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government contracts update

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Army Suspends Insourcing Efforts While Congress Imposes Requirements for DoD Cost Comparisons to Support Insourcing Decisions

Contractors that have been battling the government's insourcing plans can view a couple of recent developments with cautious optimism. Secretary of the Army, John M. McHugh recently issued a memorandum on February 1, 2011 that suspends Army insourcing actions pending his review and approval. This memorandum requires insourcing proposals submitted to the Secretary for review to be "fully documented and justified" and further provides:

> Any proposal will include, at a minimum, a manpower requirements determination, an analysis of all potential alternatives to the establishment of permanent civilian authorizations to perform the contracted work, certification of fund availability and a comprehensive legal review.

Secretary McHugh's memorandum appears to be a positive development for Army contractors because it attempts to address concerns that government insourcing has not been implemented fairly nor supported by complete and accurate analysis. However, the McHugh Memorandum is relatively short and lacks specific detail regarding how the Secretary of the Army will conduct a thorough, fact-based review of the appropriateness of Army insourcing actions. The lack of detail in the McHugh Memorandum leaves the door open for the Army to continue making ill-advised insourcing decisions.

Though Congress recently enacted legislation that imposes more requirements for Department of Defense (DoD) insourcing decisions than those announced in the McHugh Memorandum, this legislation likewise does not go far enough to ensure that DoD insourcing decisions will not be based on erroneous, unverified cost assumptions that do not accurately reflect the full cost of replacing contractors with federal employees.

On January 7, 2011, President Obama signed into law the National Defense Authorization Act for FY 2011 (NDAA). In addition to prohibiting the use of insourcing quotas unless based on "considered research and analysis," Section 323 of the NDAA provides that the DoD must use the Directive-Type Memorandum (DTM) 09-007 (Estimating and Comparing the Full Costs of Civilian and Military Manpower and Contractor Support) or any successor guidance when conducting a cost comparison to determine whether insourcing is appropriate. DTM 09-007 requires the DoD to compare the "full cost" to the government when a position is filled by a government employee or a contractor, and determine whether the government or private employee "would perform the function(s) at a lower cost." Notably, the DTM defines "full cost" to include all direct and indirect costs, including the "unfunded portion of the civilian retirement fund and annuitant health and life insurance benefits."

The enacted NDAA is an improvement over an earlier version of the same legislation that had expressly prohibited consideration of employer contributions to health and retirement plans in making cost comparisons, which are almost universally higher for the government than private employers. However, similar to the McHugh Memorandum, the NDAA's vague and undefined language does not go far enough in closing the door to insourcing. Indeed, quotas are permissible if merely based on "considered research and analysis," which the government could arguably use to justify almost any insourcing quota. Additionally, Section 323 of the NDAA specifically provides that it is not to be construed to preclude the Secretary of Defense from meeting insourcing goals "where such goals are based on considered research and analysis" or to require the Secretary of Defense to conduct cost comparisons "where factors other than cost serve as a basis for the Secretary's [insourcing] decision." The discretion and flexibility resulting from this statutory language does not do enough to constrain DoD from continuing to insource functions that would be better and more cost effective for contractors to perform.

While these recent developments show that the DoD and Congress are responding to concerns raised by federal contractors over insourcing, these developments do not reflect substantial progress. At this time, the contracting community is awaiting the Office of Federal Procurement Policy's final "policy letter," which was supposed to be issued by the end of 2010. The final policy letter will most likely establish mandatory standards in the FAR to govern the insourcing of work currently performed by the private sector.

Although the Army memorandum is a promising development, it is clear that insourcing remains a high priority for the Administration and that agencies are committed to expanding their insourcing efforts. For example, the Federal Times reported earlier this month that the Department of Homeland Security (DHS) has recently

completed a review of 100 service contracts as part of a pilot project, and intends to review all contracts going forward to determine which functions should be insourced. DHS's aggressive approach is a reminder that the government remains focused on reducing its reliance on a contractor workforce.

In light of these developments, Army and other DoD contractors that may be impacted by insourcing need to hold the government accountable to these new standards by demanding that insourcing actions be fully documented and justified by fair cost comparisons. The **Government Contracts Group** of Venable LLP has partnered with many contractors to improve and protect their federal contracting opportunities against government insourcing. For further information regarding how Venable LLP may assist your business in these efforts, please contact the authors of this article or any member of the **Government Contracts Group**.

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