



Government Contracts Advisory

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OFPP Issues Final Policy Letter Defining “Inherently Governmental Functions”

On September 12, 2011, the Office of Federal Procurement Policy (“OFPP”) published Policy Letter 11-01 regarding the “**Performance of Inherently Governmental and Critical Functions**”. This final Policy Letter: (i) defines what functions are “inherently government” and which must be performed by federal employees, (ii) provides guidance about what agencies must do when work is “closely associated” with an inherently governmental function, and (iii) attempts to structure a framework to “strengthen the accountability for the effective implementation of these policies.” Effective October 12, 2011, agencies will be required to follow the guidelines in this Policy Letter, which furthers the Obama administration’s efforts to reign in government contracting for services, and swings the pendulum away from contracting for government functions to the direct performance of government functions by federal employees. OFPP will also be working with the Federal Acquisition Regulatory Counsel, the Defense Acquisition Regulations Council and the Civilian Agency Acquisitions Council to amend the FAR to be consistent with these new policies.

Background

On March 4, 2009, President Obama released his **Presidential Memorandum on Government Contracting** to direct the Office of Management and Budget (“OMB”) to develop guidance for agencies to determine when outsourcing of governmental services is appropriate, and to ensure that such guidance is consistent with section 321 of the Duncan Hunter National Defense Authorization Act for Fiscal Year 2009 (**Public Law 110-417**).

As we **previously reported**, on March 31, 2010, OFPP released a proposed **Policy Letter** for public comment in response to the President’s Memorandum. Given the importance of this guidance and its effect on contractors, the proposed Policy Letter received comments from more than 30,530 respondents. OFPP issued the final Policy Letter on September 12, 2011, and it becomes effective on October 12, 2011.

Implementation and Guidance

The Policy Letter includes implementation guidelines and responsibilities that agencies shall use to determine: “(1) whether their requirements involve the performance of inherently governmental functions, functions closely associated with inherently governmental functions, or critical functions; and (2) the type and level of management attention necessary to ensure that functions that should be reserved for Federal performance are not materially limited by or effectively transferred to contractors and that functions that are suitable for contractor performance are properly managed.” Determining the type and level

of management required will generally require agencies to “consider the totality of circumstances surrounding how, where, and when work is to be performed.”

Determining Whether a Function is Inherently Governmental, Closely Associated or Critical

The OFPP Policy Letter lays out various tests for agencies to utilize when deciding whether a function is inherently governmental, closely associated or critical. This determination is crucial, and has a significant impact on whether a function can be performed by a contractor. Inherently government functions can only be performed by Federal employees. Closely associated functions can be performed by Federal employees and contractors, but there is a preference for this work to be performed by Federal employees. Critical functions may be performed by both Federal employees and contractors.

- Inherently Governmental Functions

Policy Letter 11-01 adopts the definition of “inherently governmental functions” found in the Federal Activities Inventory Reform (“FAIR”) Act, Pub. L. No. 105-270, § 5, 112 Stat. 2382, 2384-85 (1998). As a result, an inherently governmental function is a “function that is so intimately related to the public interest as to require performance by Federal Government employees.” The Policy Letter also provides an illustrative list of 24 examples of inherently governmental functions, including: the command of military forces; the conduct of foreign relations; the determination of budget policy, guidance and strategy; the awarding and termination of prime contracts; and the determination of Federal program priorities or budget requests.

To determine whether a function is inherently governmental, agencies must evaluate, on a case-by-case basis: (i) the nature of the function and (ii) level of discretion associated with performance of the work. A function that satisfies either test is deemed inherently governmental. The “nature of the function” test asks agencies to consider whether the function “involve[s] the exercise of sovereign powers of the United States.” If so, the function is governmental “by [its] very nature.” The Policy Letter notes that a function can be deemed inherently governmental “based strictly on its uniquely governmental nature and without regard to the type or level of discretion associated with the function.” The “exercise of discretion test” asks agencies to evaluate whether: (i) the exercise of the discretion commits the government to a course of action “where two or more alternative courses of action exist and decision making is not already limited or guided by existing policies, procedures, directions, orders, and other guidance,” (ii) the function can be performed by a contractor where the contractor “does not have the authority to decide the overall course of action,” or (iii) the contractor’s involvement and work product would “effectively preempt the Federal official’s decision-making process, discretion or authority.” Once an agency determines that a function is inherently governmental, then the work must be insourced.

- Closely Associated Functions

Another step in the agencies’ analysis is to determine whether the function may be “closely associated” to an inherently governmental function. The Policy Letter does not clearly define “closely associated functions.” Rather, it states that “certain services and actions that generally are not considered to be inherently governmental functions may approach being in that category because of the nature of the function and the risk that performance may impinge on Federal officials’ performance of an inherently governmental function.” The Policy Letter includes an illustrative list of closely associated functions. Examples include: performing budget preparation activities, such as fact finding and should-cost analyses; activities to support agency planning

and reorganization; and supporting acquisition planning, source selection and contract management. Agencies must give special consideration to utilizing Federal employees to perform “closely associated functions.”

- Critical Functions

The Policy Letter also fails to provide a concrete definition of “critical functions.” To determine whether a function is critical, the agency must “consider the importance that a function holds for the agency and its mission and operations. The more important the function, the more important that the agency have internal capability to maintain control of its mission and operations.” The Policy Letter only provides two examples of critical functions: analyzing areas of tax law that impose significant compliance burdens on taxpayers for the Internal Revenue Service’s Office of the Taxpayer Advocate, and performing mediation services for the Federal Mediation and Conciliation Service.

Critical functions can be both outsourced and insourced. When determining whether a contractor may perform the work, the agency “must have sufficient internal capability to control its mission and operations and must ensure it is cost effective to contract the services.” The Policy Letter defines “sufficient internal capacity.” The definition requires that the agency have positions filled by Federal employees “with appropriate training, experience, and expertise” to understand that agency’s requirements, to manage the work/contractors, and to continue critical operations in-house should the contractor default. Determinations should be made on a case-by-case basis. The agency’s analysis should include the: “(i) agency’s mission; (ii) complexity of the function and the need for specialized skill; (iii) current strength of the agency’s in-house expertise; (iv) current size and capability of the agency’s acquisition workforce; and (v) effect of contractor default on mission performance.”

Effect on the Agencies, and Pre- and Post Contract Award Procedures

As a result of Policy Letter 11-01, agencies are required to develop and maintain internal procedures reflecting OFPP’s guidance. Agencies with 100 or more full-time employees must identify at least one senior official to be accountable for developing and implementing such procedures and policies.

The Policy Letter also mandates that agencies undertake a myriad of actions, both pre- and post-contract award. When an agency plans or awards a contract, it must now confirm that the services it seeks are not inherently governmental, and that it can maintain control of its missions and operations. Agencies must include this analysis in the contract file.

As a recognition of the impact insourcing could have on small business, the Policy Letter states that agencies should place a lower priority on reviewing work performed by small businesses where the contractor’s performance of the work does not place the agency at “risk of losing control of its mission or operations.” Further consideration should be given if the agency has not met its small business and socio-economic goals. The Policy Letter notes that the small business advocate should be involved in the decision-making process if the agency is “considering the insourcing of work currently being performed by small business,” and that the “rule of two” should apply to the work that remains outsourced. This guidance related to small business contracting directly resulted from the public comments received by OFPP.

After the award of a contract, agencies are now required to analyze, on an ongoing basis, the way in which contractors are performing, and agencies are managing, closely associated and critical functions. If an agency determines that a contractor is performing an inherently governmental function, then it must take corrective actions. Such corrective actions include strengthening

contractor oversight or terminating the part of the work that is inherently governmental. If an agency determines that “internal control of its mission and operations is at risk due to overreliance on contractors to perform critical functions,” then it must develop a plan to reduce reliance on contractors. Finally, to the extent an agency has the capacity to control its mission and operations, it must use a cost analysis to determine whether it can procure additional closely associated and critical functions from contractors.

Conclusion

Contractors should closely monitor the effects of Policy Letter 11-01 after it becomes effective on October 2, 2011. While the Policy Letter attempts to strike a fair and consistent balance between government outsourcing and insourcing, each individual agency will be making its own decisions about whether the function is inherently governmental, closely associated or critical. As a result, agencies may classify functions inconsistently, which will dictate what types of work contractors will be able to perform for the Federal government.

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