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A-76 Does Not Govern In-House Performance Of Work Under Expired Contract Pending Resolicitation

LABAT-Anderson v. U.S., 2005 WL 958225 (Fed. Cl. April 26, 2005)

The U.S. Court of Federal Claims has held that the competitive sourcing procedures in Office of Management and Budget Circular A-76 do not apply to a defense agency's decision to convert work to in-house performance pending a resolicitation necessitated by the expiration of a contract with a private company. The Court also held that the agency complied with 10 USCA § 2462, which requires the Department of Defense to contract with the private sector unless, after conducting a realistic and fair cost comparison, DOD determines that it can perform the work in-house at a lower cost.

LABAT-Anderson Inc. performed packing and distribution services for the Defense Logistics Agency under a contract awarded after a public-private competition under the 1999 version of Circular A-76. Although performance under the contract was satisfactory, the parties could not resolve disputes that arose during performance concerning pricing of added work, and DLA declined to exercise its option to renew the contract. Before the contract expired, DLA informed LABAT that it would perform the work in-house until it could resolicit and award a new contract.

LABAT sought declaratory and injunctive relief to prohibit DLA from performing the work in-house until DLA resolicited the requirement and prevailed in a public-private competition. The Court temporarily stayed DLA's action, but then held, in a December 2004 order, that Circular A-76 and other procurement provisions underlying its preliminary decision did not apply. The Court's April 26 decision provides findings and conclusions to supplement its December 2004 order vacating the stay and allowing the agency action to stand.

Standing—The Tucker Act gives the COFC jurisdiction over actions 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." 28 USCA § 1491(b)(1). LABAT alleged that DLA's performance of work in-house without first prevailing in a public-private cost comparison violated laws requiring procurement from the private sector. The Court held that, although LABAT did not seek review of a solicitation or award, it did allege a violation of a statute or regulation in connection with a procurement and, therefore, met one prong of the standing test.

Addressing the second prong, qualification as an interested party, the Court stated that Federal Circuit precedent defines "interested party" under § 1491(b)(1) as "an actual or prospective bidder or offeror whose direct economic interest would be affected by the award of the contract or the failure to award the contract." See *Am. Fed'n of Gov't Employees v. U.S.*, 258 F.3d 1294 (Fed. Cir. 2001). LABAT alleged that it lost the chance for earnings by "not being allowed to compete with the Government for the renewed contract" and incurred other losses from the Government's decision to perform the work in-house. Moreover, the parties agreed that LABAT, the capable incumbent, would legitimately compete for the new contract. Those circumstances make LABAT an interested party, the Court held.

The Court distinguished cases requiring a pending procurement as a prerequisite to standing. The Court held that, if no solicitation is pending, an interested party, like LABAT, still has standing if the

Government "deprive[s] the plaintiff of an opportunity to compete for the work in a fair competition."

Availability of Declaratory and Injunctive Relief—Before addressing the merits, the Court examined whether it could provide the relief LABAT requested. The Court declined to issue a declaratory judgment that the Government illegally moved the contract work in-house. Because the Government began performing the work when the Court lifted the stay, a declaratory judgment "would have no practical effect." A declaratory judgment was, therefore, an academic exercise, tantamount to an advisory opinion.

The Court then determined that it had authority to grant the other relief LABAT sought—an order enjoining the Government's in-house performance until DLA had completed, and prevailed in, the resolicitation. The Court rejected the Government's argument that such an order would improperly award a contract to LABAT. The Court distinguished case law holding that the COFC lacked authority to award a contract, relying on *Parcel 49C Ltd. P'ship v. U.S.*, 31 F.3d 1147 (Fed. Cir. 1994), which upheld the trial court's rescission of a cancellation of a lease, although the practical effect was to award the lease to plaintiff. The Court held that an injunction would not directly award a contract but, like the order in *Parcel 49C,* merely "restore the procurement process to the same posture that existed before the alleged violation."

The Merits—Section 2462 of title 10 U.S. Code and related regulations govern DOD's choice between contracting with the private sector and performing work in-house. These laws require contracting with the private sector unless the Government can perform the work in-house at a lower cost. Section 2462(b) also requires that, in deciding whether the private or in-house supplier provides the lower cost, DOD must conduct a "realistic and fair" cost comparison.

The regulations defining DOD's Commercial Activities Program, 32 CFR pts. 169 and 169a, give effect to § 2462's requirements. Parts 169 and 169a incorporate the procedures in Circular A-76, which is not a DOD regulation, for use in performing the cost comparison required by 10 USCA § 2462, the Court held.

The Government contended that Circular A-76 was a statement of presidential management policy and could not underlie review of agency action. The Court's analysis of relevant case law from the U.S. Courts of Appeals for the Fourth and Sixth Circuits suggests that the Court would find that A-76 standards, if required by law, provide a basis for review of agency action. Without expressly deciding the issue, however, the Court determined that A-76 provisions did not apply to DLA's action.

DOD must use A-76 procedures "only to the extent that Parts 169 and 169a of the Commercial Activities Program incorporate them," the Court held. Section 169a.10 of the program regulations authorizes resolicitation if contract costs become unreasonable or performance becomes unsatisfactory—neither of which applied to the instant case. Resolicitation must be performed according to A-76 procedures if in-house performance is feasible. The regulation also provides that if contract work will move in-house, "the contract will be allowed to expire (options will not be exercised) once in-house capability is established." LABAT asserted that this provision implies an obligation on DLA not to allow the contract to expire before completing the resolicitation.

However, the Court held that the regulations do not address a situation in which an agency does not complete the resolicitation before the existing contract expires. Accordingly, the Court held that DLA's conversion of the work to in-house performance was not governed by the regulations in pts. 169 and 169a and, therefore, A-76 procedures did not apply.

The Court went on to hold that, even in situations not covered by pts. 169 and 169a, an agency still must comply with § 2462's requirement to conduct a cost comparison, but can use procedures other than those set out in Circular A-76 for ascertaining whether the Government or the private supplier is the lower cost provider. The Court concluded that some cost comparison was required because the statute does not distinguish between temporary and permanent in-house work. The lack of sufficient time to resolicit the work when the agency decided not to exercise LABAT's option did not relieve the agency from doing some sort of cost comparison to comply with § 2462, the Court held.

Section 2462 gives agencies substantial discretion to conduct "realistic and fair" cost comparisons, yet provides meaningful standards against which to judge agency action, the Court said. DLA's comparison of LABAT's charges with the

cost of the in-house operation, though not a full comparison as contemplated by Circular A-76, was "realistic and fair" under § 2462. DLA compared LABAT's $425,000 offer to the in-house estimate of $365,000. Using the software it regularly uses to perform cost comparisons, DLA considered "personnel costs, supply and material costs, overhead, and other 'specifically-attributable costs' " to calculate the in-house estimate. The agency also discounted overhead costs that "would have been attributable to the Government regardless of who performed the work." Although the cost comparison "did not comply with OMB Circular A-76 or with Parts 169 and 169a," it did meet § 2462's requirements, the Court held.

Finally, the Court held that Executive Order 12615 did not provide a meaningful standard for review of agency action. The EO states, "The head of each Executive department and agency shall to the extent permitted by law … [e]nsure that new Federal Government requirements for commercial activities are provided by private industry, except where statute or national security requires government performance or where private industry costs are unreasonable. …" The Court noted that section five of the EO states that "[n]othing in this Order shall be construed to confer a private right of action …, or to add in any way to applicable procurement procedures required by existing law." Accordingly, the Court held that the EO should be viewed as "a directive or memorandum within the Executive Branch," and did not provide a basis to challenge DLA's action.

As the Court explained, the ruling on the merits, alone, precluded relief for LABAT. The Court, nonetheless, reviewed the remaining factors governing injunctive relief, and then dismissed the complaint.

✦ **Practitioner's Comment**—The Court's ruling in *LABAT-Anderson v. U.S.* is a significant, and arguably troubling, development for the Government's competitive sourcing initiatives. Put briefly, the opinion sanctions conversions of commercial activities contracted with the private sector to temporary, in-house Government performance prior to issuing a formal resolicitation. Moreover, the ruling permits such conversions even absent a complete A-76 cost comparison. The decision also sets a low threshold for what constitutes a "realistic and fair" cost comparison under 10 USCA § 2462, and permits considerable agency discretion in conducting the required cost comparison.

In May 2001, LABAT won an A-76 competition to provide distribution services at the Defense Distribution Center (DDC), a business unit within DLA, in Cherry Point, North Carolina. On Sept. 30, 2004, DDC informed LABAT that it would not exercise the option to renew the contract when it expired on Dec. 1, 2004. Although LABAT had been performing the contract work in a satisfactory manner, DDC elected not to exercise the option because of the parties' failure to agree on the price of new work added to the contract after award by a unilateral change order from the Government. When DDC informed LABAT that it was creating an Interim Government Operation (IGO) to perform the distribution services in-house until a new contract could be awarded, LABAT offered to provide all required services (including the new work) for a flat monthly rate. DDC, however, insisted on converting the services to in-house performance.

On Oct. 22, 2004, LABAT filed suit to enjoin DDC from converting to in-house performance without issuing a solicitation or conducting a cost comparison study according to A-76 procedures, or at a minimum, as required by 10 USCA § 2462. Following an expedited briefing schedule and oral arguments, LABAT won an initial victory as the Court issued a temporary restraining order enjoining the Government's conversion to the IGO on Nov. 30, 2004. The Court, however, lifted the stay on Dec. 3, 2004, and permitted DDC to convert the distribution services to Government performance without conducting an A-76 competition and prior to issuing a new solicitation. Nearly seven months later, DDC is still performing the distribution services at Cherry Point as an "interim" Government operation.

While the Court's standing analysis clarifies what constitutes a procurement under the Court's bid protest jurisdiction, the decision on the merits could have negative implications for those commercial activities subject to A-76 requirements. For instance, the Court concluded that DOD could perform a realistic and fair cost comparison using procedures *other than those* established by Circular A-76 if the circumstances *were not covered* by DOD's Commercial Activities Program regulations,

32 CFR pts. 169 and 169a. Specifically, the Court ruled that "the regulations do not address a situation in which an Agency component does not complete resolicitation before the expiration of an existing contract," and, therefore, held that DOD was not required to conduct a cost comparison in conformity with A-76.

The Court reached this conclusion even though DDC, in prior proceedings before the U.S. District Court for the District of Columbia, had produced a "deviation letter" from OMB, purporting to temporarily permit DOD to avoid the A-76 requirements. This deviation letter demonstrated that DDC was concerned that the A-76 procedures would limit its ability to create the IGO, and thus sought a deviation from OMB. The Court did not address the validity and applicability of the deviation letter when it ruled that DOD was only required to follow A-76 procedures to the extent that those procedures were incorporated into 32 CFR pts. 169 and 169a. Because the regulations did not address the situation at hand, DOD was free to convert the services to an IGO without conducting an A-76 cost comparison.

Despite considerable briefing and discussions of 32 CFR § 169a.4(h) during oral argument, the opinion is devoid of any mention of this key regulation, which is the only DOD regulatory authority for the creation of an interim in-house Government operation. The regulation states that "a DoD in-house [commercial activity] may be established on a temporary basis if a contractor *defaults*." Yet in this case, LABAT was not terminated for default, and DOD failed to cite any authority for the creation of the IGO. Similarly, the Court neglected to cite any regulation authorizing the temporary, in-house performance, but rather permitted the creation of such an organization provided only that DOD had complied with the cost comparison requirements of 10 USCA § 2462.

Although the statute does not distinguish between permanent and temporary performance, the Court found that the statute applied to DDC's decision to move the services in-house, even on a temporary basis. 10 USCA § 2462 provides:

> (a) **In General.**—Except as otherwise provided by law, the Secretary of Defense shall procure each supply or service necessary for or beneficial to the accomplishment of the authorized functions of the Department of Defense (other than functions which the Secretary of Defense determines must be performed by military or Government personnel) from a source in the private sector if such a source can provide such supply or service to the Department at a cost that is lower (after including any cost differential required by law, Executive order, or regulation) than the cost at which the Department can provide the same supply or service.
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> (b) **Realistic and Fair Cost Comparisons.**—For the purpose of determining whether to contract with a source in the private sector for the performance of a Department of Defense function on the basis of a comparison of the costs of procuring supplies or services from such a source with the costs of providing the same supplies or services by the Department of Defense, the Secretary of Defense shall ensure that all costs considered (including the costs of quality assurance, technical monitoring of the performance of such function, liability insurance, employee retirement and disability benefits, and all other overhead costs) are realistic and fair.

Here, the Court found that "[t]he cost comparison ... did not comply with OMB Circular A-76 or with Parts 169 and 169a, but the comparison did comply with the section 2462 mandate to use a realistic and fair cost comparison. ..." The Court determined that DOD made a "reasonable effort" to comply with the statute because it considered the factors listed in § 2462(b) in making its conversion decision. In particular, the Court relied on DDC's use of the same software to conduct the cost comparison that it normally used to perform A-76 cost comparisons.

The Court's holding essentially provides DOD components an easy out whenever insufficient time remains in the procurement cycle to complete a full or streamlined A-76 cost comparison. Specifically, as long as the agency conducts some type of cost comparison, it is free to perform the commercial services in-house, albeit on a "temporary" basis, until the A-76 cost comparison process is complete, which could take up to 24 months.

Furthermore, the ruling sets a low standard for what constitutes a "realistic and fair" cost comparison under 10 USCA § 2462. As set forth above, § 2462(b) specifically lists the elements of

what should constitute a "realistic and fair" cost comparison. The Court, however, treated these elements as mere "examples" and permitted DDC's informal cost comparison, which did not include all of the listed statutory elements. In addition, there was no evidence that the cost comparison took into account the "cost differential required by law, Executive Order, or regulation" as required by § 2462(a). In the case of commercial activities, a "conversion differential" is required by Circular A-76 to be added to the cost of performance of any non-incumbent source. It will be interesting to see if federal employee unions argue that the conversion differential should be applied in the follow-on competition, or if, because the IGO is only a temporary organization, that it would not qualify as the incumbent provider and, therefore, the conversion differential should not apply. Lastly, DDC's cost comparison was conducted nearly two months after the agency decided to create the IGO and was produced in the heat of litigation.

In sum, *LABAT-Anderson v. U.S.* is a blow to contractors seeking consistency and predictability in the Government's compliance with Circular A-76. The Court's approval of DDC's Interim Government Operation, without any specific regulatory or statutory authority, most likely will create additional situations in which private providers of commercial activities lose their incumbent status and competitive advantage when the Government delays the resolication process. It remains to be seen whether OMB and DOD will recognize the gap in Circular A-76 and DOD's Commercial Activities Program and seek to eliminate, or at least more accurately define, the appropriate circumstances for converting commercial activities to in-house Government performance.

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