



# Insourcing Functions Performed by Federal Contractors: An Overview of the Legal Issues

**Kate M. Manuel**

Legislative Attorney

**Jack Maskell**

Legislative Attorney

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## Summary

Recent Congresses and the Obama Administration have taken numerous actions to promote “insourcing,” or the use of government personnel to perform functions that contractors previously performed on behalf of federal agencies. Among other things, the 109<sup>th</sup> through the 111<sup>th</sup> Congresses enacted several statutes requiring the development of policies and guidelines to ensure that agencies “consider” using government employees to perform functions previously performed by contractors, as well as any new functions. These statutes also require that “special consideration” be given to using government personnel to perform certain functions, including those functions (1) performed by government employees in the recent past, (2) closely associated with the performance of inherently governmental functions, (3) performed pursuant to a contract awarded on a non-competitive basis, or (4) performed poorly by a contractor because of excessive costs or inferior quality. The Obama Administration has similarly promoted insourcing. Among other things, on July 29, 2009, the Office of Management and Budget directed federal agencies to conduct pilot human capital analyses of programs where the agency has concerns about its reliance on contractors, as a prelude to potentially insourcing functions performed by contractors.

Several lawsuits have recently been filed, alleging that agencies’ determinations to insource particular functions were “arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with the law” in violation of the Administrative Procedure Act (APA). These suits raise several legal issues that are presently unresolved. First, questions have arisen as to whether the federal district courts or the U.S. Court of Federal Claims have jurisdiction over such suits. Courts have reached differing conclusions as to whether a contractor challenging an insourcing determination is an “interested party” within the meaning of the Administrative Dispute Resolution Act (ADRA) of 1996, and whether an insourcing determination is made “in connection with a proposed procurement” under the act. Assuming that contractors are interested parties and insourcing determinations are made in connection with proposed procurements, the U.S. Court of Federal Claims would have exclusive jurisdiction under ADRA. If not, the district courts would have jurisdiction under the APA. Second, there is the question of whether contractors meet any prudential standing requirements to challenge insourcing decisions. Courts have also reached differing conclusions as to whether such standing requirements apply to “interested parties” under ADRA, and there may also be disagreement as to whether contractors are within the “zone of interests” to be protected by insourcing statutes. Finally, assuming that contractors meet any prudential standing requirements, there could also be questions as to whether particular insourcing guidelines are legally binding under the APA, as well as to whether particular agency actions were contrary to any binding guidelines.

Other provisions of law could also constrain whether and how agencies may proceed with insourcing in particular circumstances, or limit the activities that former contractor employees may perform after being hired by the federal government. These include (1) contract law, under which agencies could be found to have constructively terminated certain requirements contracts by augmenting their in-house capacity to perform services provided for in the contract; (2) civil service law, which would generally limit “direct hires” of contractor employees; and (3) ethics law, which could limit the involvement of former contractor employees in certain agency actions.

The 112<sup>th</sup> Congress is considering legislation that could constrain insourcing initiatives by requiring agencies to conduct a public-private competition and determine that provision of goods or services by federal employees provides “best value” prior to insourcing (H.R. 1474, S. 785). A provision of the House-passed National Defense Authorization Act for FY2012 (H.R. 1540, § 939) could also limit agencies’ ability to insource functions.

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## Introduction

While agencies are prohibited by federal law and policy from contracting out functions that are “inherently governmental,”<sup>1</sup> other functions could potentially be contracted out.<sup>2</sup> There has long been debate over both general government policies promoting the use of the private sector to perform “commercial functions”<sup>3</sup> and whether specific functions should be performed by government personnel or contractors.<sup>4</sup> However, since 2008, the “insourcing” initiatives of recent Congresses and the Obama Administration have caused particular controversy.<sup>5</sup> Several lawsuits have been filed challenging agencies’ determinations to insource particular functions, and broader questions have been raised as to whether agencies’ implementation of insourcing runs afoul of civil service, ethics, or small business laws. This report provides a brief overview of key legal issues related to recent insourcing initiatives. It will be updated as developments occur.

## Background

Since January 1955, the federal government has consistently had policies promoting the use of the private sector to produce commercial products and perform commercial services, although the wording of such policies and, particularly, the degree to which they have been implemented by the executive branch have varied over time.<sup>6</sup> The George W. Bush Administration, for example,

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<sup>1</sup> In brief, an “inherently governmental function” is one that is “so intimately related to the public interest as to require performance by Federal Government employees.” 31 U.S.C. § 501 note, at § 5(2)(A). There has recently been concern about the definition of “inherently governmental functions” and, particularly, whether the existence of multiple and/or contradictory definitions of this term has resulted in the contracting out of functions that must be performed by federal employees. See CRS Report R40641, *Inherently Governmental Functions and Department of Defense Operations: Background, Issues, and Options for Congress*, by John R. Luckey, Valerie Bailey Grasso, and Kate M. Manuel (surveying existing definitions of inherently governmental functions); CRS Report R41209, *Inherently Governmental Functions and Other Work Reserved for Performance by Federal Government Employees: The Obama Administration’s Proposed Policy Letter*, by L. Elaine Halchin et al., (discussing the Obama Administration’s proposed guidance regarding inherently governmental and related functions).

<sup>2</sup> See, e.g., *Gulf Group, Inc. v. United States*, 61 Fed. Cl. 338, 341, n.7 (2004) (treating items on the Federal Acquisition Regulation’s list of “functions approaching inherently governmental” as capable of being contracted out by agencies). Congress can, however, remove agencies discretion to contract out particular functions by prohibiting them from doing so (or from using appropriated funds to do so). See, e.g., Consolidated Appropriations Act, 2008, P.L. 110-161, § 730, 121 Stat. 1846 (2008) (“None of the funds made available in this Act may be used to study, complete a study of, or enter into a contract with a private party to carry out, without specific authorization in a subsequent Act of Congress, a competitive sourcing activity of the Secretary of Agriculture, including support personnel of the Department of Agriculture, relating to rural development or farm loan programs.”).

<sup>3</sup> See CRS Report R40641, *Inherently Governmental Functions and Department of Defense Operations: Background, Issues, and Options for Congress*, by John R. Luckey, Valerie Bailey Grasso, and Kate M. Manuel, at pp. 2-6. For purposes of insourcing and outsourcing, a “commercial function” is “[a] recurring service that could be performed by the private sector. This recurring service is an agency requirement that is funded and controlled through a contract, fee-for-service agreement, or performance by government personnel. Commercial activities may be found within, or throughout, organizations that perform inherently governmental activities or classified work.” See U.S. Office of Management and Budget, Circular No. A-76 (Revised), May 29, 2003, at D-2.

<sup>4</sup> See, e.g., Duncan Hunter National Defense Authorization Act for FY2009, P.L. 110-417, § 832, 122 Stat. 4535 (Oct. 14, 2008) (“It is the sense of Congress that ... the regulations issued by the Secretary of Defense pursuant to section 862(a) of the National Defense Authorization Act for Fiscal Year 2008 ... should ensure that private security contractors are not authorized to perform inherently governmental functions in an area of combat operations.”).

<sup>5</sup> See *infra* notes 43, 94, and 99 and accompanying text.

<sup>6</sup> Compare Bureau of the Budget Bulletin No. 55-4 (Jan. 15, 1955) (“[The] Federal Government will not start or carry (continued...)”).

promoted this policy vigorously under the name of “competitive sourcing” (later “commercial services management”), which was a key component of the President’s Management Agenda.<sup>7</sup> Its doing so prompted concern among some commentators, who asserted that competitive sourcing represented a concerted effort to shift work to the private sector and resulted in contractors performing functions that should have been performed by government employees.<sup>8</sup>

Responding, in part, to such concerns, the 109<sup>th</sup> Congress enacted legislation directing the Secretary of Defense to “prescribe guidelines and procedures for ensuring that consideration is given to using Federal Government employees for work that is currently performed or would otherwise be performed under Department of Defense [DOD] contracts.”<sup>9</sup> These guidelines and procedures are to ensure that “special consideration” is given to using government personnel to perform functions that

- had been performed by government employees at any time on or after October 1, 1980;
- are closely associated with the performance of inherently governmental functions;
- are performed under contracts that were not competitively awarded; or
- have been performed poorly by a contractor due to excessive costs or inferior quality.<sup>10</sup>

Subsequent Congresses expanded upon these requirements. First, the 110<sup>th</sup> Congress required that DOD guidelines and procedures also give consideration to using government employees to perform new functions, as well as those contracted out.<sup>11</sup> Then, the 111<sup>th</sup> Congress imposed similar requirements upon civilian agencies.<sup>12</sup>

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(...continued)

on any commercial activity to provide a service or product for its own use if such product or service can be procured from private enterprise through ordinary business channels.”) *with* Bureau of the Budget Circular A-76 (March 3, 1966) (“The guidelines in this Circular are in furtherance of the Government’s general policy of relying on the private enterprise system to supply its needs.”) *and* Office of Management and Budget Circular A-76, *supra* note 3 (“The longstanding policy of the federal government has been to rely on the private sector for needed commercial services. To ensure that the American people receive maximum value for their tax dollars, commercial activities should be subject to the forces of competition.”).

<sup>7</sup> U.S. Office of Management and Budget, Performance of Commercial Activities, 67 Fed. Reg. 69772 (Nov. 19, 2002) (“President [George W. Bush] has identified competitive sourcing—i.e., the process of opening the government’s commercial activities to the discipline of competition—as one of the five main initiatives of his Management Agenda for improving the performance of government.”).

<sup>8</sup> Peter R. Orszag, Director, U.S. Office of Management and Budget, Managing the Multi-Sector Workforce, July 29, 2009, p. 1, *available at* [http://www.whitehouse.gov/sites/default/files/omb/assets/memoranda\\_fy2009/m-09-26.pdf](http://www.whitehouse.gov/sites/default/files/omb/assets/memoranda_fy2009/m-09-26.pdf) (stating that overreliance on contractors was “encouraged by one-sided management priorities that have publicly rewarded agencies for becoming experts identifying functions to outsource”).

<sup>9</sup> National Defense Authorization Act for FY2006, P.L. 109-163, § 343(a)(1), 119 Stat. 3200-01 (Jan. 6, 2006) (codified at 10 U.S.C. § 2461 note).

<sup>10</sup> *Id.* at § 343(a)(2)(A)-(D).

<sup>11</sup> National Defense Authorization Act for FY2008, P.L. 110-181, § 324, 122 Stat. 60-61 (Jan. 28, 2008) (codified at 10 U.S.C. § 2463).

<sup>12</sup> Omnibus Appropriations Act, 2009, P.L. 111-8, § 736, 123 Stat. 689-91 (Mar. 11, 2009) (codified at 31 U.S.C. § 501 note).

When President Obama took office, these and related legislative actions<sup>13</sup> were supplemented by a number of executive branch initiatives that also promoted insourcing of at least certain functions. President Obama himself paved the way for such initiatives with a March 4, 2009, memorandum on government contracting, which suggested that “contractors may be performing inherently governmental functions.”<sup>14</sup> Although explicitly focused on impermissible and inappropriate outsourcing of inherently governmental functions, this memorandum implied that at least certain functions that have been outsourced should be returned to government performance (i.e., insourced). DOD and the Office of Management and Budget (OMB), in particular, both subsequently issued additional guidance regarding insourcing. In a May 28, 2009, memorandum, the Deputy Secretary for Defense called for the development of insourcing plans and stated that insourcing should be part of a “total force approach to workforce management and strategic human capital planning.”<sup>15</sup> OMB took a similar approach in its July 29, 2009, memorandum on “Managing the Multi-sector Workforce,” directing agencies to conduct pilot human capital analyses of programs where the agency has concerns about reliance on contractors.<sup>16</sup>

The President’s FY2011 budget submissions later reiterated the call for agencies to “be alert for situations in which excessive reliance on contractors undermines the ability of the Federal Government to control its own operations and accomplish its missions for the American people.”<sup>17</sup> DOD, in particular, heeded this call, with the Secretary of the Army testifying in February 2010 that the Army intended to insource 7,162 positions in FY2010 and 11,084 positions in FY2011 through FY2015.<sup>18</sup> Such announcements prompted some commentators to object that DOD’s insourcing initiatives had become a “quota driven exercise.”<sup>19</sup> While DOD’s initiatives were largely abandoned after the Secretary of Defense noted that DOD was not “seeing the savings [it] had hoped from insourcing,”<sup>20</sup> they generated several lawsuits, discussed in more

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<sup>13</sup> In addition to requiring the development of insourcing guidelines and procedures, the 109<sup>th</sup> through the 111<sup>th</sup> Congresses enacted other legislation that could promote insourcing, or at least government performance of particular functions. For example, the 111<sup>th</sup> Congress enacted legislation requiring agencies to complete inventories of their service contracts before they “begin, plan for, or announce a study or public-private competition regarding the conversion to contractor performance of any function performed by Federal employees pursuant to Office of Management and Budget [OMB] Circular A–76 or any other administrative regulation or directive.” Consolidated Appropriations Act, 2010, P.L. 111-117, § 743(g), 123 Stat. 3218 (Dec. 16, 2009). Previously, the 110<sup>th</sup> Congress had enacted legislation requiring OMB to review existing definitions of inherently governmental functions, in part to ensure that such functions are not contracted out. Duncan Hunter National Defense Authorization Act for FY2009, P.L. 110-417, § 321(a)(1)-(4), 122 Stat. 4411 (October 14, 2008).

<sup>14</sup> President Barack Obama, Government Contracting, Mar. 4, 2009, at 2, *available at* [http://www.whitehouse.gov/the\\_press\\_office/Memorandum-for-the-Heads-of-Executive-Departments-and-Agencies-Subject-Government](http://www.whitehouse.gov/the_press_office/Memorandum-for-the-Heads-of-Executive-Departments-and-Agencies-Subject-Government).

<sup>15</sup> Deputy Secretary of Defense, Insourcing Contracted Services: Implementation Guidance, May 28, 2009, Attachment I, at 1, *available at* <http://www.asamra.army.mil/scra/documents/DepSecDef%20Memo%2028MAY09%20Insourcing%20Implementation%20Guidance.pdf>.

<sup>16</sup> Managing the Multi-Sector Workforce, *see supra* note 8.

<sup>17</sup> ABA Public Contract Law Section, Legislative Coordinating Committee, Insourcing Initiatives, Mar. 6, 2010, *available at* [http://www.arnoldandporter.com/resources/documents/In-Sourcing%20Presentation%20for%20ABA\\_\\_VA\\_804440\\_1\\_%20\\_2\\_.pdf](http://www.arnoldandporter.com/resources/documents/In-Sourcing%20Presentation%20for%20ABA__VA_804440_1_%20_2_.pdf)

<sup>18</sup> *See, e.g.*, Matthew Weigelt, Army Vows to Cut 7,000 Contractor Jobs This Year, *Wash. Tech.*, Feb. 23, 2010, *available at* <http://washingtontechnology.com/articles/2010/02/23/army-insourcing-core-governmental-functions.aspx>.

<sup>19</sup> Professional Services Council, Letter to the Honorable Robert Gates, May 3, 2010, *available at* <http://www.govexec.com/pdfs/050410rb1b.pdf> (objecting that DOD had largely insourced routine commercial functions, not critical positions). In fact, the Ike Skelton National Defense Authorization Act for FY2011 responded to such concerns by prohibiting DOD from establishing goals or quotas for insourcing functions. *See* P.L. 111-383, § 323, 124 Stat. 4184 (Jan. 7, 2011) (codified at 10 U.S.C. § 2463).

<sup>20</sup> *See, e.g.*, Matthew Weigelt, Insourcing Failed, DOD’s Gates Says. Now What?, *Wash. Tech.*, Aug. 10, 2010, (continued...)

detail below, alleging that agencies failed to comply with their own policies and procedures when determining to insource specific functions.

## Legal Issues

Because federal agencies have broad discretion in determining their own requirements and how they will meet these requirements, whether with their own employees or by contracting out,<sup>21</sup> there do not appear to be any legal barriers to insourcing *per se*.<sup>22</sup> However, various provisions of federal law could constrain whether and how agencies may proceed with insourcing in particular circumstances, as well as limit the activities that former contractor employees may perform after being hired by the federal government. These provisions include (1) the Administrative Procedure Act, which could potentially preclude agencies from implementing insourcing determinations that were not made in accordance with agency guidelines; (2) contract law, under which agencies could be found to have constructively terminated for convenience, or even breached, certain requirements contracts by augmenting their in-house capacity to perform services provided for in the contract; (3) civil service law, which would generally limit “direct hires” of contractor employees; and (4) ethics law, which could limit the involvement of former contractor employees who are hired by the government in certain agency actions. No issues of small business law would appear to be implicated, even though small businesses are generally given special consideration under federal law,<sup>23</sup> and some commentators have expressed concern that insourcing, at least as implemented to date, has disproportionately affected small businesses.<sup>24</sup>

## Administrative Procedure Act and Insourcing Guidelines

The Administrative Procedure Act (APA) could potentially constrain an agency’s implementation of insourcing by requiring the agency to abide by its insourcing guidelines, even if compliance

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available at <http://washingtontechnology.com/articles/2010/08/10/gates-insourcing-did-not-work.aspx>. Instead, among other things, Secretary Gates directed a 10% reduction in funding for support contractors in each of the next three fiscal years.

<sup>21</sup> See *Perkins v. Lukens Steel Co.*, 310 U.S. 113, 127 (1940) (“Like private individuals and businesses, the Government enjoys the *unrestricted power to produce its own supplies*, to determine those with whom it will deal, and to fix the terms and conditions upon which it will make needed purchases.”) (emphasis added). The legislative branch can, however, restrict the discretion of the executive branch to contract out, or perform in-house, specific functions. See, e.g., Water Resources Development Act, P.L. 101-640, § 314, 104 Stat. 4641 (Nov. 28, 1990) (codified at 33 U.S.C. § 2321) (“Activities currently performed by personnel under the direction of the Secretary in connection with the operation and maintenance of hydroelectric power generating facilities at Corps of Engineers water resources projects are to be considered as inherently governmental functions and not commercial activities.”); National Defense Authorization Act for FY1994, P.L. 103-160, § 848(a)(1), 107 Stat. 1724-25 (Nov. 30, 1993) (codified at 10 U.S.C. § 2304e(a)) (prohibiting certain types of competition between Department of Defense (DOD) and small businesses).

<sup>22</sup> Other aspects of sourcing policy may also raise legal issues, such as whether the agency properly conducted any public private competitions that resulted in outsourcing determinations. See, e.g., Patricia A. Thompson—Agency Tender Official, B-310910.4 (Jan. 22, 2009). However, such issues are outside the scope of this report. This report also does not address any *de facto* limits on insourcing that may be imposed by agency personnel ceilings or caps.

<sup>23</sup> See, e.g., Small Business Act of 1958, P.L. 85-536, § 2(a), 72 Stat. 384 (July 18, 1958) (codified at 15 U.S.C. § 631(a)) (“[It is] the declared policy of the Congress that the Government should aid, counsel, assist, and protect, insofar as is possible, the interests of small-business concerns.”).

<sup>24</sup> See, e.g., Robert A. Burton & James Y. Boland, Concrete Steps Government Should Take to Alleviate Growing Procurement Challenges for Small Businesses, 94 *Fed. Cont. Rep.* 190 (Aug. 17, 2010).

with these guidelines would result in the continued outsourcing of certain functions. The APA allows challenges to agency actions that are “arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with the law,”<sup>25</sup> including, in certain circumstances, an agency’s failure to comply with its own guidelines.<sup>26</sup> The APA also waives the government’s sovereign immunity as to suits brought against it in the federal district courts.<sup>27</sup> However, this waiver is limited and does not apply if “any other statute that grants consent to suit expressly or impliedly forbids the relief which is sought.”<sup>28</sup> Among the other statutes waiving the government’s sovereign immunity is the Tucker Act, as amended by the Administrative Dispute Resolution Act (ADRA) of 1996, which also provides that, effective January 1, 2001, the U.S. Court of Federal Claims has exclusive trial-level jurisdiction over any “action by an interested party objecting to a solicitation by a Federal agency for bids or proposals for a proposed contract or to a proposed award or the award of a contract or any alleged violation of statute or regulation in connection with a procurement or a proposed procurement.”<sup>29</sup> Thus, the key questions raised, to date, by litigation challenging the Obama Administration’s insourcing initiatives have been jurisdictional, with contractors and federal agencies contesting whether the federal district courts or the U.S. Court of Federal Claims have jurisdiction over such claims.<sup>30</sup> Until these jurisdictional issues are resolved, courts are unlikely to reach the question of which, if any, of the numerous insourcing guidelines currently in effect are legally binding upon the agency.

## **Jurisdictional Questions**

It is presently unclear whether the federal district courts or the Court of Federal Claims have jurisdiction over complaints alleging that agency insourcing determinations were “arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with the law,” in violation of the APA. The district courts that have addressed this question have split in their findings, and no court of appeals appears to have addressed the issue.<sup>31</sup>

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<sup>25</sup> 5 U.S.C. § 706(a)(2)(A).

<sup>26</sup> *See, e.g., Pacific Molasses Co. v. Fed. Trade Comm’n*, 356 F.2d 386, 389-90 (5<sup>th</sup> Cir. 1996) (“When an administrative agency promulgates rules to govern its proceedings, these rules must be scrupulously observed. This is so even when the defined procedures are ‘... generous beyond the requirements that bind such agency ...’ For once an agency exercises its discretion and creates the procedural rules under which it desires to have its actions judged, it denies itself the right to violate these rules.”). *But see Farrell v. Dept of the Interior*, 314 F.3d 584, 590 (Fed. Cir. 2002) (“The general consensus is that an agency statement, not issued as a formal regulation, binds the agency only if the agency intended the statement to be binding.”).

<sup>27</sup> 5 U.S.C. § 702. Because it is a sovereign, the United States is immune to suits without its consent. *See, e.g., United States v. Sherwood*, 312 U.S. 584, 586 (1941).

<sup>28</sup> 5 U.S.C. § 702.

<sup>29</sup> Ch. 359, 24 Stat. 505 (Mar. 3, 1887) (codified, as amended, at 28 U.S.C. § 1491(b)(1)).

<sup>30</sup> *See Vero Technical Support, Inc. v. U.S. Dep’t of Defense*, 733 F. Supp. 2d 1336, 1340 (S.D. Fla. 2010) (“There appears to be no dispute that the APA governs the Plaintiff’s claim. Rather the dispute concerns which court has jurisdiction to hear the APA claim.”). Although the government has also argued that contractor challenges to insourcing determinations constitute contract disputes, which are within the exclusive jurisdiction of the Court of Federal Claims under the Contract Disputes Act, this argument has generally been rejected. *See, e.g., K-Mar Industries v. U.S. Dep’t of Defense*, 2010 U.S. Dist. LEXIS 126885 (W.D. Okla. Nov. 4, 2010); *Rothe Development, Inc. v. U.S. Dep’t of Defense*, 2010 U.S. Dist. LEXIS 116934 (W.D. Tex. Nov. 3, 2010), *motion to amend denied*, 2011 U.S. Dist. LEXIS 5236 (W.D. Tex. Jan. 19, 2011).

<sup>31</sup> Additional cases are reportedly pending. *See, e.g., Robert Brodsky, Tell It to the Judge: Contractors Are Turning to Courts to Challenge Insourcing, Gov’t Exec.*, Nov. 1, 2010, *available at* <http://www.govexec.com/features/1110-01/1110-01na2.htm> (reporting that eight cases were pending as of November 1, 2010).



## **District Court Decisions**

In *K-Mar Industries, Inc. v. U.S. Department of Defense*, the U.S. District Court for the Western District of Oklahoma found that it had jurisdiction because the case was not within the Court of Federal Claims' jurisdiction under ADRA.<sup>32</sup> ADRA amended the Tucker Act to give the Court of Federal Claims exclusive jurisdiction over "any action by an *interested party* objecting to a solicitation by a Federal agency for bids or proposals for a proposed contract or to a proposed award of a contract or any alleged violation of statute or regulation *in connection with a procurement or a proposed procurement*" brought after January 1, 2001.<sup>33</sup> According to the *K-Mar* court, a contractor challenging an insourcing determination is not an "interested party," within the meaning of the Competition in Contracting Act (CICA) of 1984, because no contract or prospective contract is at issue.<sup>34</sup> CICA defines an "interested party" as an "actual or prospective bidder or offeror whose direct economic interest would be affected by the award of the contract or by failure to award the contract."<sup>35</sup> The *K-Mar* court similarly found that an insourcing determination is not made "in connection with a procurement or a proposed procurement," given the definition of "procurement" in the Office of Federal Procurement Policy Act (OFPPA) of 1974.<sup>36</sup> The OFPPA defines "procurement" as including "all stages of the process of acquiring property or services, beginning with the process for determining a need for property or services and ending with contract completion and closeout."<sup>37</sup> In so finding, the court relied on the plain meaning of the OFPPA, which, according to the court, provides that procurement begins with determining "a need for property or services," not with determining "whether there is a need" for property or services.<sup>38</sup> It also noted that the term "acquisition," which it characterized as "the critical concept" within the definition of "procurement," denotes only purchasing or leasing by contract,<sup>39</sup> and that even if ADRA's grant of jurisdiction arguably applied through a broad reading

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<sup>32</sup> 2010 U.S. Dist. LEXIS 126885. In a separate decision, the court denied *K-Mar*'s motion for a preliminary injunction. However, in so doing it made clear that "[n]othing stated in this order is intended to pre-judge in any way the merits of the procedures-based claims. At this stage the court has no view regarding the merits of any permanent relief based on these claims." *K-Mar Industries v. U.S. Dep't of Defense*, 2010 U.S. Dist. LEXIS 126955 (W.D. Okla., Nov. 4, 2010).

<sup>33</sup> P.L. 104-320, § 12(a) & (d), 110 Stat. 3874-75 (Oct. 19, 1996) (codified, as amended, at 28 U.S.C. § 1491(b)) (emphasis added). ADRA did not define either "interested parties" or "procurement."

<sup>34</sup> *K-Mar Indus.*, 2010 U.S. Dist. LEXIS 126885, at \*9-\*10. The court relied on the U.S. Court of Appeals for the Federal Circuit's decision in *American Federation of Government Employees, AFL-CIO v. United States*, 258 F.3d 1294, 1302 (Fed. Cir. 2001), in concluding that ADRA relies on CICA's definition of "interested party." The U.S. District Court for the Southern District of Florida, however, has questioned the relevance of this case to determinations of who is an interested party for purposes of ADRA because the case involved a challenge by government employees—not a contractor—to agency sourcing determinations. See *Vero Technical Support*, 733 F. Supp. 2d, at 1343.

<sup>35</sup> P.L. 98-369, § 2713, 98 Stat. 1183 (July 18, 1984) (codified, as amended, at 31 U.S.C. § 3551(2)).

<sup>36</sup> *K-Mar Indus.*, 2010 U.S. Dist. LEXIS 126885, at \*11-\*12. See also *Distributed Solutions, Inc. v. United States*, 539 F.3d 1340, 1345 (Fed. Cir. 2008) (holding that the meaning of "procurement," for purposes of ADRA, comes from the OFPPA).

<sup>37</sup> P.L. 93-400, § 4, 88 Stat. 796 (Aug. 30, 1974) (codified, as amended, at 41 U.S.C. § 403(2)).

<sup>38</sup> *K-Mar Indus.*, 2010 U.S. Dist. LEXIS 126885, at \*11. The government had attempted to argue that, for purposes of ADRA and the OFPPA, the "process for determining a need for property or services" begins with a decision by the agency as to whether there is a need to acquire property or services and, thus, encompasses any insourcing determination.

<sup>39</sup> *Id.* at \*12. This definition also comes from the OFPPA. See 41 U.S.C. § 403(16) ("The term 'acquisition'—(A) means the process of acquiring, with appropriated funds, by contract for purchase or lease, property or services (including construction) that support the missions and goals of an executive agency, from the point at which the requirements of the executive agency are established in consultation with the chief acquisition officer of the executive agency; and (B) includes—(i) the process of acquiring property or services that are already in existence, or that must be created, developed, demonstrated, and evaluated; (ii) the description of requirements to satisfy agency needs; (iii) (continued...)

of the definition of “procurement,” this would not constitute a clear jurisdictional grant and waiver of sovereign immunity, only an implied one, and waivers of sovereign immunity are construed narrowly.<sup>40</sup>

In contrast, in *Rothe Development, Inc. v. U.S. Department of Defense*, the U.S. District Court for the Western District of Texas found that a contractor’s challenge to an insourcing determination falls within the exclusive jurisdiction of the Court of Federal Claims under ADRA because a contractor is an interested party and an insourcing determination is made in connection with a procurement.<sup>41</sup> The *Rothe* court found that the contractor was an interested party because it had identified itself as “a prospective bidder in a future procurement process,”<sup>42</sup> and it was only within the “zone of interest,” as is required for standing for an APA or other challenge, insofar as it was a prospective bidder.<sup>43</sup> The *Rothe* court similarly found that ARDA’s language regarding activities “in connection with a procurement” is to be construed broadly and includes anything with “a connection with any stage of the federal contracting acquisition process, including ‘the process of determining a need for property or services.’”<sup>44</sup> It characterized a decision to insource as a “decision not to acquire, not to enter a procurement process” and, thus, “necessarily a decision made ‘in connection with a procurement or proposed procurement.’”<sup>45</sup> It further noted the incongruity between the district court’s having jurisdiction when an agency determines to insource, but not when it determines to outsource.<sup>46</sup>

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(...continued)

solicitation and selection of sources; (iv) award of contracts; (v) contract performance; (vi) contract financing; (vii) management and measurement of contract performance through final delivery and payment; and (viii) technical and management functions directly related to the process of fulfilling agency requirements by contract.”)

<sup>40</sup> *K-Mar Indus.*, 2010 U.S. Dist. LEXIS 126885, at \*12.

<sup>41</sup> 2010 U.S. Dist. LEXIS 116934. Another case challenging an agency insourcing determination was settled by the parties without a decision on the merits. *See Rohmann Servs., Inc. v. Dep’t of Defense*, Case No. 10-CV-0061 (W.D. Texas). This appears to have been the earliest of the cases challenging the Obama Administration’s insourcing initiatives, and the terms of the settlement, which resulted in the agency continuing the contract, were widely characterized as a “win” for the contractor. *See, e.g.*, Matthew Weigelt, Small Business Fights Insourcing ... and Wins, *Wash. Tech.*, May 5, 2010, available at <http://washingtontechnology.com/articles/2010/05/03/procurement-insourcing-boone-v-air-force.aspx>. Rohmann’s president was also quoted in the media encouraging other contractors to obtain cost estimates for any insourced work from the government and carefully “scrutinize” them. *Id.* Additionally, a partner at the law firm that represented Rohmann formed the Small Business Coalition for Fair Contracting, an association which reportedly seeks “to give small companies an opportunity to respond to procurement actions that could have major consequences for their contracts and business overall.” *See, e.g.*, Matthew Weigelt, Small-biz Coalition Takes up Insourcing Fight, *Wash. Tech.*, May 7, 2010, available at <http://washingtontechnology.com/articles/2010/05/07/burton-small-business-coalition-for-fair-contracting.aspx>.

<sup>42</sup> *Rothe*, 2010 U.S. Dist. LEXIS 116934 at \*13.

<sup>43</sup> *Id.* at \*14-15 (stating that the plaintiff “cannot rely on its potential bidder status for its theory of APA standing and simultaneously refute it in an effort to keep its lawsuit in this Court.”). Courts generally limit standing to plaintiffs whose asserted interests are “within the zone of interests to be protected or regulated by the statute or constitutional guarantee in question.” *Ass’n of Data Processing Serv. Orgs., Inc. v. Camp*, 397 U.S. 150, 153 (1970). The *Rothe* court reached no findings as to whether the plaintiff would have been within the zone of interests protected by the various insourcing statutes, and there is some question as to whether requirement that agencies develop and implement insourcing guidelines reflects a congressional intent to be “fair” to contractors, as well as government employees.

<sup>44</sup> *Rothe*, 2010 U.S. Dist. LEXIS 116934 at \*10 (quoting *Distributed Solutions*, 539 F.3d at 1346).

<sup>45</sup> *Id.* at \*12.

<sup>46</sup> *Id.* at \*12-\*13 (“[I]t is illogical to conclude that a challenge to the identical procedure does not fall under the Tucker Act when, for economic reasons, it happens to result in the opposite outcome.”).

The U.S. District Court for the Southern District of Florida reached the same conclusion on similar grounds in *Vero Technical Support, Inc. v. U.S. Department of Defense*.<sup>47</sup> However, it also noted that standing to bring suit under ARDA in the Court of Federal Claims is “narrower” than standing to bring suit under the APA in district court.<sup>48</sup> This is potentially significant because insourcing determinations could be found to be made in connection with procurements, while contractors challenging such determinations are found not to be interested parties. Were this the case, agencies’ insourcing decisions could be immune from judicial review.

### *Court of Federal Claims Decisions*

The Court of Federal Claims initially seemed at least somewhat sympathetic to the argument that challenges to agency insourcing determinations are within the jurisdiction of the district courts, stating that

[P]laintiff’s deliberate choice of forum in the District Court and chosen basis for jurisdiction, traditional APA jurisdiction, resonates with this court. Without a contract or solicitation at issue, even as amended by the ADRA, Tucker Act jurisdiction to challenge insourcing policy decisions is not immediately apparent.<sup>49</sup>

More recently, however, the Court of Federal Claims held in *Santa Barbara Applied Research, Inc. v. United States* that it has jurisdiction over contractors’ challenges to insourcing determinations.<sup>50</sup> While the court did so in the context of a challenge to plaintiff’s standing and without addressing arguments that the district courts have jurisdiction under the APA, the court found that the Air Force’s determination to insource certain support services that had been performed by the plaintiff was a decision made “in connection with a procurement.”<sup>51</sup> In reaching this conclusion, the court noted that, under the precedents of the U.S. Court of Appeals for the Federal Circuit, the phrase “in connection with a procurement” includes any connection with any stage in the acquisition process, including “the process for determining a need for property or services.”<sup>52</sup> The court found that there was such a connection here because an insourcing determination involves a decision to stop procuring goods or services and, thus, is “made for the

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<sup>47</sup> 733 F. Supp. 2d, at 1341-43.

<sup>48</sup> *Id.* at 1343.

<sup>49</sup> *Vero Technical Support, Inc. v. United States*, 94 Fed. Cl. 784, 792 (2010). However, the *Vero* court also noted that it had “not fully explored the issue at this time” and did not reach any holding as to its jurisdiction. *Id.* The Government Accountability Office (GAO), which, pursuant to CICA, shares jurisdiction over contractor bid protests with the Court of Federal Claims, has found that it cannot hear challenges to insourcing determinations that allege an agency failed to comply with its internal guidelines. *See, e.g.*, *Triad Logistics Servs. Corp.*, B-403726 (Nov. 24, 2010) (dismissing challenge to agency insourcing determination); *Aleut Facilities Support Servs., LLC*, B-401925 (Oct. 13, 2009) (same); *Hughes Space and Communications Co., Lockheed Missiles & Space Co., Inc.*, B-266225.6, B-266225.7, B-266225.8, B-266225.9, B-266225.10 (Apr. 15, 1996) (“[O]ur Office generally will not review an alleged violation of an internal policy.”). In one of these cases, GAO also noted that 10 U.S.C. § 129a, the key statute that the protester relied upon in alleging that the agency’s insourcing determination was based on an improperly performed comparison of the costs of performance by the government and the contractor, (1) did not actually require a cost comparison and (2) did not constitute a procurement statute. *Triad Logistics Servs. Corp.*, B-403726 (Nov. 24, 2010). Instead, GAO viewed this statute as one governing DOD personnel policy and, thus, outside its jurisdiction to hear protests “concerning an alleged violation of a procurement statute or regulation.” *Id.* (quoting 31 U.S.C. §§ 2552, 3553(a)).

<sup>50</sup> 2011 U.S. Claims LEXIS 732, at \*15-\*23 (May 4, 2011).

<sup>51</sup> *Id.* at \*21.

<sup>52</sup> *Id.*

purpose of determining the need for contract services.”<sup>53</sup> The court also held that the plaintiff is an “interested party” under ADRA because insourcing would directly affect its economic interests given that it “has a government contract and claims that it would expect to compete for future government contracts but for the errors made by the Air Force in its in-sourcing determination, which prevents [the incumbent contractor] or any other contractor from performing the functions at issue.”<sup>54</sup>

The court in *Santa Barbara* also rejected the government’s argument that the case should be dismissed because the plaintiff contractor did not meet the prudential standing requirements.<sup>55</sup> The concept of prudential standing is a “judicially self-imposed limit[] on the exercise of federal jurisdiction”<sup>56</sup> that is “founded in concern about the proper—and properly limited—role of the courts in a democratic society.”<sup>57</sup> In determining whether prudential standing exists, the analysis focuses upon “whether the interest sought to be protected by the [plaintiff] is arguably within the zone of interests to be protected by the statute ... in question,”<sup>58</sup> or whether the plaintiffs are “merely incidental beneficiaries” of the statutory provisions at issue.<sup>59</sup> In *Santa Barbara*, the Court of Federal Claims, in a decision by Judge Firestone, held that the concept of prudential standing does not apply to bid protests under ADRA.<sup>60</sup> It did so because it construed the Federal Circuit’s decision in *American Federation of Government Employees, AFL-CIO v. United States* to mean that “interested parties” under ADRA automatically have standing because the standing requirements under ADRA are “more stringent” than those under the APA.<sup>61</sup> However, the court also suggested that even were prudential standing required, contractors challenging insourcing determinations would possess such standing because the Ike Skelton National Defense Authorization Act for FY2011, which prohibited DOD from establishing goals or quotas for insourcing, “was enacted, at least in part, for the benefit of the contracting community.”<sup>62</sup>

However, in a decision by Judge Allegra issued nine days after the decision in *Santa Barbara*, the Court of Federal Claims dismissed on prudential standing grounds a contractor’s challenge to the Air Force’s determination to insource certain supply services that the contractor had provided. In *Hallmark-Phoenix 3, LLC v. United States*, the court held that prudential standing requirements apply to bid protests.<sup>63</sup> In reaching this conclusion, the court relied on Supreme Court precedent that the prudential standing analysis applies in non-APA cases,<sup>64</sup> as well as earlier district court

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<sup>53</sup> *Id.*

<sup>54</sup> *Id.* at \*22. The court expressly distinguished the instant case from that in *American Federation of Government Employees, AFL-CIO v. United States*, 258 F.3d 1294 (Fed. Cir. 2001). In *AFGE*, the court held that federal employees who were likely to lose their jobs because of a government decision to outsource their functions did not have standing because they were ineligible to bid on government contracts. The court in *Santa Barbara* did so because, “in contrast to the parties in *AFGE*,” the plaintiff here has a government contract. *Id.*

<sup>55</sup> *Id.* at \*23-\*27.

<sup>56</sup> *Elk Grove Unified Sch. Dist. v. Newdow*, 542 U.S. 1, 11 (2004) (internal quotations omitted).

<sup>57</sup> *Warth v. Seldin*, 422 U.S. 490, 498 (1975).

<sup>58</sup> *Ass’n of Data Processing Serv. Orgs., Inc. v. Camp*, 397 U.S. 150, 152-53 (1970).

<sup>59</sup> *Nat’l Credit Union Admin. v. First Nat’l Bank & Trust Co.*, 522 U.S. 479, 494 n.7 (1998).

<sup>60</sup> 2011 U.S. Claims LEXIS 732, at \*25.

<sup>61</sup> *Id.* For more on the *AFGE* decision, see *supra* note 23.

<sup>62</sup> 2011 U.S. Claims LEXIS 732, at \*26.

<sup>63</sup> 2011 U.S. Claims LEXIS 914, at \*11-\*23.

<sup>64</sup> *Id.* at \*12-\*14 (discussing *Bennett v. Spear*, 520 U.S. 154, 163 (1997) (noting that courts will apply the prudential standing requirements unless Congress has “expressly negated” them)).

decisions applying prudential standing requirements to bid protest decisions.<sup>65</sup> The court further found that, given these prudential standing requirements, the contractor was not within the “zone of interests” protected by either 10 U.S.C. § 129a or 10 U.S.C. § 2463.<sup>66</sup> Section 129a requires the Secretary of Defense to “use the least costly form of personnel consistent with military requirements and other needs of the Department. However, the court noted that both the text and legislative history of this provision indicated that it was to be enforced by legislative oversight, not judicial review.<sup>67</sup> According to the court, the fact that Section 129a’s direction to “use the least costly form of personnel” is “buried” among reporting provisions, along with Section 129a’s origin as a “sense of Congress” provision,” indicate it was not intended to benefit contractors.<sup>68</sup> Section 2463 similarly requires the development and implementation of insourcing guidelines, but the court also found that nothing in this provision “remotely suggests an intent to confer a right to judicial review.”<sup>69</sup> The court reached this conclusion because both the text and legislative history of Section 2463 evidenced an intent that DOD would be accountable to Congress, not the courts, for its performance in insourcing, including its compliance with insourcing guidelines.<sup>70</sup> The court further noted that “[a] contrary ruling would fling open the doors of this court to any contractor who can reasonably claim that an agency’s in-sourcing decision denied it a contracting opportunity. Such putative plaintiffs constitute neither a small nor well-defined class.”<sup>71</sup>

## **Whether Particular Guidelines Are Binding**

Once these jurisdictional questions are resolved and contractors meet any prudential standing requirements, courts may have to determine which, if any, of the current insourcing guidelines constrain an agency’s actions when bringing work in-house.<sup>72</sup> There are a number of such guidelines,<sup>73</sup> some of which are binding upon the agency (e.g., statutes, regulations promulgated

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<sup>65</sup> *Id.* at \*18-\*19.

<sup>66</sup> *Id.* at \*23-\*37.

<sup>67</sup> *Id.* at \*23-\*27.

<sup>68</sup> *Id.* at \*25.

<sup>69</sup> *Id.* at \*30.

<sup>70</sup> *Id.* at \*30-\*33.

<sup>71</sup> *Id.* at \*53.

<sup>72</sup> *But see Santa Barbara Applied Research*, 2011 U.S. Claims LEXIS 732, at \*28-\*57 (apparently assuming, without deciding, that all of the guidelines in question were legally binding). Nonetheless, the court in *Santa Barbara* upheld the agency’s insourcing determination because it found that various actions taken in making this determination (e.g., using the full costs to DOD rather than the full costs to the federal government) were not arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with the law.

<sup>73</sup> The recent statutes directing agencies to “consider” insourcing certain functions have, among other things, required agencies to develop and implement guidelines for determining which functions should be insourced, a requirement that the Office of Management and Budget (OMB) and individual federal agencies have met by developing several policies that ensure functions are “performed in the most fiscally advantageous way possible” and establishing procedures for conducting cost comparisons. *See, e.g.*, Omnibus Appropriations Act, 2009, P.L. 111-8, § 736, 123 Stat. 689-90 (Mar. 11, 2009) (requiring civilian agencies to develop guidelines); National Defense Authorization Act for FY2008, P.L. 110-181, § 324(a)(1), 122 Stat. 60 (Jan. 28, 2008) (requiring defense agencies to develop guidelines); Dep’t of Defense, Personnel & Readiness, OSD Costing Information, *available at* [http://prhome.defense.gov/RSI/REQUIREMENTS/INSOURCE/INSOURCE\\_COSTING.ASPX](http://prhome.defense.gov/RSI/REQUIREMENTS/INSOURCE/INSOURCE_COSTING.ASPX); OMB Civilian Fringe Benefit Cost Factor, quoted in *Rohmann Servs., Inc. v. U.S. Dep’t of Defense*, No. SA-10-CA-0061-XR, Application for Preliminary Injunction (W.D. Tex., filed Feb. 9, 2010) (requiring agencies to assume certain “fringe costs,” as well as loss of manpower productivity, when conducting cost comparisons). Other sources cited by Rohmann include (1) 10 U.S.C. § 129a, which states that “[t]he Secretary of Defense shall use the least costly form of personnel consistent with military requirements and other needs of the Department;” (2) Under Secretary of Defense (Personnel and Readiness)’s Guidelines and Procedures for (continued...)

by a notice and comment process) and others of which may not be (e.g., statements, policies). Where guidelines not based in statutes or regulations are concerned, courts may need to determine, among other things, whether the agency intended to be bound or has employed the guidelines in a manner such that they are binding as a practical matter, because this is key to determining which agency statements or policies are enforceable under the APA.<sup>74</sup>

As courts consider the various guidelines that might apply, it is possible that they could find that binding guidelines do not require the specific procedures that the agency failed to implement when making its allegedly improper insourcing determination. This proved to be the case in *Labat-Anderson, Inc. v. United States*, where the contractor claimed that the Department of Defense (DOD) improperly insourced functions the contractor had performed for DOD while DOD prepared to award a new contract.<sup>75</sup> The contractor alleged that DOD's insourcing determination was improper because DOD did not follow the procedures for comparing the costs of performing the function in question with government and contractor employees that were set forth in OMB Circular A-76, 10 U.S.C. § 2462, and Executive Order 12615.<sup>76</sup> However, this argument proved unavailing because the Court of Federal Claims found that

1. the cost-comparison and other requirements of OMB Circular A-76 were binding only insofar as they had been incorporated into agency regulations, and the relevant DOD regulations either did not specify procedures for conducting cost comparisons or did not apply;<sup>77</sup>
2. the agency had complied with the requirements in 10 U.S.C. § 2462, although not with the allegedly related requirements in OMB Circular A-76 that had not been incorporated into regulations;<sup>78</sup> and
3. Executive Order 12615 did not bind the executive branch because it explicitly stated that it did not create a private right of action, and it did not provide the court with a meaningful standard of review.<sup>79</sup>

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Implementation of 10 U.S.C. §2463, which reads, “[r]equests for manpower shall be fiscally informed and closely managed to ensure responsible stewardship of Defense resources. When a [DOD] Component ... is considering whether to convert from contractor to government performance, manpower managers shall follow standard ... procedures to determine and validate the manpower requirements. ... Also, the effectiveness, efficiency, and economy of the activity shall be assessed;” and (3) Insourcing Implementation Guidance, which authorizes the insourcing of “contracted services that [DOD] civilian employees can perform ... if a cost analysis shows that [DOD] civilian employees would perform the work more effectively than the private sector.” *Rohmann Servs., Inc. v. U.S. Dep’t of Defense*, No. SA-10-CA-0061-XR, Original Complaint for Declaratory and Injunctive Relief, at ¶¶ 34-36 (W.D. Tex., filed Jan. 26, 2010).

<sup>74</sup> See, e.g., *United States v. Alameda Gateway Ltd.*, 213 F.3d 1161, 1168 (9<sup>th</sup> Cir. 2000); *Chiron Corp. v. Nat’l Transp. Safety Bd.*, 198 F.3d 935, 943-44 (D.C. Cir. 1999); *Troy Corp. v. Browner*, 120 F.3d 277, 287 (D.C. Cir. 1997); *Am. Portland Cement Alliance v. Envtl. Prot. Agency*, 101 F.3d 772, 776 (D.C. Cir. 1996). *But see* *U.S. Tel. Ass’n v. Fed. Comm’n’s Comm’n*, 28 F.3d 1232, 1234-35 (D.C. Cir. 1994) (policy statement not binding on agency unless promulgated as rule).

<sup>75</sup> 75 Fed. Cl. at 572.

<sup>76</sup> *Id.* at 573-74.

<sup>77</sup> *Id.* at 577-79.

<sup>78</sup> *Id.* at 579-80.

<sup>79</sup> *Id.* at 580-81.

Similar findings could result as courts consider the particular insourcing guidelines currently at issue. Additionally, if the district courts find they *do* have jurisdiction under the APA over agency insourcing determinations, there is also the possibility that different courts could reach different conclusions as to whether particular guidelines are binding.<sup>80</sup>

## **Constructive Termination or Breach of Requirements Contracts**

Because certain contracts provide for the contractor to supply all of the contracting activity's requirements for goods or services, there could also be situations where the government must either delay insourcing so as to allow current contracts to expire, or face the prospect of liability to the contractor for constructive termination for convenience<sup>81</sup> or even breach of contract.<sup>82</sup> This issue is most likely to arise with so-called "requirements contracts," or contracts

... by which one party, the seller, agrees to satisfy all of the agency's requirements for services and/or items for a specified period of time. That contract is violated if either the buyer does not purchase all of its requirements from the seller, or, if the seller fails to satisfy all of the buyer's needs. The consideration that makes such a contract binding is the buyer's promise to purchase all of its requirements from the seller and the seller's promise to satisfy those requirements.<sup>83</sup>

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<sup>80</sup> For example, some, but not all, federal circuits have found that the 1983 and 2003 versions of OMB Circular A-76 were issued pursuant to statutory authority, which is one of the conditions for guidelines being reviewable by the federal courts. *See Labat-Anderson*, 65 Fed. Cl. at 578 (2003 version); *Diebold v. United States*, 947 F.2d 787, 800 (6<sup>th</sup> Cir. 1991) (1983 version).

<sup>81</sup> The government always has the right to terminate a contract for convenience, even if the "standard" termination-for-convenience clause was not included in the contract. *See, e.g., G.L.A. Christian & Assocs. v. United States*, 375 U.S. 954 (1963) (court reading the standard termination-for-convenience clause into a contract from which it was lacking). Depending upon the type of contract involved, agencies that no longer need certain services for which they had contracted could also be obligated to pay the contractor, at a minimum, termination costs. For example, unless it terminates the contractor for convenience, the government generally cannot avoid paying the contractor for goods or services contracted for under a firm-fixed-price contract—the preferred type of government contract—if it no longer needs those goods or services. *See, e.g., North Chicago Disposal Co.*, ASBCA 25535, 82-1 BCA ¶ 15,488 (1981) (government could not recover when it contracted for removal of "wet garbage" from galleys at the Great Lakes Naval Base and then did not use the service because the galley personnel were unaware of it and disposed of the garbage in-house); *Rolligon Corp.*, ASBCA 8812, 65-2 BCA ¶ 15,488 (1965) (government liable for the full contract price when it leased two experimental vehicles from the contractor for a one-year testing-and-evaluation period and then discontinued testing after one month).

<sup>82</sup> Courts often treat governmental failures to comply with the terms of procurement contracts as constructive terminations of the contract. *See, e.g., Nesbitt v. United States*, 543 F.2d 583 (Ct. Cl. 1965); *Integrity Mgmt. Int'l, Inc.*, ASBCA 18289, 75-1 BCA ¶ 11,235 (1975). However, they will generally not convert failure to order under a requirements contract into a termination for convenience when the failure was in bad faith or based on circumstances known to the government at the time of contracting. *See, e.g., Torncello v. United States*, 681 F.2d 756 (Fed. Cl. 1982) (termination based on the contractor's prices, which were known to the government at the time of contracting); *Kalvar Corp. v. United States*, 543 F.2d 1298 (Ct. Cl. 1976) (termination in bad faith).

<sup>83</sup> *Aviation Specialists, Inc.*, DOTBCA 1967, 91-1 BCA ¶ 23,534 (Dec. 30, 1990). If the government legitimately has no requirements for the goods or services in question, it has no obligation to purchase anything from the contractor. *See G.T. Folge & Co. v. United States*, 135 F.2d 117 (4<sup>th</sup> Cir. 1943). Any estimates of quantity contained in the solicitation or the contract are nonbinding. *See, e.g., Franklin Co. v. United States*, 381 F.2d 416 (Ct. Cl. 1967) (government not obligated to furnish work orders up to the estimated amount); *Kasehagen Sec. Servs., Inc.*, ASBCA 25629, 86-2 BCA ¶ 18,797 (1986) (contractor must fill orders above the estimate). However, the government could potentially be liable to the contractor if the estimate was negligently prepared. *See, e.g., Alert Care Ambulance Serv.*, VACAB 2844, 90-3 BCA ¶ 22,945 (1990) (government failed to exercise due care in preparing the estimates because it did not consider historical data regarding prior years' requirements); *Pied Piper Ice Cream, Inc.*, ASBCA 20605, 76-2 BCA ¶ 12,148 (1976) (same).

Because a requirements contract obligates the procuring activity to obtain “all” its requirements from the contractor,<sup>84</sup> not just a certain quantity specified in the contract,<sup>85</sup> developing additional in-house capacity to perform the function—as would be expected to occur with insourcing—could raise legal issues, depending upon the terms of the contract.

If the contract provides for the contractor to supply those goods or services “required to be purchased by the government,” it will generally be construed to allow the procuring activity to develop additional in-house capacity during the term of the contract.<sup>86</sup> However, if the contract provides that the contractor is entitled to supply those goods or services “in excess of the quantities which the activity may itself furnish with its own capabilities,” it will generally be read to refer to the procuring activity’s capabilities at the time of contracting and preclude the development of additional in-house capacity during the term of the contract. For example, in *Maya Transit Company*, the Armed Services Board of Contract Appeals found that the contractor was entitled to an equitable adjustment (i.e., additional payment) under its contract because the procuring activity developed additional in-house capacity to provide busing services and began relying upon this capacity, instead of using the contractor’s busing services, to meet its requirements, which had not changed.<sup>87</sup> Similarly, in *Henry Angelo & Sons, Inc.*, the Board granted the contractor recovery under a contract for painting and related work after the procuring activity began using its own personnel to paint military housing because it was less expensive.<sup>88</sup> In so doing, the Board explicitly noted that “[t]he Government does not have an arbitrary right to develop and use potential capabilities at the expense of a contractor.”<sup>89</sup> While older, both cases apparently remain good law.

## Civil Service Laws and Limitations on “Direct Hires”

Civil service laws could also impose certain limitations upon agencies’ implementation of insourcing by requiring that government positions generally be filled through a competitive process with selections based on merit.<sup>90</sup> Because of this requirement, it is typically not possible for an agency insourcing a function to hire, on the spot, the person currently performing that function under a contract.<sup>91</sup> Only when an agency has “direct hire” authority, or other similar

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<sup>84</sup> Requirements contracts can contain maximum quantities, requirements in excess of which the contractor is not obligated to meet. See 48 C.F.R. § 16.503(a)(2). They can also be limited to the procuring activity’s needs in a particular geographic area. See, e.g., *Metcom, Inc.*, B-153450 (May 6, 1964) (finding that a requirements contract limited to a particular geographical area is no impediment to the issuance of a new invitation for bids for the same items to be supplied to a different area).

<sup>85</sup> Even in an “indefinite quantity contract,” there is some minimum quantity specified in the contract. The government is only liable to the contractor for orders up to this amount. See, e.g., 48 C.F.R. § 16.504(a)(1); Peter J. Brandon, *AGBCA* 91-186-1, 92-1 *BCA* ¶ 24,648 (1991).

<sup>86</sup> See, e.g., *Export Packing & Crating Co., Inc.*, *ASBCA* 16133, 73-2 *BCA* ¶ 10,066 (1973); *Applied Painting & Decorating Co.*, *ASBCA* 15919, 73-2 *BCA* ¶ 10,358 (1973).

<sup>87</sup> *ASBCA* 20186, 75-2 *BCA* ¶ 11,552 (1975).

<sup>88</sup> *ASBCA* 15082, 72-1 *BCA* ¶ 9,356 (1972).

<sup>89</sup> *Id.*

<sup>90</sup> See, e.g., 5 U.S.C. §§ 3309-3318; 5 C.F.R. Parts 211 & 337.

<sup>91</sup> “Targeting” contractors’ employees by informing them of government positions and encouraging them to apply is generally permissible, even if some commentators have characterized it as inconsistent with the intent of the “Merit System’s hiring and other procedures.” See David Hubler, *Is the Government Trying to Steal Your Best Employees?*, *Wash. Tech.*, Aug. 26, 2009, available at <http://washingtontechnology.com/articles/2009/08/26/contractors-worries-feds-fish-for-their-employees.aspx>. For example, in *Labat-Anderson*, the court noted, without expressing any (continued...)



authority, may it hire “any qualified person” without engaging in the appropriate competitive process.<sup>92</sup> Currently, agencies have direct hire authority on a temporary basis under the National Defense Authorization Act for FY2004, as amended by National Defense Authorization Act for FY2008, for “Federal Acquisition positions.”<sup>93</sup> These include positions in the General Schedule (GS) contracting and purchasing series, as well as other positions in the GS series “in which significant acquisition-related functions are performed.”<sup>94</sup> However, agencies generally lack such authority for other positions, which means that they cannot directly hire contractor employees, although a person who performed a particular function on behalf of a contractor would probably be well qualified when competing for any government position that would perform that function.

It should also be noted that civil service laws are intended to protect the integrity of the government hiring process and applicants for government positions, not employers concerned about the possibility of the government hiring “their” employees.<sup>95</sup> Regardless of how sizable or destructive to a firm,<sup>96</sup> such loss of employees would not appear to give rise to any cause of action against the government, particularly in the absence of “no-solicitation” clauses in federal contracts.<sup>97</sup> Depending upon their terms, such clauses could potentially preclude one party to a contract from attempting to hire the employees of its vendors. However, such clauses are not standard terms of government contracts. Similarly, even if employers were to draft covenants not to compete that could be construed to prevent their employees from working for the government in the future, such clauses are generally enforceable only against the employee, not against any party who subsequently hires them.<sup>98</sup>

## **Ethics Laws and the Activities of Former Contractor Employees**

The federal ethics and conflict of interest laws and regulations would not prohibit or necessarily prevent the employment by a federal agency of an individual from the private sector who has experience, expertise, or knowledge about or concerning a particular project, contract, or other

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(...continued)

disapproval, that the agency emailed employees of the incumbent contractor encouraging them to apply for positions with the agency after determining to insource functions performed by the incumbent contractor. *Labat-Anderson*, 65 Fed. Cl. at 573.

<sup>92</sup> See U.S. Office of Personnel Management, Direct-Hire Authority (DHA) Fact Sheet, *available at* <http://www.opm.gov/DirectHire/factsheet.asp> (discussing the possible ways in which agencies can be authorized to make direct hires).

<sup>93</sup> P.L. 108-136, § 1413(a), 117 Stat. 1665-66 (Nov. 24, 2003) (codified at 41 U.S.C. § 433 note) (authority through September 30, 2007); P.L. 110-181, § 853, 122 Stat. 250 (Jan. 28, 2008) (authority through September 30, 2012).

<sup>94</sup> 41 U.S.C. § 433(g)(1)(A).

<sup>95</sup> See, e.g., Matthew Weigelt, Defense Officials Hone Their Insourcing Strategy, *Wash. Tech.*, Feb. 3, 2010, *available at* <http://washingtontechnology.com/blogs/acquisitive-mind/2010/02/dod-insourcing-initiative.aspx> (quoting some contractors as objecting to the government’s “aggressiveness” in hiring their employees).

<sup>96</sup> *Id.* (describing one small business that lost 20% of its workforce to the government).

<sup>97</sup> See, e.g., Hubler, *supra* note 91.

<sup>98</sup> For example, when Oracle hired the former chief executive officer of Hewlett-Packard, Hewlett-Packard filed suit against this individual to enforce a confidentiality agreement, not against Oracle. See *Hewlett-Packard Co. v. Hurd*, No. 110CV181699, Civil Complaint for Breach of Contract and Threatened Misappropriation of Trade Secrets (Cal. Sup. Ct., filed Aug. 26, 2010). Because they are restraints of trade, covenants not to compete and similar agreements are looked upon with disfavor by the courts and will generally be enforced only when they are reasonable in terms of the times, places, and activities which they encompass. See, e.g., *Kolani v. Hluska*, 75 Cal. Rptr. 2d 257 (Cal. App. 1998); *Rector-Phillips-Morse v. Vroman*, 489 S.W.2d 1 (Ark. 1973).

such matter. Once employed, however, there may exist certain narrow limitations on the official duties or conduct of that government employee in relation to matters in which that employee may have a continuing or *current* personal financial interest, or concerning which a former employer of that individual is a direct party to a governmental transaction or other such matter.

Unlike employees in the private sector, federal employees and officials are subject to several layers of ethics and conflict of interest laws and regulations which seek to limit or restrict personal “conflicts of interest,” and to assure fealty to the overall, public interest, as opposed to private financial or economic interests of persons or companies. The principal *statutory* method of dealing with potential conflicts of interest in the executive branch is through disqualification or “recusal” requirements which prohibit a federal official from participating in any particular governmental matter in which that official, or those close to the official, has any financial interest.<sup>99</sup> This conflict of interest provision, which is a criminal statute, is directed only at *current* and *existing* financial interests and connections, and does not reach past affiliations, employments, or previous representations of private clients.<sup>100</sup>

While the *statutory* disqualification provision is a criminal law covering only *current* financial interests of the official, there are also “regulatory” recusal requirements that might apply in narrow circumstances to certain *past* affiliations and previous economic interests. Such recusals are generally required in relation to a “particular matter involving specific parties,” when entities or organizations previously affiliated with the federal official are now *parties* to or *represent* parties in those matters. The regulations provide that a federal official should recuse or disqualify himself or herself from working on a particular governmental matter involving specific parties if a “person for whom the employee has, within the last year, served as an officer, director, trustee, general partner, agent, attorney, consultant, contractor or employee” is a party or represents a party in such matter.<sup>101</sup> This one-year recusal requirement, as to matters involving an official’s former employers, businesses, clients, or partners, applies to any officer or employee of the executive branch, but applies narrowly only to “a particular matter involving specific parties” when such former employer or business associate is or represents a party to the matter. Matters “involving specific parties” may apply to such things as contracts, investigations, or prosecutions involving specifically identified individuals or parties, as opposed to broader “particular matters” which may involve a number of persons or entities (such as most rule making). Notwithstanding the fact that a past employer, client, or business associate with whom the employee has a “covered relationship” may be a party or represent a party to such a matter, an employee may, as with the regulatory restriction on current interests, receive authorization by his or her agency to participate in the matter.<sup>102</sup>

There are also recusal requirements in regulations concerning such matters when a party (or one representing a party) had made an “extraordinary payment” to the official prior to the official’s entry into government. The regulations of the Office of Government Ethics provide for a *two-year* recusal requirement which bars an official in the executive branch from participating in a

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<sup>99</sup> 18 U.S.C. § 208. Interests “imputed” to the employee are the financial interests of that employee’s spouse or dependents, or the financial interests of an organization in which the employee *is* affiliated as an officer, director, trustee, general partner or employee, or one “with whom he is negotiating or has any arrangement concerning prospective employment.”

<sup>100</sup> CACI, Inc.-Federal v. United States, 719 F.2d 1567,1578 (Fed. Cir. 1983); Center for Auto Safety v. F.T.C., 586 F. Supp. 1245, 1246 (D.D.C. 1984).

<sup>101</sup> 5 C.F.R. § 2635.502(a), (b)(1)(iv).

<sup>102</sup> 5 C.F.R. § 2635.502(c), (d).

particular matter in which a “former employer” is or represents a party when that former employer had made an “extraordinary payment” to the official prior to entering government. An “extraordinary payment” is one in excess of \$10,000 in value made by an employer after the employer has learned that the employee is to enter government service, and one which is not an ordinary payment (that is, a payment other than in conformance with the employer’s “established compensation, benefits or partnership program”).<sup>103</sup> This disqualification provision may also be waived in writing by an agency head, or if the individual involved is the head of an agency, by the President or his designee.<sup>104</sup>

Finally, there are now additional restrictions on certain presidential appointees issued by way of executive order. On January 21, 2009, President Obama issued an executive order requiring the signing of an “ethics pledge” by all presidential and vice presidential appointees to full-time, non-career positions in the executive branch, including all non-career SES appointees, and appointees to positions excepted from competitive service because they are of a confidential or policy making nature (such as Schedule C appointments).<sup>105</sup> The “ethics pledge” places two additional restrictions on such appointees entering the executive branch, with respect to their former employers or clients. Initially, such “appointees” may not participate in, and must recuse themselves for two years after entering federal service from any particular governmental matter involving specific parties when a former client or former employer of the appointee is a party to or represents a party in that particular matter.<sup>106</sup> This extends the similar regulatory recusal requirement applicable to all executive branch officials from one year to two years for such “appointees.”<sup>107</sup> Secondly, any such “appointees” who were registered “lobbyists”<sup>108</sup> prior to entering the executive branch, are under additional and further restrictions. Such appointees/former lobbyists may not, for two years after entering the government, (1) participate in any particular matter on which the appointee had lobbied within the two years prior to his or her appointment, (2) participate in the specific issue area in which that particular matter falls, or (3) seek or accept employment with any agency that the appointee had lobbied within the two years prior to entering government service.<sup>109</sup>

## Small Business Law

Small businesses generally receive special consideration under federal law and policy.<sup>110</sup> For example, it is the “declared policy of Congress that the Government should ... insure that a fair proportion of the total purchases and contracts or subcontracts for property and services for the Government ... be placed with small-business enterprises,”<sup>111</sup> and there are a number of contracting preferences for various types of small businesses, including set-asides, sole-source

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<sup>103</sup> 5 C.F.R. § 2635.503(b)(1).

<sup>104</sup> 5 C.F.R. § 2635.503(c).

<sup>105</sup> Executive Order 13490, 74 Fed. Reg. 4673 (Jan. 26, 2009).

<sup>106</sup> E.O. 13490, Section 1, para. 2.

<sup>107</sup> See 5 C.F.R. § 2635.502(a), (b)(1)(iv).

<sup>108</sup> “Lobbyists” are those required to register and file under the Lobbying Disclosure Act of 1995, as amended, including employees listed as lobbyists of organizations registering under the law. See 2 U.S.C. §§ 1602 *et seq.* The restriction applies if one had been a “lobbyist” within two years of his or her appointment.

<sup>109</sup> E.O. 13490, Section 1, para. 3.

<sup>110</sup> See *supra* note 23.

<sup>111</sup> 15 U.S.C. § 631(a).

awards, and price evaluation preferences.<sup>112</sup> However, such protections do not appear to furnish grounds for challenging an insourcing determination even if, as some commentators allege, insourcing disproportionately affects small businesses.<sup>113</sup> Under most provisions of federal law, preferences for small business apply only in the case of “acquisitions” or “contract opportunities,”<sup>114</sup> which could be construed to mean that they exist only when an agency has determined to contract out a function, not when it is determining whether to contract out a function.<sup>115</sup> While the regulations implementing Section 8(a) of the Small Business Act are somewhat broader in that they refer to agency “requirements,”<sup>116</sup> there does not appear to be any precedent for construing the regulatory prohibition upon removing a requirement from the 8(a) Program without the consent of the Small Business Administration (SBA) to mean that agencies need the SBA’s permission to insource functions formerly contracted out through the 8(a) Program.<sup>117</sup> However, the Obama Administration’s Interagency Taskforce on Federal Contracting Opportunities for Small Business recently recommended that the “relationship between policies that address the rebalancing of agencies’ relationship with contractors and small business contracting policies” be clarified, and the impact of insourcing of federal small business contractors be evaluated.<sup>118</sup> It remains to be seen what, if any, changes in insourcing policy may be made in response to this recommendation.

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<sup>112</sup> See 15 U.S.C. § 637(a) (set-asides and sole-source awards for small businesses owned and controlled by socially and economically disadvantaged individuals); 15 U.S.C. § 637(m) (set-asides for women-owned small businesses); 15 U.S.C. § 644(g) (set-asides for small businesses generally); 15 U.S.C. § 657a (set-asides, sole-source awards and price evaluation preferences for Historically Underutilized Business Zone (HUBZone) small businesses); 15 U.S.C. § 657f (set-asides and sole-source awards for service-disabled veteran-owned small businesses).

<sup>113</sup> See Burton & Boland, *supra* note 24. Such commentators are concerned that the functions currently performed by small businesses are more likely to be insourced than those performed by larger firms, and several small business associations have called upon the Obama Administration to abandon its insourcing initiatives. See, e.g., U.S. Chamber of Commerce et al., Letter to the President, Aug. 19, 2010, available at [http://www.techamerica.org/content/wp-content/uploads/2010/08/Coalition\\_Letter\\_President\\_Obama-Insourcing\\_Moratorium\\_8-19-2010.pdf](http://www.techamerica.org/content/wp-content/uploads/2010/08/Coalition_Letter_President_Obama-Insourcing_Moratorium_8-19-2010.pdf) (“Given Secretary Gates’ recent acknowledgement that insourcing does not save money, Senator Menendez’s concerns that insourcing is ‘counter-intuitive’ to your Administration’s goal of creating Federal contracting opportunities, particularly for small and minority owned businesses, and the current state of the nation’s economy, **we respectfully urge your Administration to issue a revision to the insourcing agenda calling for an immediate moratorium on all insourcing efforts throughout the Federal government.**”) (emphases in original).

<sup>114</sup> By definition, an “acquisition” is “the *acquiring by contract* with appropriated funds of supplies or services (including construction) by and for the use of the Federal Government through purchase or lease, whether the supplies or services are already in existence or must be created, developed, demonstrated, and evaluated.” 48 C.F.R. § 2.101 (emphasis added).

<sup>115</sup> Cf. *supra* note 39 and accompanying text (noting that “acquisition” has a narrower meaning than “procurement” under the OFPPA).

<sup>116</sup> See, e.g., 13 C.F.R. § 126.606 (“A [contracting officer] may request that SBA release an 8(a) requirement ... However, SBA will grant its consent only where neither the incumbent nor any other 8(a) participant can perform the requirement.”).

<sup>117</sup> In fact, a recent decision by the Court of Federal Claims upheld an agency’s determination to remove a requirement from the 8(a) Program without the SBA’s consent. See *K-LAK Corp. v. United States*, 2011 U.S. Claims LEXIS 310 (Fed. Cl. Mar. 9, 2011).

<sup>118</sup> *Report of the Interagency Task Force on Federal Contracting Opportunities for Small Business*, 7 (Sept. 23, 2010), available at [http://www.sba.gov/idc/groups/public/documents/sba\\_homepage/contracting\\_task\\_force\\_report.pdf](http://www.sba.gov/idc/groups/public/documents/sba_homepage/contracting_task_force_report.pdf).

## Potential Congressional Actions

While most of the legal issues related to insourcing discussed herein arise from agencies' implementation of insourcing initiatives, there is considerable scope for Congress to influence whether and how insourcing is implemented. Broadly, Congress could restrict or expand the scope of any insourcing. For example, the 112<sup>th</sup> Congress is currently considering legislation that, if enacted, would limit agencies' ability to insource functions by requiring that agencies complete a "public-private competitive sourcing analysis" *and* determine that the "provision of such goods or services by Federal employees provides the best value to the taxpayer" before using government personnel to provide goods or services previously performed by a "private sector entity."<sup>119</sup> A provision in the House-passed National Defense Authorization Act for FY2012 (H.R. 1540, § 939) could also limit agencies' ability to insource by requiring the consideration of certain information when estimating and comparing the costs of performing functions with DOD civilian employees and contractor personnel.

Alternatively, Congress could consider legislation, like that enacted in the 109<sup>th</sup> through 111<sup>th</sup> Congresses, encouraging agencies to insource particular functions. More narrowly, Congress could also expand or limit the jurisdiction of particular courts over contractors' challenges to insourcing determinations; require that agency insourcing guidelines be promulgated in ways that are more or less likely to be found to be legally binding; expand or limit direct hire authority; impose or remove restrictions upon the activities of former contractor employees who enter government service; or seek to protect small businesses from the effects of insourcing determinations.

## Author Contact Information

Kate M. Manuel  
Legislative Attorney  
kmanuel@crs.loc.gov, 7-4477

Jack Maskell  
Legislative Attorney  
jmaskell@crs.loc.gov, 7-6972

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<sup>119</sup> Freedom from Government Competition Act, S. 785, § 4(e). There is an identical provision in the House version of this bill, H.R. 1474.