated this general requirement by requiring the manufacturing of the steel to be performed in the United States. The Tribunal, however, responded that the Buy America requirements are established sources of international law and are not per se "unfair and inequitable within the context of NAFTA."[14] In fact, the requirements are common to all three NAFTA parties and found in many other countries."

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[9] *ADF Group Inc. v. United States*, *supra* note 1, at para. 156.
[10] *Id.*
[11] *Id.* at para. 179.
[12] *Id.* at para. 180 (quoting *Mondev International Ltd. v. United States of America*, ICSID Case No. ARB(AF)/99/2).
[13] *Id.* at para. 181.
[14] *Id.* at para. 188.

ADF Group also argued that the FHWA acted "in disregard" of the Buy America requirements.[15] In response to this argument, the Tribunal explained that its role was not to determine the legality of the measures under the internal law of the country being challenged and that its authority was limited to a determination of whether the U.S. laws were inconsistent with NAFTA and applicable rules of international law.[16] The Tribunal further noted that, even an illegal act by the relevant agency does not by itself constitute a violation of the minimum standard of treatment; "something more than simple illegality or lack of authority under the domestic law of a State" is needed.[17] ADF Group had not shown that "something more" in this case.[18] Similarly, the Tribunal concluded that an assertion that the defending Party had failed to comply in good faith with the minimum standard of treatment "adds only negligible assistance in the task of determining or giving content to a standard of fair and equitable treatment."[19] This was particularly true in *ADF Group, Inc.* because the Tribunal found that the investor had not shown that FHWA had acted arbitrarily, for example by granting other companies waivers of the Buy America requirements. The Tribunal concluded by stating that "the investor did not establish a serious basis for contending that some specific treatment received by ADF International from either the FHWA or the VDOT constituted a denial of the fair and equitable treatment and full protection and security included in the customary international law minimum standard embodied in Article 1105(1)."[20] In any event, because VDOT, not FHWA, engaged in procurement, this argument of ADF Group was without merit.

Implications of the Decision

The *ADF* case is no doubt a triumph for those who promote "Buy America" provisions. "Buy America" provisions, like "Buy Mexico" provisions, will be held valid under NAFTA when they are challenged by an investor under Chapter 11 of the NAFTA, because government procurement is exempted by Article 1108(8) of the NAFTA. In addition, Chapter 10 of the NAFTA does not apply to government procurement by a local government or an "unlisted" state and federal agency.

Nevertheless, *ADF* also highlights areas in which "Buy America" proponents should focus their efforts. For example, Chapter 10 does not apply to local governments, it only excludes applicability to state agencies if the NAFTA Parties do not negotiate agreements to bind state agencies. Second, this analysis applies only to NAFTA. The United States has entered into bilateral and regional free trade agreements with many other countries, including Australia, Chile, and the countries of Central America. These free trade agreements, as well as the WTO's Government Procurement Agreement, all contain separate provisions regarding government procurement and investment. The decision in *ADF* can only be used to interpret the NAFTA. For an analysis of the government procurement provisions of these agreements, see IELP's *Citizen's Guide To Trade Law* (2005).

[15] *Id.* at para. 190.
[16] *Id.*
[17] *Id.*
[18] *Id.*
[19] *Id.* at para. 191.
[20] *Id.*

Lastly, while the validity of "buy domestic" statutes may be good news for domestic producers of goods, it may also increase the cost of procurement contracts due to decreased competition and the potential unavailability of low-cost goods from other countries. Governments that pay more for procurement may have fewer dollars to spend on other important programs.