

Congress of the United States
U.S. House of Representatives
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515-6315

To: Members, Subcommittee on Contracting and the Workforce, House Committee on Small Business
From: Mick Mulvaney, Chairman
Date: June 17, 2011
Re: Hearing: "Insourcing Gone Awry: Outsourcing Small Business Jobs"

The Subcommittee on Contracting and the Workforce of the House Committee on Small Business will meet at 10:00 a.m. on Thursday, June 23, 2011 in Room 2360 of the Rayburn House Office Building for the purposes of reviewing the implementation of the Administration's insourcing policies, and the effect of these policies on small businesses. Witnesses will include Dawn L. Hamilton, President and CEO, Security Assistance Corporation; Bryant S. Banes, Managing Shareholder, Neel, Hooper & Banes, P.C.; Bonnie C. Carroll, President, Information International Associates; and Jacque Simon, Public Policy Director, American Federation of Government Employees.

This memorandum will provide an introduction to insourcing, review current Administration guidance on insourcing, address issues with the definitions of inherently governmental and critical function and review the implementation of insourcing at the Department of Defense and in the civilian agencies. It will then summarize some of the issues with insourcing, and highlight issues for the Subcommittee's attention.

I. Introduction to Insourcing.

The Constitution of the United States vests the executive power in the President,¹ and foresees certain duties that should be restricted to government.² However, it was understood that not all functions of government need be carried out by federal employees, but that contractors could provide some goods and services.³ From that point forward, there has always remained a question as to when work should be performed by federal employees and when it should be performed by contractors. It is

¹ U.S. Const. art. II, § 1, cl. 1.

² See, e.g., U.S. Const. art. II, § 2 - 3; U.S. Const. art. I, § 8.

³ See, e.g., U.S. Const. art. I, § 8 (Congress has the power to spend); *Reeside v. Walker*, 52 U.S. 272 (1851) (plaintiff was heir to contractor who delivered the mail for the Federal government); *R.R. Co. v. Peniston*, 85 U.S. 5 (1873) (Contractor provided services to government).

accepted that work which is inherently governmental should be performed by federal employees,⁴ and there remains a debate as to how other work should be performed. The prior administration pursued a series of public-private competitions to assess the most cost effective way to perform this work, through a process that became known as outsourcing and governed by the Office of Management and Budget (OMB) Circular A-76.⁵ However, since 2006, Congress began placing limitations on the use of OMB Circular A-76 and reversing that underlying policy, as described below.

There is no statutory or regulatory definition of insourcing, which is generally understood as the conversion of work performed by private sector contractors to work performed by public sector employees through the hiring of additional public sector employees. The concept first arose in the context of Department of Defense (DoD) contracting. Specifically, the 2006 National Defense Authorization Act⁶ (NDAA) instructed the Secretary of Defense to “prescribe guidelines and procedures for ensuring that consideration is given to using Federal Government employees for work that is currently performed or would otherwise be performed under Department of Defense contracts,”⁷ and gave special consideration to work that had been performed by federal employees at any time after FY 1980,⁸ was inherently governmental;⁹ was not competitively awarded;¹⁰ or which had “been determined by a contracting officer to be poorly performed due to excessive costs or inferior quality.”¹¹

The term insourcing was not applied until two years later, when the 2008 NDAA¹² include a section entitled, “Guidelines on Insourcing New and Contracted Out Functions,”¹³ which modified and codified the prior guidance to “ensure that consideration is given to using, on a regular basis, Department of Defense civilian employees to perform new functions and functions that are performed by contractors and could be performed by Department of Defense civilian employees.”¹⁴ Unlike the earlier guidance, the statute gave more finite time limits but expanded the scope of work to be considered for insourcing. While the 2006 NDAA had looked back to 1980 to determine if work had previously been performed by DoD employees, the statute only looks back 10 years,¹⁵ and limited the period of time for which poor performance

⁴ 31 U.S.C. § 501 (note).

⁵ Citing Reorganization Plan No. 2 of 1970, 31 U.S.C. § 1111; Exec. Order No. 11,541, 35 Fed. Reg. 10,737 (July 2, 1970); the Office of Federal Procurement Policy Act, as recodified at 41 U.S.C. § 1121; and the Federal Activities Inventory Reform Act of 1998, 31 U.S.C. § 501 note.

⁶ National Defense Authorization Act for Fiscal Year 2006 [hereinafter 2006 NDAA], Pub. L. No. 109-163, 119 Stat. 3136 (2006).

⁷ *Id.* at § 343(a)(1), 119 Stat. at 3200.

⁸ *Id.* at § 343(a)(2)(A), 119 Stat. at 3200.

⁹ *Id.* at § 343(a)(2)(B), 119 Stat. at 3200.

¹⁰ *Id.* at § 343(a)(2)(C), 119 Stat. at 3200.

¹¹ *Id.* at § 343(a)(2)(D), 119 Stat. at 3200.

¹² National Defense Authorization Act for Fiscal Year 2008 [hereinafter 2008 NDAA], Pub. L. No. 110-181, 122 Stat. 3 (2008).

¹³ *Id.* at §324, 122 Stat. at 60.

¹⁴ 10 U.S.C. § 2463(a).

¹⁵ *Id.* at § 2463(b)(1)(A).

should be considered to 5 years.¹⁶ The 2006 NDAA focused on inherently governmental work, but the 2008 statute expanded this to look at work which was “closely associated with the performance of an inherently governmental function.”¹⁷ The 2008 NDAA prohibited the use of public-private competitions to implement the insourcing requirements.¹⁸

The 2009 NDAA went further, though, and created a third category of functions other than commercially available or inherently governmental – the category of critical function. The Act directed that each department of agency develop criteria to “identify critical functions with respect to the unique missions and structure of that department or agency”¹⁹ and “identify each position within that department or agency that, while the position may not exercise an inherently governmental function, nevertheless should only be performed by [civilian or military government employees] to ensure the department or agency maintains control of its mission and operations.”²⁰ Furthermore, the agencies were to provide criteria to identify positions that should be performed by military or civilian personnel in order to ensure that the agency, “develops and maintains sufficient organic expertise and technical capability.”²¹

Insourcing was expanded to include agencies outside of DoD with the Omnibus Appropriations Act (OAA) of 2009,²² which amended the prior year’s guidance on outsourcing.²³ The 2009 OAA required that agencies covered by the FAIR Act devise and implement guidance for insourcing, giving special consideration to insourcing work that had been performed by federal employees at any time in the past 10 years;²⁴ work closely associated with inherently governmental functions;²⁵ work that had been performed pursuant to a contract awarded on a noncompetitive basis;²⁶ work that the contracting officer determined to have been poorly performed by a contractor during the prior 5 years due to excessive costs or inferior quality;²⁷ or any new requirement, especially if the requirement is similar to a function previously performed by federal employees or associated with the performance of an inherently governmental function.²⁸ Thus, the reasons for civilian and military to consider insourcing requirements were brought in line.

¹⁶ *Id.* at § 2463(b)(1)(D).

¹⁷ *Id.* at § 2463(b)(1)(B).

¹⁸ *Id.* at § 2463(c).

¹⁹ *Id.* at § 321(a)(3)(A).

²⁰ *Id.* at 321(a)(3)(B).

²¹ *Id.* at § 321(a)(4).

²² Omnibus Appropriations Act, 2009 [hereinafter 2009 OAA] Pub. L. No. 111-8, 126 Stat. 524 (2009).

²³ Consolidated Appropriations Act, 2008, Pub. L. No. 110-161, § 739; 121 Stat. 1844, 2029-2035 (2007).

²⁴ 2009 OAA at § 736 (b)(2)(A)(i), 126 Stat. at 689.

²⁵ *Id.* at § 736 (b)(2)(A)(ii), 126 Stat. at 690.

²⁶ *Id.* at § 736 (b)(2)(A)(iii), 126 Stat. at 690.

²⁷ *Id.* at § 736 (b)(2)(A)(iv), 126 Stat. at 690.

²⁸ *Id.* at § 736 (b)(2)(B), 126 Stat. at 690.

II. Current Administration Guidance on Insourcing.

Up to this point, any action related to insourcing was congressionally initiated and generally limited to the Department of Defense. However, in 2009 President Obama issued a memorandum on government contracting²⁹ which never specifically addressed insourcing, but instead expressed concerns regarding outsourcing.³⁰ In the memorandum, the President stated that:

Government outsourcing for services also raises special concerns. For decades, the Federal Government has relied on the private sector for necessary commercial services used by the Government, such as transportation, food, and maintenance. [OMB] Circular A-76, first issued in 1966, was based on the reasonable premise that while inherently governmental activities should be performed by Government employees, taxpayers may receive more value for their dollars if non-inherently governmental activities that can be provided commercially are subject to the forces of competition.

However, the line between inherently governmental activities that should not be outsourced and commercial activities that may be subject to private sector competition has been blurred and inadequately defined. As a result, contractors may be performing inherently governmental functions. Agencies and departments must operate under clear rules prescribing when outsourcing is and is not appropriate.

74 Fed. Reg. 9755 -9756.

The memorandum continued to direct the Director of the OMB, the Office of Federal Procurement Policy (OFPP), and the FAR Council to “clarify when governmental outsourcing for services is and is not appropriate, consistent with section 321 [2009 NDAA] (31 U.S.C. 501 note).”³¹

Shortly thereafter, the Director of OMB issued a memorandum on “Managing the Multi-Sector Workforce.”³² In the memorandum, each agency was directed to “[a]dopt a framework for planning and managing the multi-sector workforce that is built on strong

²⁹ *Government Contracting*, 74 Fed. Reg. 9755 (March 6, 2009).

³⁰ Outsourcing is the term commonly applied to the public-private competitions conducted pursuant to the Office of Management and Budget (OMB) Circular A-76.

³¹ 74 Fed. Reg. 9755 at 9756.

³² Office of Management and Budget, M-09-26, *Managing the Multi-Sector Workforce*, (Jul. 29, 2009).

strategic human capital planning.”³³ The agency was then to conduct a “pilot human capital analysis of at least one program, project, or activity, where the agency has concerns about the extent of reliance on contractors, with the pilot to be completed no later than April 30, 2010.”³⁴ The pilot was to help better develop procedures to “support the broader vision of a multi-sector workforce.”³⁵ Finally, when considering insourcing, each agency was to use the guidelines it had developed pursuant to the 2009 OAA, or the 2008 NDAA.³⁶

III. Inherently Governmental.

Much of the debate regarding insourcing focuses on which work should be performed by government employees. All parties agree that some functions, deemed “inherently governmental” should be performed by government employees. However, there are a plethora of definitions for inherently governmental, none of which conclusively define what work needs to be performed by the government. The Federal Activities Inventory Reform (FAIR) Act of 1998³⁷ stated that the term “‘inherently governmental function’ means a function that is so intimately related to the public interest as to require performance by Federal Government employees.”³⁸ The FAIR Act continues to state that inherently governmental functions include “activities that require either the exercise of discretion in applying Federal Government authority or the making of value judgments in making decisions for the Federal Government, including judgments relating to monetary transactions and entitlements.”³⁹ It further enumerates that:

An inherently governmental function involves . . . the interpretation and execution of the laws of the United States so as—

- (i) to bind the United States to take or not to take some action by contract, policy, regulation, authorization, order, or otherwise;
- (ii) to determine, protect, and advance United States economic, political, territorial, property, or other interests by military or diplomatic action, civil or criminal judicial proceedings, contract management, or otherwise;
- (iii) to significantly affect the life, liberty, or property of private persons;

³³ *Id.*

³⁴ *Id.* However, pursuant to the Ike Skelton National Defense Authorization Act for Fiscal Year 2011 DoD is forbidden to establish quotas for insourcing, unless they are based on statutory requirements. Pub. L. No. 111-383 §323; 124 Stat. 3247, 4184 (2011).

³⁵ *Id.*

³⁶ *Id.*

³⁷ Federal Activities Inventory Reform Act of 1998 [hereinafter FAIR Act], Pub. L. No. 105-270, 112 Stat. 2382, 31 U.S.C. § 501 note (1998).

³⁸ *Id.* at §5 (2)(A), 112 Stat. at 2384.

³⁹ *Id.* at §5 (2)(B), 112 Stat. at 2385. 10 U.S.C. § 2383 incorporates the FAR definition by reference.

- (iv) to commission, appoint, direct, or control officers or employees of the United States; or
- (v) to exert ultimate control over the acquisition, use, or disposition of the property, real or personal, tangible or intangible, of the United States, including the collection, control, or disbursement of appropriated and other Federal funds.

FAIR Act at §5 (2)(B), 112 Stat. at 2385.

While perhaps the most comprehensive statutory definition of inherently governmental, the FAIR Act definition is by no means the only definition. The National and Community Service Trust Act of 1993,⁴⁰ provides that “the term ‘inherently governmental function’ means any activity that is so intimately related to the public interest as to mandate performance by an officer or employee of the Federal Government.”⁴¹ In OMB Circular A-76,⁴² and in the Federal Acquisition Regulation (FAR), “[i]nherently governmental function’ means, as a matter of policy, a function that is so intimately related to the public interest as to mandate performance by Government employees.”⁴³

The 2009 National Defense Authorization Act (NDAA)⁴⁴ required the OMB, the Chief Acquisition Officers Council (CAOC)⁴⁵ and the Chief Human Capital Officers Council (CHCOC)⁴⁶ to develop a comprehensive, government-wide definition⁴⁷ of “inherently governmental function.”⁴⁸ The purpose of the legislation was to ensure that each department or agency could “identify each position within that department or agency that exercises an inherently governmental function and should only be performed by officers or employees of the Federal Government or members of the Armed Forces.”⁴⁹

To address the requirements of the 2009 NDAA and the Presidential Memorandum, OFPP issued a proposed policy letter “to provide guidance to Executive Departments and agencies on circumstances when work must be reserved for performance by

⁴⁰ Pub. L. No. 103-82, § 196(a)(1)(C)(iii); 107 Stat. 785, 886; 42 U.S.C. § 12,651g, 12,651g(a)(1)(C)(iii) (1993).

⁴¹ *Id.*

⁴² This circular addresses outsourcing of commercial work to nongovernmental employees through public-private competitions.

⁴³ 48 C.F.R. § 2.101 (2011); *see also* 48 C.F.R. § 7.500 et seq.(2011) for a discussion of inherently governmental functions.

⁴⁴ The Duncan Hunter National Defense Authorization Act for Fiscal Year 2009 [hereinafter 2009 NDAA], Pub. L. No. 110-417 § 321, 122 Stat. 4356, 4411-4412 (2008).

⁴⁵ The CAOC is composed of the Chief Acquisition Officers of the 23 Chief Financial Officers (CFO) Act (31 U.S.C. 501 et seq.) agencies and the Department of Homeland Security.

⁴⁶ The CHCOC is composed of the Chief Human Capital Officers of the 23 CFO Act agencies and the Department of Homeland Security.

⁴⁷ While this guidance was due within a year of enactment, it has not yet been finalized.

⁴⁸ 2009 NDAA at § 321 (a), 122 Stat. at 4411.

⁴⁹ *Id.* at § 321(a)(2)(C), 122 Stat. at 4411.

Federal government employees.”⁵⁰ In the discussion of inherently governmental work, the policy letter generally adopts the FAIR Act definition, which defines an activity as inherently governmental when it is so intimately related to the public interest as to mandate performance by Federal employees. The letter provides additional guidance, stating that the definition:

[I]ncludes functions that require either the exercise of discretion in applying Federal Government authority or the making of value judgments in making decisions for the Federal Government, including judgments relating to monetary transactions and entitlements. An inherently governmental function involves, among other things, the interpretation and execution of the laws of the United States so as—

- (1) To bind the United States to take or not to take some action by contract, policy, regulation, authorization, order, or otherwise;
- (2) To determine, protect, and advance United States economic, political, territorial, property, or other interests by military or diplomatic action, civil or criminal judicial proceedings, contract management, or otherwise;
- (3) To significantly affect the life, liberty, or property of private persons;
- (4) To commission, appoint, direct, or control officers or employees of the United States; or
- (5) To exert ultimate control over the acquisition, use, or disposition of the property, real or personal, tangible or intangible, of the United States, including the collection, control, or disbursement of appropriations and other Federal funds.

75 Fed. Reg. at 16,193.⁵¹

⁵⁰ Work Reserved for Performance by Federal Government Employees, 75 Fed. Reg. 16,188 (March 31, 2010).

⁵¹ The draft policy letter includes an appendix with examples of inherently governmental functions, which includes the direct conduct of criminal investigations; the control of prosecutions and performance of adjudicatory functions; the command of military forces; the conduct of foreign relations and determination of foreign policy; the determination of agency policy; the determination of Federal program priorities or budget requests and policies; the direction and control of Federal employees, including hiring of employees and creation of position descriptions; and the direction and control of intelligence and counter-intelligence operations; the determination of what Government property is to be disposed of and on what terms; many procurement activities; the approval of agency responses to Freedom of Information Act (FOIA) requests that require the exercise of judgment or approval of agency response to administrative FOIA appeals; the conduct of administrative hearings to determine the eligibility of any person for a security clearance; the approval of federal licensing actions and inspections; the collection, control, and disbursement of fees, royalties, duties, fines, [continued]

The policy generally excludes functions such as information gathering, ministerial and internal functions, such as building security, facilities operations and maintenance, and mechanical services from the definition of inherently governmental.⁵²

IV. Critical Function

While the 2008 NDAA directed DoD to look at work which was “closely associated with the performance of an inherently governmental function,”⁵³ the 2009 NDAA expanded on this concept and required OMB, the CHCOC and CAOC to develop guidance and definitions so that agencies could identify critical functions that should be performed by Federal employees.⁵⁴ Specifically, such critical functions should include work that “should only be performed by officers or employees of the Federal Government or members of the Armed Forces to ensure the department or agency maintains control of its mission and operations.”⁵⁵ Furthermore, the agencies were to provide criteria to identify positions that should be performed by military or civilian personnel in order to ensure that the agency “develops and maintains sufficient organic expertise and technical capability”⁵⁶ to conduct “critical functions with respect to the unique missions and structure of that department or agency.”⁵⁷

In response, the OFPP draft policy letter defines “critical functions” as those being “necessary to the agency being able to effectively perform and maintain control of its mission and operations,”⁵⁸ stating further that “[a] function that would not expose the agency to risk of mission failure if performed entirely by contractors is not a critical function.”⁵⁹ It provides nineteen examples of functions closely associated with performance of inherently governmental functions:

1. Services that involve or relate to budget preparation, including workforce modeling, fact finding, efficiency studies, and should cost analyses.
2. Services that involve or relate to reorganization and planning activities.
3. Services that involve or relate to analyses, feasibility studies, and strategy options to be used by agency personnel in developing policy.

taxes and other public funds, unless authorized by statute, but not including fees, fines, penalties, costs or other charges from visitors to or patrons of mess halls, post or base exchange concessions, national parks, and similar entities or activities; the control of the Treasury accounts; the administration of public trusts; and official communications with Congress or the General Accountability Office. 75 Fed. Reg. at 16,196-16,197.

⁵² 75 Fed. Reg. at 16,193.

⁵³ 10 U.S.C. § 2463(b)(1)(B).

⁵⁴ 2009 NDAA at § 321(a)(3)(A)-(B), 122 Stat. at 4411.

⁵⁵ *Id.* at § 321(a)(3)(B), 122 Stat. at 4411.

⁵⁶ *Id.* at § 321(a)(4), 122 Stat. at 4411.

⁵⁷ *Id.* at § 321(a)(3)-(4), 122 Stat. at 4411.

⁵⁸ *Id.*

⁵⁹ *Id.*

4. Services that involve or relate to the development of regulations.
5. Services that involve or relate to the evaluation of another contractor's performance.
6. Services in support of acquisition planning.
7. Assistance in contract management (particular [sic] where a contractor might influence official evaluations of other contractors' offers).
8. Technical evaluation of contract proposals.
9. Assistance in the development of statements of work.
10. Support in preparing responses to Freedom of Information Act requests.
11. Work in any situation that permits or might permit access to confidential business information and/or any other sensitive information (other than situations covered by the National Industrial Security Program described in FAR 4.402(b)).
12. Dissemination of information regarding agency policies or regulations, such as attending conferences on behalf of an agency, conducting community relations campaigns, or conducting agency training courses.
13. Participation in any situation where it might be assumed that participants are agency employees or representatives.
14. Participation as technical advisors to a source selection board or as nonvoting members of a source evaluation board.
15. Service as arbitrators or provision of alternative dispute resolution (ADR) services.
16. Construction of buildings or structures intended to be secure from electronic eavesdropping or other penetration by foreign governments.
17. Provision of inspection services.
18. Drafting of legal advice and interpretations of regulations and statutes to government officials.
19. Provision of special non-law enforcement security activities that do not directly involve criminal investigations, such as prisoner detention or transport and nonmilitary national security details.

75 Fed. Reg. at 16,197.

V. Implementation of Insourcing at DoD.

As a result of the 2008 NDAA, then-Deputy Secretary of Defense Gordon England issued guidance to the each of the services regarding implementation of Section 2463 (hereinafter, the England Guidance).⁶⁰ DoD chose to implement Section 2463 using the

⁶⁰ Deputy Secretary of Defense, *Implementation of Section 324 of the National Defense Authorization Act for Fiscal Year 2008 (FY 2008 NDAA)-Guidelines and Procedures on In-sourcing New and Contracted Out Functions*, (Apr. 4, 2008).

inventory of contractors⁶¹ to identify insourcing targets, and the guidance already issued to implement the Manpower Management provisions 10 U.S.C. § 129a. The Manpower Management provisions require that DoD use, “the least costly form of personnel consistent with military requirements and other needs of the Department,”⁶² and directs DoD to “consider particularly the advantages of converting from one form of personnel (military, civilian, or private contract) to another for the performance of a specified job” and then to provide Congress with the justification for the conversion.⁶³

To that end, the England Guidance allows the use of civilian employees to perform new functions or functions that are currently performed by a contractor, “if an economic analysis shows that DoD civilian employees are the low cost provider, or the DoD Component has determined, consistent with DoD Instruction 1100.22, “Guidance for Determining Workforce Mix,” that the function under review is inherently governmental or exempt from private sector performance.”⁶⁴ The England Guidance emphasizes that the decision to use DoD civilian employees must be “fiscally informed and analytically based”⁶⁵ and that the overall goal is to “reduce workforce costs, realign inherently governmental and exempt functions for government performance, and manage more efficiently and effectively.”⁶⁶

Accompanying the England Guidance was the “*Under Secretary of Defense (Personnel and Readiness)’s Guidelines and Procedures for Implementation of 10 U.S.C. §2463*,”⁶⁷ (PR Guidelines) which instructed DoD components to comply with 10 U.S.C. §129a, as implemented by DoD Instruction 1100.22, “Guidance for Determining Workforce Mix,” when considering whether to use contractor or DoD civilian employees. The PR Guidelines attempted to give more practical implementation guidance, and required that the DoD components document their decision-making process.⁶⁸

The conclusion reached by the PR Guidelines was that if work was exempted from contractor performance by statute, it should be performed by DoD civilian employees.⁶⁹ Otherwise, when considering who should perform new requirements the DoD component was instructed to “perform an economic analysis to determine whether DoD civilians or private sector contractors are the low cost provider and should perform the work.”⁷⁰ To reach that conclusion, the component was instructed to use “[q]ualified cost analysts/experts . . . using cost factors/models that account for the full costs of manpower, as appropriate, and make ‘like comparisons’ of all relevant costs.”⁷¹

⁶¹ 2008 NDAA at § 807, 122 Stat. at 213.

⁶² 10 U.S.C. §129a.

⁶³ *Id.*

⁶⁴ England Guidance at p. 1.

⁶⁵ *Id.*

⁶⁶ *Id.* at p. 2.

⁶⁷ Under Secretary of Defense - Personnel and Readiness, “*Under Secretary of Defense (Personnel and Readiness)’s Guidelines and Procedures for Implementation of 10 U.S.C. §2463 (as added to the U.S.C. by Section 324 of the FY 2008. NDAA)*,” (April 4, 2008).

⁶⁸ *Id.* at § 8.

⁶⁹ *Id.* at § 4.2.

⁷⁰ *Id.* at § 4.3.

⁷¹ *Id.*

Interestingly, the standard for work being converted from contractor to civilian performance was not as equitable. In such cases, “managers shall follow standard manpower management procedures to determine and validate the manpower requirements . . . include[ing] verifying the mission, functions, and tasks to be performed, required level of performance, and (consistent with title 10 U.S.C. §129) workload necessary for mission success.”⁷² Further, the manager is instructed to assess “the effectiveness, efficiency, and economy of the activity. . . to determine if improvements can be made to reduce workload.”⁷³ Work should be assessed every four years to consider insourcing.⁷⁴

As further implemented in the latest version of DoD Instruction (DoDI) 1100.22,⁷⁵ the burden has been further shifted to favor the use of civilian employees. Specifically, components, “**shall** use DoD civilian personnel to perform the function **unless** DoD civilians are not the low-cost provider or there is a legal, regulatory, or procedural impediment to using DoD civilian personnel.”⁷⁶ Contrast this with the 2006 implementation guidelines, which imposed no such presumption but, instead, found that if an activity was not otherwise exempted from commercial performance, it should be considered for private sector performance or divestiture.⁷⁷

⁷² *Id.* at § 7.1.

⁷³ *Id.*

⁷⁴ *Id.* at § 7.3.

⁷⁵ Department of Defense Instruction [hereinafter DoDI] 1100.22, April 12, 2010.

⁷⁶ *Id.* at § 5. Emphasis added.

⁷⁷ DoDI 1100.22, September 7, 2006 at T1.

VI. Implementation of Insourcing at Civilian Agencies.

The 2009 OMB Memorandum provides initial guidance for implementation at civilian agencies. First, it instructs agencies to determine if work must be performed by federal employees or by either federal employees or private sector contractor, using the following chart:⁷⁸

If the function is . . .	Positions performing the function may be filled . . .
Inherently governmental	<i>only</i> with federal employees
Critical, but not inherently governmental	<p><i>only</i> with federal employees <i>to the extent</i> required by the agency to maintain control of its mission and operations (or if required by law, executive order, or international agreement);</p> <p>and</p> <p>by <i>either</i> federal employees or private sector contractors once the agency has sufficient internal capability to control its mission and operations.</p>
Essential, but not inherently governmental	by either federal employees or private sector contractors.

If the function is essential or critical, but not inherently governmental and sufficient internal capabilities are in place to control mission and operations, agencies are then instructed to “[p]erform a cost analysis if both sectors are being considered for performance of a function.”⁷⁹

Unlike DoD, after controlling for inherently governmental and critical functions, the civilian agency is not required to consider which option is less costly to the government, so it may use federal employees even if they are more expensive. However, if an agency is considering both sectors for the performance of a function, the agency “should perform a cost analysis that addresses the full costs of government and private sector performance and provides ‘like comparisons’ of costs that are of a sufficient magnitude to influence the final decision on the most cost effective source of support for the organization.”⁸⁰

⁷⁸ M-09-26, Attachment 1, at p. 2.

⁷⁹ *Id.*

⁸⁰ *Id.*

The OFPP draft policy letter strikes a more balanced note, beginning by averring that:

Nothing in this guidance is intended to discourage the appropriate use of contractors. Contractors can provide expertise, innovation, and cost-effective support to federal agencies for a wide range of services. Reliance on contractors is not, by itself, a cause for concern, provided that the work they perform is not work that should be reserved for federal employees and that federal officials are appropriately managing contractor performance.

75 Fed. Reg. at 16,193.

The draft policy only provides guidance on addressing inherently governmental and critical functions. In the case of the latter functions, OFPP does provide guidance on when it may be appropriate to have contractors perform some critical functions work, assuming that the “agency has sufficient internal capability to control its mission and operations.”⁸¹ In such cases, OFPP directs that the “extent to which additional work is performed by federal employees should be based on cost considerations unless performance and risk considerations in favor of federal employee performance will clearly outweigh cost considerations,” and states that to support such a finding, “cost analysis should address the full costs of government and private sector performance and provide like comparisons of costs that are of a sufficient magnitude to influence the final decision on the most cost effective source of support for the organization.”⁸²

Unfortunately, the draft policy does not address how agencies should handle conversion of non-inherently governmental and non-critical function to civilian employees. In the absence of this guidance, each agency is preparing its own, most of which is not publicly available.

VII. Problems with Insourcing

A. Lack of Transparency

Insourcing faces problems with lack of transparency both on the programmatic and case specific levels. On the programmatic level, pursuant to the 2009 OAA, each civilian agency was required to publish insourcing guidance by mid-July of 2009. However, nearly two years later, that guidance has not been made publicly available. According to GAO, agencies are waiting for final guidance from OFPP before issuing their own guidelines, so that the two documents will not conflict.⁸³ That does not mean that agencies have not been insourcing, simply that there is no guidance publicly available to the small businesses whose work is being insourced.

⁸¹ 75 Fed. Reg. at 16,196.

⁸² *Id.*

⁸³ Government Accountability Office, “*Insourcing Guidelines*,” Report GAO-10-58R (Oct. 6, 2009).

Ideally, such guidance would be published as notice and comment rulemaking, subject to the Administrative Procedure Act⁸⁴ (APA). In such cases, small businesses would then have the right to comment on the guidance, and would be able to challenge the agencies if they failed to follow their own rules. However, in draft guidance made available to the Committee, the guidance will be issued solely as a management document.

On a more case specific basis, individual businesses subject to insourcing have no standard way by which they are notified and have little access to documents explaining the decision in their specific cases. Each company interviewed by the Committee had to FOIA its insourcing decision in order to learn the basis for the insourcing decision. Most only learned that the work was being insourced from their employees, who themselves had learned about the insourcing decision when they were told that they need to apply for their jobs.

B. Inconsistent Cost Analyses.

Insourcing was initially slated to save DoD 40%,⁸⁵ but DoD has recognized that converting from contractors to civilian employees has not achieved significant savings.⁸⁶ Consequently, the Secretary of Defense announced a moratorium on insourcing functions within the Department of Defense that were not inherently governmental work.⁸⁷ This did not freeze insourcing at the various DoD services and components, although the Army recently froze all insourcing activity absent the express written approval of the Secretary.⁸⁸

As DoD has a strict requirement for cost analyses, why are the savings not materializing? The latest detailed DoD guidance on costing may provide some insights.⁸⁹ A recent study by an independent think tank found that following the DoD guidance would not result in a fully burdened⁹⁰ cost to the government, failed to account for the full cost of DoD owned capital while attributing such costs to the private sector, failed to account for forgone tax revenues, failed to account for the risk of cost growth among public sector functions, failed to consider cumulative costs attributable to insourcing, failed to account for the costs of insuring and indemnifying public section production, failed to

⁸⁴ 5 U.S.C. 500 *et seq.*

⁸⁵ Robert M. Gates, "Defense Budget Recommendation Statement," Arlington VA (April 6, 2006).

⁸⁶ Matthew Weigelt, "Insourcing failed, DOD's Gates says. Now what?" Washington Technology, (Aug. 10, 2010), quoting Robert Gates.

⁸⁷ Robert Brodsky, "Pentagon abandons insourcing effort" Government Executive, (Aug. 10, 2010) quoting Gates as saying, "As we were reducing contractors, we weren't seeing the savings we had hoped from insourcing."

⁸⁸ Secretary of the Army, "Reservation of In-Sourcing Approval Authority" (Feb. 1, 2011).

⁸⁹ Department of Defense, Directive-Type Memorandum (DTM) 09-007, "Estimating and Comparing the Full Costs of Civilian and Military Manpower and Contract Support" (Jan. 29, 2010) as amended October 21, 2010.

⁹⁰ A fully burdened cost is one that captures all costs incurred by the government as a result of employing an individual.

account for the disproportionate costs of varying workloads in public sector functions, and failed to use a detailed statement of work as the basis for the cost analysis.⁹¹

The study found that OMB Circular A-76 did a better job of providing specificity on major cost components, including the cost of in-house production at a private sector rate of return on new investments, including foregone taxes, accounting for casualty and liability insurance, and providing a performance work statement.⁹² However, it also noted that OMB Circular A-76 failed to implement object cost comparisons, because it used an unsupported blanket overhead cost of 12% for all government functions and failed to account for the true cost of capital on the public side.⁹³

Contractors bring needed flexibility to government requirements, especially since their forces can be easily scaled to meet current needs and the latest requirements. Federal employees are much more appropriate for work that will remain consistent over a career. As making adjustments to the number of public sector employees is incredibly difficult, a true cost analysis should look at the lifespan cost of a federal employee. Americans for Tax Reform has estimated, that over a 40 year career, a federal employee costs the government “between \$2.02 million for the cheapest employee (GS-1), and \$11.3 million for the most expensive employee (GS-15).⁹⁴ An employee in the middle of the federal pay scale (GS-8) will cost \$4.27 million.”⁹⁵ However, in many of the cases that have been brought to the attention of the Committee, the government is not even accounting for the fully loaded cost of an employee, let alone looking at the lifespan of that employee. This approach seems to be condoned by DTM 09-007, which differentiates between “Full Costs to DoD” and the higher “Full Costs to the Federal Government” for insourced personnel. In such cases, DoD uses the former number, rather than the latter, for cost comparisons.

Likewise, witnesses will testify that the government has changed the scope of the work before beginning a cost comparison. For example, in the recent case of *Santa Barbara Applied Research (SBAR) v. United States*,⁹⁶ the Court acknowledged that the Air Force, for purposes of the evaluation, assumed that it would only required 75% of the full time equivalents as the incumbent contractor and would need no additional overtime,

⁹¹ Center for Strategic and International Studies, *DoD Cost Realism Assessment*, May 2011 at pp. 10-11.

⁹² *Id.* at 12.

⁹³ *Id.*

⁹⁴ Americans for Tax Reform, *Cost of Government Day*® 2010, (2010) at p. 16. However, these numbers do not account for locality pay adjustments. Senior Executive Service employees typically make more than a GS-15, but as much of their work consists of supervising Federal employees, their work is traditionally considered inherently governmental.

⁹⁵ *Id.*

⁹⁶ No. 11-86C (CoFC May 4, 2011). Plaintiff small business protested Air Force insourcing decision based on flawed cost comparison required by 10 U.S.C. § 2463. Judge Firestone finds that plaintiff has standing as the Air Force decision was made “in connection with a procurement decision” and is an interested party as “SBAR has a track record of winning contracts for the work that the Air Force is now in-sourcing, the economic impact to SBAR cannot be denied. This is all that is required for SBAR to satisfy the criteria for standing under section 1491(b)(1).” However, SBAR ultimately loses upon finding that the Air Force’s actions were not arbitrary and capricious.

without providing a basis for these assumptions.⁹⁷ Further, the Air Force assumed that there would be no quality assurance evaluation costs if the work was performed in house.⁹⁸

C. Prohibition on Competition

Both DoD and the civilian agencies are statutorily prohibited from using a public-private competition in order to inform the decision on whether to insource a function.⁹⁹ However, DoD is statutorily instructed to use the “least costly form of personnel consistent with military requirements and other needs of the Department.”¹⁰⁰ While public employees are given the right to prove that they can perform more efficiently than a contractor under OMB Circular A-76,¹⁰¹ the reverse privilege has been denied to companies seeking to retain commercial work slated for insourcing.

D. Standing

There is currently a split at the Court of Federal Claims as to whether a company has standing to challenge an insourcing decision, and if so, what that standing permits. In *SBAR*, Judge Firestone granted the small business standing, and found that “[c]ontrary to the government’s contentions, Congress’ decision to require compliance with DTM 09-007[DoD published Directive-Type Memorandum 09-007, Estimating and Comparing the Full Costs of Civilian and Military Manpower and Contract Support] for in-sourcing (sic) decisions based, like this one, on cost savings alone gives the court a meaningful standard against which to judge the Air Force’s exercise of discretion. *SBAR*’s complaint, which is based on the alleged misapplication of DTM 09-007 by the Air Force, states a claim for relief.”¹⁰²

However, in *Hallmark-Phoenix III v. United States*,¹⁰³ Judge Allegra held that “[i]t is not enough that plaintiff will experience a competitive injury as a result of the in-sourcing (sic) decision or that this injury might be remedied by a ruling setting aside that decision. For even where it is undisputed that a governmental decision causes competitive injury” there must be prudential standing.¹⁰⁴ In other words, Judge Allegra did not believe that current law provided a remedy.

⁹⁷ *Id.* at 23.

⁹⁸ *Id.* at 25.

⁹⁹ 10 U.S.C. § 2463(c); 2009 OAA at § 736, 126 Stat. at 689-690.

¹⁰⁰ 10 U.S.C. § 129a.

¹⁰¹ Indeed, the Agency Tender Official, who represents the federal employees, is given a budget with which to compete. OMB Circular A-76 at Attachment B § 8(a).

¹⁰² *SBAR* at 19.

¹⁰³ No. 11-98C slip op (CoFC May 24, 2011). Plaintiff small business challenged the Air Force’s decision to insource work on the grounds that it was not in accordance with 10 U.S.C. § 129a, § 2463(a).

¹⁰⁴ *Id.* at 17. While standing usually requires that the party be an interested party pursuant to Article III of the Constitution, prudential standing requires that either the Constitution or a statute provide a remedy.

It is worth noting that both of these cases are DoD based. It remains to be seen if the courts will find standing or a remedy for cases brought under the 2009 OAA.

VIII. Issues Before the Committee.

A. Transparency

The lack of transparency in the insourcing process gives rise to many questions that the Committee will be exploring. For example, should agencies be required to publish their insourcing guidance before insourcing functions? Does the answer change if the work is inherently governmental, critical, or commercial in nature? Should the guidance be published through notice and comment rule making?

Given the importance of long-term planning to small businesses, at what point should they be notified that the work they are under contract to perform is being considered for insourcing? Should small businesses need to FOIA insourcing decisions, or should the public have access to data regarding insourcing? How could such information be shared while still protecting procurement-sensitive or competition-sensitive information?

B. Cost Comparisons

Given the problems with the current costs studies, the Committee is concerned with the application of cost studies, and is considering whether agencies should have uniform standards for cost comparisons? Should these cost comparisons be executed by the personnel offices or by the procurement divisions? Should agencies be able to outsource the cost comparisons?

In cases where insourcing is appropriate, should the cost analysis be based on an objective and transparent model, and what would that model include? If work is being insourced, should the government be allowed to change the scope of the work for purposes of the cost analysis? Should the government be held accountable for any projected savings?

C. Competition

While public-private competitions are prohibited for purposes of insourcing, should small businesses be permitted to share cost information on a voluntary basis to help inform the decisions being made by the government? Should Congress permit public-private competition for insourcing?

How often should insourcing be considered? Current administration guidance states that it should be considered every four years, but the standard services contract is a one-year base contract with four one-year options. Thus, the policy would place all contracts at risk of insourcing during their period of performance.

When insourcing work that is not inherently governmental, how should a small businesses size be considered? Does the answer vary depending on whether the agency is meeting its small business goals?

D. Standing

Given the current split at the Court of Federal Claims, Congress may wish to address the issue of standing. If so, should Congress provide interested party status under Article III of the Constitution to a small business whose work is being insourced? Further, should Congress address the issues of remedies in order to provide prudential jurisdiction to small businesses?

E. The Role of the SBA

What role, if any, should the Small Business Administration (SBA) play in the insourcing process? Two specific possibilities exist. Currently, if a requirement is accepted into the 8(a) program of the Small Business Act, it can only be removed from this program with the consent of SBA.¹⁰⁵ Further, the SBA issued a "Form 70" against a Coast Guard decision to insource work currently being performed by a small firm.¹⁰⁶ Should SBA be encouraged to intervene in the decision to insource a requirement, and if so, in which circumstances?

IX. Conclusion

The Subcommittee hearing should provide Members with the opportunity to explore the issues and lines of questions raised in this memorandum. The resulting information should help Congress and the Administration better develop policies and procedures that protect taxpayer interests, increase efficiencies, and promote small business job creation.

¹⁰⁵ 13 C.F.R. 124.504(d).

¹⁰⁶ A Form 70 is SBA's way of protesting a agency's decision not to set a contract aside for small business pursuant to § 15(l)(3) of the Small Business Act.