

Pentagon Insourcing Fueling Contractor Anxiety

April 2011

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In the nineties, government workers used to fret about their jobs being outsourced. Now, it's industry's turn.

The Obama administration's push to shift work that had been performed by contractors to government employees is ratcheting up tensions inside the Beltway and putting the private sector on the defensive.

With billions of federal dollars and thousands of jobs at stake, a campaign to create smart government is devolving into open warfare. Pentagon contractors stand to lose the most because the Defense Department is the government's biggest buyer of contracted-out services — estimated at about \$200 billion a year.

In 2010, the Pentagon added 17,000 employees to its payroll as a result of insourcing efforts, says Thomas Hessel, insourcing program lead at the office of the undersecretary of defense for personnel and readiness.

Within a work force of 750,000, that is a very small percentage, he points out in a recent interview.

Industry critics of insourcing are making it sound as if the Pentagon is taking away all the work from contractors, Hessel says. That is far from the truth, he contends. "It is not an all-out war on contractors."

This is simply about rebalancing a federal work force that, after nearly two decades of steady outsourcing, is lacking critical skills, Hessel says. Both Congress and the administration concluded that the pendulum had swung too far. What is being done now is a "course correction, not a sea change," says Hessel.

Of the 17,000 new Pentagon hires, half were for functions that were considered too sensitive, or "inherently governmental," to be contracted out. The other half was the result of cost analyses that showed that shifting the work in house saved the government money, Hessel says.

Whether insourcing will continue at the current pace is hard to forecast because there are no specific "quotas" that have to be met government-wide. This unpredictability — not knowing how far agencies will go with insourcing — is precisely what is causing angst in industry, several executives say.

Defense agencies have ample latitude to determine that a particular function is inherently governmental, and if they ascertain that specific duties should be performed by civil servants and not by contractors, they have the authority to bring the work in house.

For industry, the process is "very disconcerting," says Robert Burton, a federal procurement attorney at Venable LLP who represents contractors. The leeway afforded to agencies to define a critical function is leaving the door open for abuse, he says. "You can argue that anything is critical."

Another industry beef has to do with transparency. When the government decides to insource work for cost-saving reasons, the losing contractors are not provided the cost-analysis data that led to the insourcing decision, Burton says. The only recourse is a Freedom of Information Act request, which can take months or years, he says. And even when those FOIA documents are supplied, they are "not much of a cost analysis," Burton says. "It's a one-page long statement listing salaries."

He says government estimates sometimes fail to account for the full cost of hiring public servants, which in addition to salaries, should include health and pension benefits. "We're not comparing apples to apples," says Burton. "Decisions are being made without a robust cost analysis, and not in the taxpayers' best interest."

Hessel rebuts such claims. "It's Defense Department policy to conduct a fully burdened cost analysis as part of the decision process," he says. "There's no overarching Defense Department policy that says it [the analysis] has to be shared with industry. Companies don't want their costs being publicized because it will affect their ability to compete."

Analyses have revealed that the Defense Department has overpaid for many contracted-out services that could have been performed at a lower cost in house, says Hessel. That was the rationale for half of the insourcing decisions made in 2010.

Industry advocates point to Defense Secretary Robert Gates' comments in August — when he disclosed that insourcing was not saving as much money as he thought it would — and a recent memorandum by Army Secretary John McHugh that calls for tighter oversight of insourcing as evidence that the policy may have overreached.

It bothers contractors that the system doesn't allow for competition, says Burton.

The policy that would allow for private-public competitions, known as the Office of Management and Budget A-76 circular, was suspended by Congress two years ago, and it is not clear if and when it will be reinstated. "It's illegal to base an insourcing decision on a private-public competition," Hessel says.

The cost-based insourcing evaluations are built on publicly available data on federal work force compensation, he says. That data is compared against the rates that contractors have charged for a given job. Companies that lose work because an agency concludes that they were too expensive face a bit of a catch-22, says Hessel. "If you say you can do it for less, why haven't you?"

A senior corporate executive who asked to not be quoted by name says the industry is not opposed to insourcing where it makes sense — such as in management positions that oversee contractors. But in cases where companies lose work because the government says it can do it at lower cost, industry would like agencies to provide proof, says the executive. "The business case analysis is not disclosed. So it's hard for us to know where to improve if we want to stay in the business."

Many top contractors have been lobbying members of Congress to slow down insourcing, arguing that during times of rising federal deficits there should be a more open process for deciding who can give taxpayers the best deal. "We are not asking for the government to outsource, but to source smartly," the executive says.

Hessel says the Pentagon has saved \$900 million in 2010 through insourcing. At the same time, it increased spending on contracted services by \$6 billion. "When you put the two together, contract dollars went up," he says.

Opponents of insourcing often are fixated on government workers' pay and benefits, and often neglect to see the non-financial justifications, such as national security needs, Hessel says. When outsourcing goes too far, vital military functions can be put at risk, he says.

Chronology of Insourcing

■ **January 2006:** Section 343 of the National Defense Authorization Act (NDAA) for fiscal year 2006 required the Defense Department to give consideration to federal government employees for work performed under defense contracts.

■ **March 2009:** The Omnibus Appropriations Act of 2009 (Pub. L. No. 111-8) required agencies to issue "guidelines and procedures to ensure that consideration is given to using, on a regular basis, federal employees to perform new functions and functions that are performed by contractors and could be performed by federal employees."

■ **Mid-2009 to present:** Multiple agency regulations and memoranda have been issued dealing with the general practice of insourcing.

■ **August 2009:** Defense Secretary Robert Gates announces the department's goal to hire as many as 13,000 new civil servants in fiscal year 2010 to replace contractors and up to 30,000 new civil servants in place of contractors over the next five years.

■ **December 2010:** Insourcing provisions proposed for both the Omnibus Appropriations Bill and National Defense Authorization Bill for fiscal year 2011 were rejected. The provisions would have reserved for federal employees work identified as "closely associated with inherently governmental functions."

Case in point was the interruption of operations at Oklahoma's Vance Air Force Base in June 2009 because the contractors that performed almost every job on post went on strike. Labor disagreements between the International Association of Machinists and Aerospace Workers and three contractors resulted in significant disruptions as even basic duties such as providing meals, and more sensitive functions such as firefighting and security, were left undone.

That is an example of having contracted out too much, Hessel says. "We should preclude that from happening in the future," he says. "We should have the basic core capacity internally to continue to operate."

Even if the private sector technically can do much of the work that is needed to run a military base, the government has the discretion to designate commercial-type jobs as "exempt" from outsourcing because it falls within the "core" capability of essential government operations, he says. "Anything could fall into that category."

Manufacturers in the aerospace and defense sectors, which derive much of their revenues from maintaining and repairing the aircraft, ships, trucks and engines they sell to the military, could be particularly vulnerable under this exemption. The Defense Department expects to insource more weapon maintenance and repair work because, under current laws and policies, it must have a core capacity to fix critical systems in house.

Original equipment manufacturers usually are best suited to repair the systems they make, but the military services also need their own in-house mechanics to maintain and fix items while on deployments, says Hessel. An OEM who makes aircraft, he says, "is not going to deploy with my aircraft carrier. They're not going to sit on an aircraft carrier when I'm in a hostile theater doing 24/7 combat operations," he says. "So I designate the work for 'performance by the government.'" That means that the work, although commercial in nature, needs to be executed by military mechanics under certain circumstances.

When work is insourced under the "exempt from private sector performance" category, it doesn't matter who charges more. "Cost is not a factor because we need that work internally," Hessel says.

The acquisition work force is another example. The Pentagon plans to insource 20,000 contract-management and program-oversight positions over the next five years. Of the 17,000 new federal hires in 2010, some 3,500 were in acquisition jobs. "We don't want companies overseeing other companies," says Hessel. "And they don't want that either."

Other areas that are prime for insourcing include human resources, information technology, cybersecurity and financial services. "That doesn't mean that all this work is going to be automatically insourced," Hessel cautions. But these are skills that in the past have been disproportionately outsourced and should be "rebalanced," he says. "What's the right mix? There is no one right mix. The right mix for one functional area or organization may be different for another."

Hessel declines to offer any projections about future insourcing. "There are no predetermined outcomes or numbers," he says. "From day to day, factors change, our operating environment and our missions change." What will not change is that "we're required by law to do insourcing."

When A-76 public-private competitions were conducted in the past, he says, the "media said it was a numbers drill. Now there's talk about insourcing, and it's industry associations saying it's a numbers drill," he says. It's not about numbers, he adds, "We follow the law. ... It's not about winning or losing. It's about supporting our war fighters and meeting our overarching obligations to protect the country in a fiscally responsible manner."

Some experts predict an outbreak of lawsuits that will be filed by companies that have lost work to government employees. But challenging insourcing decisions can be tricky, and expensive.

"The question of which court has jurisdiction over challenges to insourcing actions has not yet been settled," warns an advisory sent to clients by the Greenberg Traurig government contracts practice.

"Contractors have sought to bring insourcing challenges in one of three venues — the Court of Federal Claims, a federal district court or the Government Accountability Office (GAO) — with mixed success."

In Texas, Rohmann Services Inc. sued the Defense Department in U.S. District Court for the Western District of Texas. The small business challenged the Air Force's insourcing of its contract to provide multimedia and

audiovisual services at Edwards Air Force Base, Calif.

In February 2010, while the case was pending, the Air Force reversed its decision to insource and stated that it had "determined the audiovisual work was not presently an appropriate candidate for insourcing," says the Greenberg Traurig memo.

More recently, K-MAR Industries Inc. sued the government in U. S. District Court for the Western District of Oklahoma. The plaintiffs alleged that the Army violated established guidelines when it insourced work that was being performed by the company without conducting an adequate cost analysis. In November, the court denied a motion to dismiss, and the case is still ongoing.

But several contractors have struck out. Both federal district courts and GAO already have dismissed several insourcing claims. To date, no court has overturned an agency's insourcing decision.