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## Small Business Hard Hit as Obama Takes Back Contractors' Work

By Leah Nylan | July 19, 2011 12:01AM ET

(Bloomberg) -- Dawn Hamilton got the call two days before Christmas: The Coast Guard would be canceling most of her \$5 million a year contract in six months to bring the work in house.

"I was just shocked," Hamilton, chief executive officer and founder of Security Assistance Corporation, told Bloomberg Government in a June interview at her company's offices in Arlington, Virginia. "We always had outstanding and excellent reviews from the Coast Guard."

SAC is one of dozens of small businesses that have lost employees and revenue as federal agencies cancel contracts and hire civil servants to do the work, a practice known as insourcing.

By the end of June, the Coast Guard had made job offers to 54 of Hamilton's 63 employees. A few others accepted jobs with other companies, she said. The Coast Guard extended one part of the contract until Sept. 30 to allow for a "more orderly transition," Lt. Paul Rhynard, an agency spokesman, said in an e-mail.

The Coast Guard identified SAC's contract as a candidate for insourcing after an assessment and cost comparison, Rhynard said. Based on the comparison, the agency determined it could achieve "substantial annual savings" of about \$2.8 million a year by insourcing most of the work, he said.

### 'Out of Business'

"The government is aggressively removing work from some small businesses," said Robert Burton, a partner at Venable LLP in Washington, who represented SAC and other small vendors in insourcing cases. Insourcing "impacts small businesses much more than midsize and large businesses. If small businesses lose their employees, they can go out of business."

Federal procurement officials said the impact on small business from in-sourcing has been minimal, though they had little data on the number of businesses affected.

"The impact is smaller than some people expected," Daniel I. Gordon, the administrator of the Office of Federal Procurement Policy, said in a June 28 interview. "We are keenly sensitive to the impact of insourcing on small businesses. We have provided guidance to the agencies to make clear that they need to be sensitive to the impact on small businesses."

In a February memo, Gordon's office instructed agencies to conduct impact analyses of the dollar value of contracts that have been insourced and how much of the work was performed by small businesses, he said in a July 11 e-mail. Those analyses are still being completed.

### 'Inflated Numbers'

The memo also instructed agencies to place "lower priority" on reviewing work by small businesses if it was not "inherently governmental," or work that only federal employees may perform, he said.

Agencies don't have to notify the Small Business Administration before insourcing a contract held by a small vendor unless it's within the 8(a) program, said Michele Chang, a senior adviser in the agency's office of government contracting and business development.

The 8(a) program reserves some contracts for small companies owned by socially and economically disadvantaged individuals. If an agency wants to insource an 8(a) contract, it must first ask the SBA to "release" it from the program, Chang said in a July 12 e-mail.

#### Agencies:

- Small Business Administration
- Coast Guard
- Air Force

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That didn't happen in SAC's case, Hamilton said. After the Coast Guard notified her, Hamilton filed a

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Freedom of Information Act request seeking the cost analysis the agency used to make the decision to insource. Hamilton said the agency used inflated numbers to determine the cost of using the company, and she is now working with the SBA to see if she can appeal the decision.

### 1,000 Small Business Jobs

At the beginning of his administration, President Barack Obama said the government would take back some tasks that have been outsourced. In a 2009 memo, he called for the Office of Management and Budget, which includes Gordon's office, to develop "clear rules prescribing when outsourcing is and is

not appropriate."

The office plans to issue a policy letter later this summer that will give agencies more instructions on how to address inherently government functions, Gordon said in the e-mail.

The Defense Department estimated that it has created nearly 17,000 new civilian positions in fiscal 2010 as a result of insourcing, according to a June 20 communication to the House Small Business Committee. About 1,000 of those positions resulted from situations where a small business held the prime contract to provide the service, according to the department.

Department officials told the committee they couldn't estimate how many of the positions were created from work a small business was performing as a subcontractor for a larger business.

#### Twelve Lawsuits

"There is no over-arching DOD policy that protects small business," Thomas Hessel, the program lead for Pentagon insourcing, said in a June 28 interview. Defense Department agencies "are very cognizant of their small business requirements," he said.

Hessel, who works in the defense secretary's office, said the department doesn't have a master list of contracts that have been terminated because of insourcing efforts and couldn't immediately estimate how many small business contracts have been terminated. The insourcing efforts saved the department about \$900 million in fiscal year 2010, he said.

So far, at least twelve companies have filed lawsuits in federal court challenging insourcing decisions, according to court filings by the Justice Department. All of those cases involve small businesses, and seven of the lawsuits concern work insourced by the Air Force.

#### \$300,000 Cheaper

The Air Force planned to base most of its insourcing decisions on cost analyses to determine whether government employees would be less expensive, according to a January Government Accountability Office report.

The Air Force decided in 2010 to end an \$8.6 million vehicle maintenance contract to a small business after a cost estimate showed it would be about \$300,000 cheaper to have in-house employees do the work.

Triad Logistics Services Corp., owned by two Air Force veterans and based in Merritt Island, Florida, had provided the services since 2006. After its contract was insourced, Triad sued in the Court of Federal Claims. Its lawsuit is still ongoing.

The insourced contract accounted for about 20 percent of the company's gross revenue, Timothy Tuggle, the company co-owner, said in an interview after a March court hearing. The company had to lay off six people when the contract ended, he said.

#### 'Low-Hanging Fruit'

"We're the low-hanging fruit on the tree," Tuggle said. "Why are they picking on me?"

The Air Force also insourced two contracts held by Information International Associates to manage education and training programs. The Air Force determined it would be cheaper to do the work in-house, Bonnie Carroll, the company's president, said in an interview.

Air Force officials never offered the company a figure for how much it would save by insourcing the work, Carroll said.

The Oak Ridge, Tennessee-based company lost about 15 percent of its employees and 11 percent of its monthly revenue because of the insourcing, she said. Four employees were hired by the Air Force. Some of the others were laid off, though the company keeps a list and tries to consider them for future openings, Carroll said.

SAC's Hamilton said the Coast Guard probably selected the company's contract for insourcing because her business didn't have the means to fight back.

"In my opinion, it was because we are a small business," she said. "Clearly we don't have the resources to go up against the government."

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#### IMPACT

##### Action

As U.S. agencies move previously contracted work in house to save money, small businesses are most affected by the loss of revenue and employees.

##### Cost

The Defense Department estimates it saved about \$900 million through insourcing efforts in the fiscal year that ended in September.

##### Outcome

Small vendors whose contracts are terminated because of insourcing often have to lay off employees.

##### Strategy

Some small businesses have filed lawsuits in federal court challenging insourcing decisions. Others have filed Freedom of Information Act requests to receive the "cost analysis" conducted by the agency so they can challenge the conclusions.

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