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Contractors Can Challenge the Government's In-Sourcing Efforts

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After filing suit in the United States District Court for the Western District of Texas, the United States Air Force ("USAF") decided to cancel an effort to in-source a contract that had been performed by a small business for over ten years. This case demonstrates that although the Obama Administration may be seeking to in-source much of the services the Federal government currently fulfills through private contractors, it will not be allowed to do so in a *carte blanche* manner.

Background on In-Sourcing Efforts: In March 2009, Congress enacted Section 736 of the Omnibus Appropriations Act of 2009 (Pub. L. No. 111-8), which requires federal agencies, with the exception of the Department of Defense ("DoD"), to devise and implement guidelines for in-sourcing new and contracted-out functions by mid-July 2009. Accordingly, on July 29, 2009, the Office of Management and Budget ("OMB") directed each "agency [to] consider 'on a regular basis' the use of federal employees 'to perform new functions and functions that are performed by contractors and could be performed by Federal employees.' "As part of this effort, OMB stated that such evaluations should "generally include a cost analysis that addresses the full costs of performance and provides 'like comparisons' of relevant costs to determine the most cost effective source of support." OMB further ordered every agency in fiscal year 2010 to conduct a study of at least one outsourced function to determine if outsourcing is appropriate, cost-effective and well managed. If the agency determined it was not, OMB provided that such work should be brought in-house or agencies should hire more federal employees to oversee the contractor. In October 2009, the non-DoD agencies submitted their proposals to OMB and the agencies will report on the results of those reviews in April 2010.

With respect to the DoD, in 2006, Congress passed an in-sourcing statute that required the DoD to establish procedures for in-sourcing. *See* 10 U.S.C. § 2463. However, the statute did not detail the content of the implementing regulations. In 2008, the Bush Administration promulgated procedures that required the DoD to meet certain requirements when in-sourcing, among these obligations was the requirement to perform a cost analysis that would determine and account for the "full cost of manpower."

Since taking office, the Obama Administration has made in-sourcing a major piece of acquisition reform agenda. For instance, the Administrator for Federal Procurement Policy at the Office of Management and Budget ("OMB"), Daniel Gordon, stated that the Obama Administration's 2011 budget proposal will "rebalance" the relationship between the government and its contractors through more oversight and in-sourcing. The public interest, as far as OMB is concerned, is to increase the size of the workforce managing contracts to provide better oversight; to decrease contract costs; and to ensure that the government is not abdicating its decision-making role when it decides what to buy and who to buy it from.

To address this, the Obama Administration's 2011 budget proposes adding nearly 20,000 new civilian and military personnel to the DoD and spending $158 million at civilian agencies to hire over 10,000 acquisition personnel to perform work now done by contractors. Non-defense agencies have told OMB that a third of the positions they will study for possible in-sourcing are acquisition-support functions, such as cost estimating. Gordon added that these agencies also are reviewing information technology support work performed by contractors for possible in-sourcing, as many agencies fear they have lost the ability to manage their own networks.

The Case: In 1997, Rohmann Services, Inc. ("RSI") of San Antonio, Texas first began performance on a multimedia and audiovisual services contract for the USAF at Edwards Air Force base in California. In October 2009, after more then ten years of service, the USAF began positioning itself to in-source the work performed by RSI. Notably, the USAF failed to inform RSI until January 2010.

However, under the DoD's in-sourcing procedures, the USAF was obligated to maintain its contract with RSI if a cost analysis demonstrated that RSI was more cost effective to continue with the out-

sourced work (*i.e.,* it was less costly to contract with RSI than it would be to in-source the work). The USAF performed a cost analysis, but apparently erred in performing its analysis, in turn causing the DoD in-sourcing figure to be artificially lower than the cost to out-source to RSI. Among the alleged errors in the cost analysis were the USAF's omission of certain positions, and the failure to include overhead, fringe benefit and overtime costs.

As a result of the alleged errors, RSI filed suit in the United States District Court for the Western District of Texas (No. 10-CV-0061), arguing that Congress required DoD to implement in-sourcing procedures that guaranteed fairness to all parties and that the USAF failed to follow those procedures. Accordingly, the USAF decided to withdraw its in-sourcing decision and to extend RSI's contract term, thus rendering the lawsuit moot.

Most Recent In-Sourcing Developments at DoD: On January 29, 2010, DoD expanded upon the 2008 in-sourcing regulations with a "Directive-Type Memorandum" ("Directive") that again asserted the need for all components to estimate and compare the full costs of civilian and military manpower and contract support, but also established the "business rules" that should be used to estimate the full costs of the defense workforce in support of strategic planning, defense acquisition and force structure decisions. These "business rules," outlined in Attachment 2 to the Directive provide that the direct and indirect costs must be assessed when estimating workforce costs. The purpose of this Directive and the "business rules" contained therein, is to assist DoD components in performing an economic analysis in support of workforce decisions.

> This includes, but is not limited to, determining the workforce mix of new or expanding mission requirements that are **not inherently governmental or exempt from private-sector performance**. The DoD Components also shall use the business rules to decide whether to use DoD civilians to perform functions that are currently being performed by contractors but that could be performed by DoD civilians.

(Emphasis added). The full text of the Directive and business rules can be viewed at: **http://www.dtic.mil/whs/directives/corres/pdf/DTM-09-007.pdf**.

Practitioner's Tips: While the USAF apparently failed to properly follow the DoD in-sourcing procedures in this particular procurement, it signifies the real threat of in-sourcing to government contractors, as well as the tools and defenses available to them in defending their contracts. As a result, government contractors should be mindful of the government in-sourcing efforts and take steps to protect their contracts and document their true cost. These steps may include some or all of the following as appropriate:

- Maintain an open and positive communication channel with the government. This should include all of the government officials assigned to oversee and administer your contract, including the contracting officer, contracting officer's representative, contracting officer's technical representative and the ultimate end user.
- Establish appropriately detailed and accurate accounting records that demonstrate the true cost of contracts. For many contracts, this type of information is already required.
- In the event the government informs a contractor that a certain contract is being considered for in-sourcing, inform your organization's legal counsel (in-house or outside counsel) immediately to determine what, if anything, can be done to maintain the contract.

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