

U.S. MARKET REVIEW

□ **U.S. POLICY: DOMESTIC PREFERENCE REQUIREMENTS APPLICABLE TO PV DEVICES UNDER CERTAIN DEPARTMENT OF DEFENSE CONTRACTS**

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Industry watchers expect that the Department of Defense (DoD) renewable energy initiative will present substantial opportunities for renewable energy companies and investors in coming years. DoD's commitment to sourcing 25% of its power from renewable energy by 2025 should make it a foremost driver of renewable energy growth in the United States. Underlying this commitment is a consensus view among U.S. defense policymakers that distributed renewable energy sources will contribute substantially to U.S. security.

Each of the three U.S. military services is broadly expanding use of renewable energy. In 2012, the Army announced a USD \$7 billion request for proposals for multiple award task order contracts (MATOC). In October 2012, scores of applicants submitted MATOC proposals (reportedly far more than the Army anticipated). MATOC awardees will be deemed qualified to compete for "task orders" – project-specific contracts to supply renewable energy. Like the Navy and Air Force, the Army is also proceeding with more *ad hoc* awards of renewable energy contracts outside of the MATOC initiative.

The expected expansion of DoD purchases of renewable energy, especially energy from solar projects, augments positive trends in the development of industry overall. In 2012, newly installed utility-scale solar capacity more than doubled from year-end 2011 (residential and commercial scale solar had similar positive growth). Solar projects have relied largely on panels from the

world's leading supplier – China. But hostility to Chinese solar panel imports has emerged, particularly among companies that manufacture panels in the United States.

Groups that plan to compete for DoD solar projects should bear in mind special domestic preference requirements applicable to sourcing of photovoltaic (PV) devices – the "PV Device Requirements." These requirements are expected generally to forestall sourcing of PV panels for DoD projects from China. As explained below, the DoD PV Device Requirements have a solid political base and are likely to remain in place into the foreseeable future.

DEVELOPMENT OF DOD PV DEVICE REQUIREMENTS

The PV Device Requirements specify that acquisition of PV devices under certain types of DoD contracts must comply with the "Buy American Act," subject to the exceptions of the Trade Agreements Act. As a consequence, developers performing these DoD contracts generally must source PV panels from the United States or other designated countries.

The PV Device Requirements emerged in the context of an ongoing fight between the U.S. PV panel industry and Chinese competitors over U.S. import competition. In October 2011, a coalition of seven U.S. solar panel manufacturers, led by SolarWorld America, petitioned U.S. government agencies for antidumping and countervailing duties on imports of

crystalline silicon photovoltaic cells and modules manufactured in China. Antidumping duties are to address allegedly unfair pricing of imports, and countervailing duties are to address alleged subsidies on imports.

SolarWorld America, based in Oregon, announced the trade case with the support of Oregon's U.S. senators, Democrats Ron Wyden and Jeff Merkley. Oregon is the largest PV manufacturing state in the United States. SolarWorld America accused Chinese companies of selling subsidized PV cells and panels below fair value, causing shutdowns and layoffs in the United States. SolarWorld America claimed that seven manufacturers had either closed their operations or downsized over the 18 months prior to the filing of the petition, and laid off 1,600 workers. Based on findings by the U.S. Commerce Department and International Trade Commission, the U.S. government imposed antidumping and countervailing duties on Chinese solar cell and panel imports in October 2012.

In addition to the trade case, U.S. solar manufacturers and their supporters in the Congress have explored other ways to support U.S. solar panel production. Their thoughts turned to domestic preference rules for government procurement. In this regard, some have observed with consternation that normal Buy American requirements often do not extend to solar panels due to the structure of government solar projects. The government normally contracts simply to buy power from a developer. While the contractor typically has to build a facility on government property to produce the power, the government does not usually take title to the facility and the renewable project is not ordinarily considered to be a "public work" or "public building" to which Buy American rules on construction materials would apply. Consequently, policymakers had to legislate special provisions to establish that a domestic preference requirement applies to solar panels used for facilities to produce power for the government.

The PV Device Requirements were legislated as part of the 2011 National Defense Authorization Act (the

2011 NDAA) the President signed into law in January 2011. The PV Device Requirements were developed mainly by House of Representative and Senate participants in a conference committee immediately before the final bill was passed. Representative Maurice Hinchey of New York, whose district includes operations of Prism Solar Technologies, fought to have the provision included in the NDAA. SolarWorld issued a statement after the 2011 NDAA was passed praising the PV Device Requirements and highlighting the need to help level the playing field with China. The DoD implemented the PV Device Requirements in procurement regulations applicable to DoD projects in May 2012.

DOD DOMESTIC PREFERENCE REQUIREMENTS FOR PV DEVICES

The PV Device Requirements apply to specified types of DoD contracts that result in "DoD ownership" of PV devices. One would expect this to limit the rules to contracts under which DoD takes title to the devices. But the 2011 NDAA defines "ownership" in an artificial, expansive way. Even if the government does not take title to PV devices, DoD is considered to "own" them if (i) the devices are installed on DoD property or in a facility owned by DoD; and (ii) the devices are "reserved for the exclusive use of DoD" for their full economic life. It is understood that this unusual conception of "ownership" will generally result in the PV Device Requirements applying to DoD solar projects.

The 2011 NDAA defines PV devices as "devices that convert light directly into electricity through a solid-state, semiconductor process." It appears, then, that both solar panels and individual solar cells would be considered to be PV devices sourcing of which could be covered by the PV Device Requirements.

For covered contracts that will entail acquisition of PV devices valued at over USD \$202,000, the PV Device Requirements instruct DoD to procure only PV devices that are manufactured in the United States, a "qualifying" country or a "designated" country. These include countries that are parties to the World Trade Organization (WTO) Procurement

Agreement, that have a free trade agreement with the United States, or that have certain qualifying reciprocal defense procurement arrangements with the United States. Qualifying and designated countries include: Aruba, Austria, Bahrain, Belgium, Bulgaria, Canada, Chile, Costa Rica, Cyprus, Czech Republic, Denmark, Dominican Republic, El Salvador, Estonia, Finland, France, Germany, Greece, Guatemala, Honduras, Hungary, Iceland, Ireland, Israel, Italy, Japan, Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, Mexico, Morocco, Netherlands, Nicaragua, Norway, Peru, Poland, Portugal, Singapore, Slovenia, Spain, Slovak Republic, Sweden, Switzerland, Taiwan and the United Kingdom.

Notably absent from this list is China. China is the leading producer and exporter of PV panels. But it is not a party to the WTO Government Procurement Agreement or any other agreement that would result in it being a qualifying or designated country. Consequently, the PV Device Requirements are expected to prevent sourcing of PV panels from China for most or all DoD solar energy projects. (China has been negotiating to join as a signatory to the WTO Procurement Agreement, but negotiations have, thus far, been slow and inconclusive.)

It is important for investors to understand the circumstances in which PV devices will be considered to be manufactured in the United States or a qualifying or designated country. There is fairly developed case law on where a device will be considered to have been manufactured for purposes of domestic preference rules like those imposed by the 2011 NDAA. If a device contains all qualifying component solar cells but is assembled in China, the item still would not qualify under the PV Device Requirements. Conversely, if the solar cells were all from a non-qualifying country but the panel was assembled in the United States (or a qualifying or designated country, like Taiwan), the device could, depending on the circumstances, be considered to be manufactured in the United States or such qualifying or designated country.

At the same time, the Buy American Act, with which the PV Device Requirements mandate compliance,

generally contemplates that an item will be considered to be manufactured in the United States or in a qualifying or designated country only if “substantially all” of its components were made in the United States or designated or qualified countries. When applied to products other than solar panels, this has traditionally meant that greater than 50% of the cost of the components, in aggregate, must be attributable to mining, manufacturing or production in the United States or qualifying or designated countries. While the matter is not entirely clear from the regulations implementing the PV Device Requirements, the government would be expected to apply the 50% rule to the PV Device Requirements.

CONCLUSION

Antidumping and countervailing duties place upward pressure on U.S. prices for Chinese PV panels. Furthermore, annual recalculation of duty levels make pricing uncertain, particularly since updated duty rates are applied retroactively.

Nonetheless, Chinese PV panels are often the lowest cost options for developers of solar energy projects. As the PV Device Requirements generally make Chinese panels unusable for DoD PV projects, developers should account for China/non-China panel price disparities in developing budgets and proposals for DoD projects.

ABOUT THE AUTHORS

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