

COMPETITIVE SOURCING

Report on the Use of Best Value Tradeoffs in Public-Private Competitions



April 2006

*Executive Office of the President
Office of Management and Budget*

Report on the Use of Best Value Tradeoffs in Public-Private Competitions

Section 842 of the Transportation, Treasury, Housing and Urban Development, the Judiciary, the District of Columbia, and Independent Agencies Appropriations Act, FY 2006, P.L. 109-115, precludes an agency from converting work currently performed by more than 10 federal employees to private sector performance absent a showing, through competition, that performance by a contractor would be less costly to the agency by an amount that equals or exceeds the lesser of 10 percent of the personnel-related costs associated with performance by the agency's most efficient organization (MEO) or \$10 million. Under section 842, an agency may not convert work to private sector performance if this differential is not met, even if the agency can demonstrate that private sector performance would provide a superior solution, considering both cost and quality. In the absence of section 842, OMB Circular A-76 would authorize an agency to consider this conversion, but only if certain procedures are followed to ensure an impartial and properly justified decision.

In passing section 842, the Conferees requested that OMB advise them of the impact of this section "on the Federal government's ability to obtain value for the taxpayer, both in terms of cost and quality, through the use of competitive sourcing." The Conference report states that this information will be considered by the Conferees in deciding whether this restriction should be continued in FY 2007.

This report discusses the impact of section 842. As the report explains, OMB believes the limitation in section 842 inappropriately precludes taxpayers from receiving significant benefits generated by public-private competition. For the reasons stated below, section 842 should be repealed, or at least modified to permit decisions on the basis of both cost and quality.

A. Background

Agencies have always had the discretion to determine the appropriate performance standards in a public-private competition and to make tradeoffs in determining the best value among private sector offers.¹ However, prior to 2003, agencies were not allowed to consider tradeoffs between the cost and quality of the MEO (i.e., the in-house government provider's proposed solution) and the best private sector contractor's proposed solution. Traditionally, Circular A-76 required the government to conduct a cost-based comparison between the MEO and the best private sector contractor. To enable this comparison, the government's source selection evaluation board would adjust the MEO's offer, as necessary, to match the level of performance and quality proposed by the best private sector contractor. In other words, the private sector contractor's solution was shared with the MEO who would then adjust its offer to reflect the cost of performing the desired solution. Selection between the MEO and the contractor would be based strictly on cost alone – i.e., work would be performed by the MEO

¹ Performance standards are defined in Circular A-76 as "verifiable, measurable levels of service in terms of quantity, quality, timeliness, location, and work units."

unless conversion would result in a savings of at least 10 percent or \$10 million (whichever is less) when compared to the cost of performance by the MEO.

The cost-based comparison model generally works for public-private competitions that involve routine needs, such as building or lawn maintenance, where transformational improvement is not required. However, agencies have found that this model is less effective for highly technical activities or for encouraging innovative thinking, by either contractors or government workers, when the agency must modernize its operations and fundamentally change the way service is provided to customers. Developing proposals for these types of needs generally requires a substantial investment of time and money. Private sector contractors will be disinclined to make this investment if their proposed solutions are shared with the MEO in order to enable a cost comparison. The likely result is either no private sector participation or the submission of offers with minimal innovation that basically reflect the status quo.

1. Recommendations of the Commercial Activities Panel. In 2002, the Commercial Activities Panel, a bipartisan, government-industry panel tasked by Congress with reviewing the competitive sourcing process, issued a report that acknowledged the importance of considering both cost and quality in public-private competitions.² The Panel's report characterizes the cost comparison process described above as an anachronism in the federal procurement system, which has long authorized agencies to conduct competitions among private sector contractors using tradeoffs of cost and non-cost factors such as technical approach and management plan.³ The Panel heard complaints from contractors that the cost comparison process for public-private competition denied them the benefits of their investment and commitment to innovation and technology.⁴ Their report acknowledges these concerns, citing to the "unfairness that stems from leveling the public sector proposal with that of the private sector, including the risk of disclosure of intellectual property."⁵ Although a few Panel members expressed concern that tradeoffs might be used to dismantle the workforce, at least two-thirds of the Panel recommended that the Circular's best value provisions be revised to ensure that agencies are able to identify high value service providers in public-private competitions.⁶

"In making source selection decisions in public-private competitions, cost must always be considered . . . but the government should not buy whatever services are least expensive regardless of quality. Instead, public-private competitions should be structured to take into account the government's need for high-quality, reliable, and sustained performance, as well as cost efficiencies."

Improving the Sourcing Decisions of the Government
Report of the Commercial Activities Panel (April 2002)

²*Improving the Sourcing Decisions of the Government* Final Report of the Commercial Activities Panel (2002) [hereinafter CAP Report], available at www.gao.gov/a76panel/dcap0201.pdf.

³The Panel noted that the Circular's leveling process is not in any procurement system of which the Panel was aware. CAP Report at p. 42.

⁴ CAP Report at p. 41.

⁵ CAP Report at pp. 42-43.

⁶ CAP Report at p. 9.

2. Circular A-76's framework for tradeoff competitions. In May 2003, after solicitation of public comment and careful deliberation, OMB revised the Circular to allow agencies to consider both cost and quality in deciding whether work should remain in-house or be converted to private sector performance. In authorizing cost-technical tradeoffs, OMB imposed certain caveats to ensure that *cost remains a significant factor in all tradeoff decisions*. Specifically, agencies must: (a) identify the specific weight given to each evaluation factor and sub-factor, and (b) make the specific weight for cost or price at least equal to all other evaluation factors combined unless quantifiable performance measures can be used to assess value and can be independently evaluated.

Equally important, the Circular creates an accountability structure for use of the tradeoff process. It requires that the agency's competitive sourcing official approve use of the tradeoff process for activities other than information technology (IT). And, it requires the source selection authority to develop a narrative explanation of the tradeoffs performed and a rationale for the decision to award to other than the low cost provider.

The Comptroller General testified that the revised Circular is generally consistent with the Panel's sourcing principles and provides an improved foundation for competitive sourcing decisions. In reaching this conclusion, the Comptroller specifically cited to the authority to make source selection decisions based on tradeoffs between technical factors and cost.⁷

B. Findings⁸

Agencies began using the tradeoff process for public-private competitions in FY 2004. Through the end of FY 2005, agencies conducted 14 tradeoff competitions. Table 1 provides an overall comparison of results achieved in competitions using the tradeoff process to those where final selection decisions were based strictly on cost. For a description of each tradeoff competition and the results achieved, see the Appendix.

Results are impressive. Proposals selected through the tradeoff process in FYs 2004 and 2005 as representing the best value include many MEOs and are expected to help agencies achieve savings of about \$68,000 per FTE competed, as opposed to \$24,000 per FTE competed on the basis of cost alone during this same timeframe – almost *three times* the level of savings per position competed.

Agencies have used best value tradeoff authority judiciously to maximize expected returns. Over the last two years, best value tradeoff competitions accounted for only one-third of the FTEs competed and less than 15 percent of the standard competitions conducted. Yet, these competitions generated in excess of 70 percent of the total estimated net savings reported in FY 2004 and 2005 – i.e., \$3 billion out of \$4.3 billion.

⁷ *COMPETITIVE SOURCING: Implementation Will Be Challenging for Federal Agencies* (GAO-03-1022T).

⁸ Information in this report is based on data collected by agencies tracked under the President's Management Agenda (PMA) in accordance with OMB Memorandum M-06-01, *Report to Congress on FY 2005 Competitive Sourcing Efforts* (October 7, 2005), and M-05-01, *Report to Congress on FY 2004 Competitive Sourcing Efforts* (October 15, 2004), available at www.omb.gov.

Table 1. Comparing results: best value “tradeoff” vs. cost-only standard competitions*

Factor	Best Value “Tradeoff”	Cost-Only Competition	Combined
Number of Competitions	14 (13%)	96 (87%)	110 (100%)
Number of FTE	5,204 (33%)	10,511 (67%)	15,715 (100%)
Average Number of FTE	372	109	143
Average Number of Bids Received	2.4	1.9	2.0
Average Annualized Net Savings per FTE	\$68,000	\$24,000	\$39,000
Total Annualized Net Savings	\$357 M (59%)	\$253 M (41%)	\$610 M (100%)
Total Net Savings	\$3.0 B (70%)	\$1.3 B (30%)	\$4.3 B (100%)

* Data reflects competitions completed in FYs 2004 & 2005. Best value tradeoffs were first authorized in public-private competitions by the 2003 revisions to OMB Circular A-76. Agencies did not complete competitions using best value tradeoffs until FY 2004.

The most significant benefit of the tradeoff process is measured not in dollars alone, but in the transformational improvements that are made possible when the government has the ability to choose the solution that is best in terms of both cost and quality. Measuring value in more ways than just cost reduction gives offerors more options for proposing solutions that are both high quality and cost-effective.⁹

In terms of cost-effectiveness, the 10 percent/\$10 million conversion differential was met in *all* tradeoff competitions involving the conversion of work to private sector performance. There were *no* instances of work being converted to a contractor at a cost higher than the MEO. The conversion differential was overridden in just one tradeoff competition, which resulted in work being kept in house even though private sector performance was more than 10 percent less expensive than performance by the MEO. See the Appendix for additional information on individual competitions.

⁹ OMB believes best value tradeoffs are most likely to represent the best strategy for facilitating the competitive migration of common support services to either public or private shared service centers with a demonstrated capability and capacity to provide efficient and effective service. Shared services might include hosting and application management associated with financial management systems and services. Lines of business migrations are an important component of the PMA’s E-Government initiative because they will help agencies eliminate costly and redundant investments in “in-house” technology solutions that can be provided more effectively by another public or private sector source.

In summary, the experience to date suggests that the *repeal of 842* would have *minimal negative effect* while the *retention of 842* would have *significant negative effect*. The repeal of section 842 will not encourage agencies to convert work from government to private sector performance at higher cost or nominal savings. Agencies will likely meet the cost conversion differential in almost all cases, as data in the Appendix indicates. However, if the restriction in section 842 that requires decisions to be based strictly on cost is retained, agencies will have difficulty obtaining proposals with the combination of cost and quality that represents the best value for the taxpayer. This restriction will be especially harmful for competitions where there are opportunities for high quality, innovation, or transformational improvements. The FAA's competition for automated flight services illustrates this point (see text box, below).

How Section 842 Would Have Harmed FAA's Modernization of Automated Flight Services

Prior to the enactment of section 842. . .

- FAA conducted a public-private competition for automated flight services and evaluated offers under a best value tradeoff process that permitted the agency to consider both cost and quality in the final selection between public and private offerors.
- Offerors developed innovative proposals because they knew FAA had the option to make an award to other than the lowest cost provider. The selected proposal will yield \$2.2 billion in taxpayer savings through modernized facilities, state-of-the art technology and high-quality customer service. Several indicators already are beginning to show performance improvements. In the first month following transition from the old provider to the new one, the lost call volume decreased by more than 50 percent and the length of time pilots spent waiting on the phone for service decreased by about half.

Had section 842 been applied to FAA's competition. . .

- The winning provider could have competed. However, instead of offering the best solution, as measured in terms of both cost and quality, the provider would have focused on offering the *cheapest solution* because section 842 requires that the final selection between the public and private sectors be based on cost alone.
- Section 842 would not have prevented the winning provider from offering a high quality, innovative solution. However, the provider would not likely have offered to do much reengineering. In fact, few private sector companies are likely to undertake the effort and expense of developing an innovative offer if the agency intends to share it with the in-house provider to make a cost-only comparison between the two sources, as mandated by section 842. They will want to be rewarded for their creativity and investment.
- FAA would have been left selecting between proposals that offered little more than maintaining the current environment – i.e., a low-cost, short-term fix with minimal capital investment, and a remaining burden, which FAA could not support over the long term given the cost and risk of continued reliance on substandard technology and a deteriorating infrastructure.

C. Conclusions

Agencies' ability to repeat the most impressive results from tradeoffs in future years (e.g., the FAA's AFSS competition) are jeopardized by section 842, which requires the government to conduct a cost-based comparison between the MEO and the best private sector contractor. The cost comparison model generally works well for public-private competitions that involve routine needs, such as building or lawn maintenance, where transformational improvement is not required. However, agencies find that this model is less effective for highly technical activities or for encouraging innovative thinking, by either contractors or government workers, when the agency must modernize its operations and fundamentally change the way service is provided to customers.

Solutions prepared with the expectation of being evaluated only on cost typically perpetuate the status quo and rarely offer innovation or capital investment when it is needed. By contrast, the tradeoff authority provided in the Circular offers an impartial and transparent process for encouraging results that are both innovative and cost-effective.

The availability of tradeoff authority has already provided, and should continue to yield, solid results and responsible stewardship. For these reasons, Congress is urged to repeal section 842 or, at a minimum, modify the requirement to permit decisions on the basis of both cost and quality.¹⁰

¹⁰ For example, section 647(a) of P.L. 108-199, unlike section 842, permitted agencies to take both cost and quality into account in all situations in the final selection of a provider.

Table 1. Public-private competitions conducted using the tradeoff source-selection process in FYs 2004 & 2005

Agency	Activity	Number of FTE	Cost-Saving Changes and Other Improvements Facilitated by Competition	Annual Net Savings per FTE	Total Net Savings	10% / \$10M Conversion Differential Applied
DOT	Flight Services	2,300	<ul style="list-style-type: none"> Consolidation & modernization of facilities; improved customer service. 	\$ 96,000	\$2.2B	YES
SSA	IT Help Desk	68	<ul style="list-style-type: none"> Consolidation & streamlining; redeployment of labor to understaffed activities. 	\$103,500	\$35.1 M	YES
ED	HR Training Services	123	<ul style="list-style-type: none"> Automation of processes/increased use of technology. Process streamlining/reengineering. 	\$ 86,000	\$53.0 M	YES
ED	Payment Processing	97	<ul style="list-style-type: none"> Consolidation of accounts payable operations; customer focused performance standards. 	\$ 70,500	\$34.2 M	YES
DOE	IT	642	<ul style="list-style-type: none"> Consolidation of IT services; improvements in cyber security and use of public-private partnership to reduce costs. 	\$100,800	\$452.9 M	YES
DOE	HR Training	146	<ul style="list-style-type: none"> Consolidated training support services; reengineered processes and systems for maximum efficiency. 	\$ 45,500	\$33.2 M	YES
USDA	IT Technology	1,200	<ul style="list-style-type: none"> Consolidation of operations; enhanced performance standards; opportunity to reduce IT capital expenditures through leveraged purchasing. 	\$ 24,000	\$142.6 M	YES
DHS	Retiree Annuitant Services	31	<ul style="list-style-type: none"> Consolidation of operations; enhanced performance standards; restructuring of management. 	\$ 19,000	\$2.9 M	YES
HHS	Visual & Medical Arts	60	<ul style="list-style-type: none"> Consolidation of operations; more efficient use of resources. 	\$ 41,400	\$19.8 M	YES
NASA	Shared Services	200	<ul style="list-style-type: none"> Elimination of redundant systems & processes. 	\$ 21,000	\$39.1 M	YES
NASA	Test & Machining Services	37	<ul style="list-style-type: none"> Synergy of a single consolidated service provider performing a highly integrated activity. 	\$ 21,600	\$3.5 M	NO*
DOI	Maint & Minor Construction	176	<ul style="list-style-type: none"> Restructuring of management; more efficient use of resources. 	\$ 9,500	\$8.3 M	YES
DOI	Maintenance	74	<ul style="list-style-type: none"> Restructuring of management; more efficient use of resources. 	\$ 2,500	\$0.9 M	YES
Treasury	Tour Ops	50	<ul style="list-style-type: none"> Improved customer service; more efficient use of resources. 	\$ 6,500	\$1.7 M	YES

*The agency decided to retain work in-house on the basis that the agency MEO offered the best value even though the evaluated cost of the best private sector offeror was more than 10% lower than the cost of performance by the MEO.