
# Government Contracts Advisory

April 2, 2010

## OFPP Issues Proposed New Definition of "Inherently Governmental"

On March 31, 2010, the Obama administration released its new government-wide definition of "inherently governmental functions," and directing federal agencies to tighten their use of contractors for "critical functions" and functions "closely associated" with the core work of those agencies. Wednesday's proposed rule continues the Obama administration's efforts to reign in government contracting for services, and further swing the pendulum away from contracting for government functions to the direct performance of government functions by federal employees.

**Defining "Inherently Governmental Functions"**

The new definition, which is included in a proposed policy letter published on Wednesday by the Office of Federal Procurement Policy ("OFPP"), adopts the description of "inherently governmental functions" from the Federal Activities Inventory Reform ("FAIR") Act, Pub. L. No. 105-270, § 5, 112 Stat. 2382, 2384-85 (1998), which defines such functions as those "that [are] so intimately related to the public interest as to require performance by Federal Government employees."

**CONTACTS**

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OFPP chose the FAIR Act definition over two other potential definitions from the Federal Acquisition Regulation ("FAR") and OMB Circular A-76. In the proposed policy, OFPP says there is little difference between the three, but it preferred the language from the FAIR Act, which includes activities that require the "exercise of discretion" in applying "Federal Government authority," unlike the OMB Circular A-76 definition, which refers to the exercise of "substantial discretion" in applying "sovereign" Federal government authority.

The proposed policy includes two tests for agencies to use in applying this definition. The "nature of the function" test would ask agencies to consider whether the direct exercise of sovereign power is involved, such as representation by an ambassador overseas, criminal citation by a police officer, and issuance of a criminal sentence by a judge. The "discretion" test would ask agencies to evaluate whether the discretion associated with the function, when exercised by a contractor, would have the effect of committing the government to a particular course of action, or the contractor's action would effectively pre-empt the decision-making process, discretion or authority of federal officials. To further aid agency officials in divining what is an inherently governmental function, the new policy incorporates the FAR's list of examples (found in FAR 7.503) for inherently governmental functions, including the awarding and termination of prime contracts, command of military forces, determination of agency policy, and others.

Additionally, OFPP's proposed policy directs agencies to take specific pre- and post-award actions with respect to policing the line between contractor functions and inherently governmental functions. As currently required by FAR Subpart 7.5, agency heads or designated requirements officials must continue to make written determinations that proposed contracts do not include inherently governmental functions. Agencies must now also determine in advance that they have sufficient internal capability to manage and control the contractors,

particularly those performing work closely associated with inherently governmental functions, and take appropriate action where "internal control of mission and operations is at risk due to inappropriate or excessive reliance on contractors to perform critical functions."

**"Closely Associated Functions"**

The new policy also requires federal agencies to identify "functions that are closely associated with inherently governmental functions," defined as those where "the nature of the function and the risk that performance may impinge on federal officials' performance of an inherently governmental function." As an initial matter, the policy directs agencies to "give special consideration" to having such functions performed by federal employees, mirroring both the Obama administration's policy preference for government employees over contractors, and the language of the 2009 Omnibus Appropriations Act, which directs the insourcing of these functions too.

To provide greater clarity on what these "closely associated functions" are, the new policy includes an illustrative list of functions such as services that involve or relate to the evaluation of another contractor's performance, services in support of acquisition planning, and assistance in contract management, among others. Notably, this list is drawn from FAR 7.503's list of services *generally not considered* to be inherently governmental functions. However, the list operates very differently in the context of this policy. First, it provides an illustrative list of functions for which there is now a government preference for using federal employees over contractors. Second, should an agency choose to contract for one of the functions on the list, it must ensure it takes special actions to manage and control the contractors doing these jobs. These controls include actions to "limit or guide a contractor's exercise of discretion and retain control of government operations," assignment of sufficient personnel to oversee contractors, mitigation of organizational conflicts of interest, and "reasonable identification of contractors and contractor work products" whenever there is risk that Congress, the public or others might confuse contractor personnel with government personnel. Further, when agencies choose to outsource such functions, they must make a written determination that (i) the function is closely associated with an inherently governmental function, (ii) private sector performance is appropriate and the most cost effective source of support for the agency, and (iii) the agency has sufficient management and control resources to properly oversee the contractor.

**Critical Functions**

In addition, OFPP's proposed policy letter establishes a policy on "critical functions," which it defines as those which an agency must have the internal capability to substantially perform, because they are so central to the agency's mission and operations. As examples, the policy cites designing and constructing the next generation of satellites by the National Aeronautics and Space Administration and performing mediation services for the Federal Mediation and Conciliation Service. Where a critical function is not inherently governmental, the new rule allows agencies to perform such functions with both federal employees and contractors. However, OFPP's new rule directs agencies to maintain "a sufficient internal capability to control its mission and operations," and only contract for the performance of critical functions where it is cost-effective to do so.

Towards this end, the new policy also requires agencies to conduct Strategic Human Capital Planning to determine what is necessary to develop and maintain their in-house critical functions, provide for continuity of operations, and retain institutional knowledge, and ensure sufficient personnel are available to manage and control contractors. Each agency must develop an annual Human Capital Plan for Acquisition which shall specifically identify how the agency will build and maintain its acquisition workforce, including program managers and contracting officer technical representatives.

**Trends in Government Contracting for the Obama Administration**

Wednesday's proposed policy follows a March 4, 2009, memorandum from President Obama which stated his administration's goals for "insourcing" government functions and policing contractor activity:

[T]he 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.

It is the policy of the Federal Government that executive agencies shall not engage in noncompetitive contracts except in those circumstances where their use can be fully justified and where appropriate safeguards have been put in place to protect the taxpayer. In addition, there shall be a preference for fixed-price type contracts. Cost-reimbursement contracts shall be used only when circumstances do not allow the agency to define its

requirements sufficiently to allow for a fixed-price type contract. Moreover, the Federal Government shall ensure that taxpayer dollars are not spent on contracts that are wasteful, inefficient, subject to misuse, or otherwise not well designed to serve the Federal Government's needs and to manage the risk associated with the goods and services being procured. The Federal Government must have sufficient capacity to manage and oversee the contracting process from start to finish, so as to ensure that taxpayer funds are spent wisely and are not subject to excessive risk. Finally, the Federal Government must ensure that those functions that are inherently governmental in nature are performed by executive agencies and are not outsourced.

In addition to these policy statements, President Obama's March 4 memorandum directed the Office of Management and Budget to develop and publish guidance on government contracting. This new proposed policy from OFPP responds to this tasking, and reflects the Administration's policy statements to date on the proper division of labor between federal employees and contractors.

Wednesday's proposed policy letter from the Obama administration follows on the heels of several months of policy and enforcement actions affecting the government contractor community. Most recently, in March 2010, the White House announced a new "payment recapture audit" initiative aimed at scrutinizing agency records to find evidence of overpayments and fraud involving contractors. *See* MLA Advisory, "Obama Administration Expands Payment Recapture Audit Program," March 26, 2010. In January 2010, President Obama directed all federal agencies to review their records with respect to contractors with potentially delinquent taxes, and consider possible actions against such contractors. *See* MLA Advisory, "Obama Administration Directs Tax-Enforcement Action Against Contractors," Feb. 1, 2010. In November 2009, the president issued Executive Order 13520, referenced above, "to reduce improper payments by intensifying efforts to eliminate payment error, waste, fraud, and abuse in the major programs administered by the Federal Government." *See* MLA Advisory, "More Focus on Improper Payments to Contractors Likely Means More Compliance and Reporting Requirements and Potential Cash Flow Impacts, Dec. 15, 2009. And on May 20, 2009, President Obama signed into law the Fraud Enforcement and Recovery Act of 2009, which substantially broadened the False Claims Act ("FCA") in an effort to get tough on contractors. *See* MLA Advisory, "Obama Signs Into Law Key Amendments to the False Claims Act," May 22, 2009. In 2010 and 2011, the Administration indicates it will continue to pursue new policy and enforcement initiatives directed at the contractor community.

With respect to the current proposed policy, OFPP has requested public comments in writing be submitted by June 1, 2010. In its announcement, OFPP stated it is seeking input on, inter alia, the definitions used by the new rule, the concepts of "closely associated functions" and "critical functions," the proposed requirement for human capital planning efforts, and the lists of specific functions included in the proposed policy. Contractors and their representative organizations should consider submitting comments in order to shape the final version of the policy, which is expected to be published this fall.