



GOVERNMENT CONTRACTORS BEWARE: *THE FEDERAL GOVERNMENT IS CRACKING DOWN ON FRAUD IN SMALL BUSINESS CONTRACTING AND SUBCONTRACTING*

Every year, the Federal Government sets aside a large number of government contracts, including construction projects, for small businesses pursuant to the Small Business Act. Under these small business set-asides, only businesses that qualify as small under the Small Business Administration's ("SBA") regulations and meet the applicable size standard for the procurement are eligible for award of the contract. Often, however, these small businesses cannot perform all of the work themselves and so they team with large businesses. Under these teaming arrangements, the small business is the prime contractor and the large business is the subcontractor.

While small business set-asides and teaming agreements play an important role in the Federal Government's small business program, there is considerable potential for fraud by unscrupulous companies – both large and small – that seek to take advantage of the program. Two of the more pervasive types of fraud are: (1) companies falsely claiming that they are small businesses when they do not qualify as such under SBA's size regulations; and (2) small businesses acting as fronts for large businesses who primarily perform the contract. Recently, the Federal Government has taken a number of measures to combat fraud in small business contracting and subcontracting.

The Small Business Jobs and Credit Act

On September 27, 2010, President Obama signed the Small Business Jobs and Credit Act of 2010. The Act contains a number of provisions that are designed to reduce fraud in the small business program. Section 1343 of the Act specifically requires the Federal Government to issue a government-wide policy on the prosecution of small business size and status fraud within one year and to develop courses for acquisition personnel to help them properly classify small businesses. In addition to provisions to combat fraud, the Small Business Jobs and Credit Act also contains a number of provisions that impact small business contracting and subcontracting in general.

Certification of Size Status

Section 1341 of the Act creates a deemed certification of small business size status. By taking one of the following actions, a business affirmatively, willfully, and intentionally certifies that it is a small business:

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- ❖ Submitting a bid or proposal for a Federal contract or subcontract that is set-aside or otherwise classified as intended for award to a small business.
- ❖ Submitting a bid or proposal for a Federal contract or subcontract which in any way encourages a Federal agency to classify the bid or proposal, if awarded, as an award to a small business.
- ❖ Registering in any Federal electronic database (such as the Central Contractor Registration (“CCR”)) for the purpose of being considered for the award of a Federal contract or subcontract as a small business concern.

Once Section 1341 is implemented, each solicitation for a Federal contract or subcontract will contain a certification concerning the small business size and status (i.e., HUBZone, 8(a), veteran-owned, etc.) of the business bidder. A bidder must certify that it qualifies as a small business of the exact size and status claimed. Section 1341 creates a presumption of loss to the United States when a large business willfully seeks and receives the award of a contract or subcontract that was set-aside or otherwise classified as intended for award to a small business. The amount of the loss to the Government is the total amount expended on the contract or subcontract. Section 1341 will make it easier for the Federal Government to prove that a bidder intentionally and falsely certified its size status and the amount of damages resulting from that false certification.

Due to SBA’s complex regulations concerning size status and affiliation between companies, contractors who are unfamiliar with SBA’s regulations could find themselves violating Section 1341 merely by misinterpreting SBA’s regulations. In order to reduce this risk, the Act requires SBA to promulgate regulations to provide “adequate protections” to bidders from liability under Section 1341 in cases of “unintentional errors, technical malfunctions, and other similar situations.” What those adequate protections will be remains to be seen.

In addition, Section 1342 of the Act creates a requirement that each small business annually certify its small business size and, if appropriate, its small business status. The certification will be part of the small business’s Online Representations and Certifications Application (“ORCA”) registration.

8(a) Mentor-Protégé Program

Section 1345 of the Act requires the Government Accountability Office (“GAO”) to conduct a study of SBA’s 8(a) mentor-protégé program and other relationships and strategic alliances pairing large businesses and small businesses to gain access to government contracts. Under the 8(a) mentor-protégé program, an SBA-approved mentor and protégé can enter into a joint venture to perform contracts that are set-aside for small businesses. The purpose of the Section 1345 study is to determine whether the programs and relationships are effectively supporting the Federal Government’s goal of increasing the



participation of small businesses in government contracting. Specifically, GAO is to examine whether there are systems in place to ensure that the mentor-protégé relationship, or similar affiliation, promotes real gain to the protégé and is not just a mechanism to enable large businesses to receive 8(a) set-asides. The results of GAO's study could result in changes to the 8(a) mentor-protégé program.

Subcontracting Plans

Prime contractors with government contracts that offer significant subcontracting opportunities are required to submit a small business subcontracting plan. The purpose of the plan is to specify how the contractor intends to meet the small business subcontracting goals set forth in the contract. Section 1322 of the Act adds the requirement that contractors make a representation that they will make a good faith effort to acquire the articles, equipment, supplies, services, or materials, or obtain the performance of construction work from the small businesses in the same amount and quality used in preparing the subcontracting plan. A contractor who fails to make a good faith effort must provide the contracting officer with a written explanation of why it failed. This failure may result in a negative past performance evaluation for the contractor and impact its ability to obtain future contracts.

Payment to Subcontractors

Section 1334 of the Act strengthens subcontractor payment protections by requiring each prime contractor with a subcontracting plan to notify the contracting officer whenever the prime contractor pays a reduced price to a subcontractor for goods and services or delays paying the subcontractor for more than 90 days. The prime contractor must advise the contracting officer of the reason for the reduced or delayed payment. If the contracting officer determines that the contractor's reduced or delayed payment was "unjustified," the contracting officer must consider that fact in its evaluation of the prime contractor's performance. In other words, a prime contractor who fails to fully pay or delays in paying its subcontractors may receive a negative past performance evaluation. Section 1334 also directs that the Federal Government develop a process for contracting officers to identify and make public through the Federal Awardee Performance and Integrity Information System the identities of prime contractors with a history of reducing or delaying payment to their subcontractors.

The GTSI Corp. Suspension

Under the Federal Acquisition Regulation, a Federal agency may suspend a contractor from doing business with the Federal Government for a number of reasons, one of which is the commission of any offense indicating a lack of business integrity or business



honesty that seriously and directly affects the contractor's present responsibility. On October 1, 2010, the SBA temporarily suspended GTSI Corp., a major IT contractor, after allegations surfaced that GTSI was using small businesses to improperly obtain and perform set-aside contracts. The suspension was lifted on October 19, 2010 after GTSI's CEO and General Counsel resigned and GTSI agreed to immediately stop working with small businesses prime contractors and to stop participating in the SBA's mentor-protégé program. Although the suspension was lifted, SBA's Inspector General continues to investigate the allegations of misconduct.

SBA E-Mail Hotline

In the wake of the GTSI suspension and other concerns regarding small business fraud and abuse, SBA has established an e-mail hotline to receive complaints of potential abuse related to the eligibility of 8(a) applicants and participants. Persons who suspect fraud or abuse in the 8(a) program can e-mail SBA at 8abdhotline@sba.gov.

Federal Court Refuses to Enforce a Subcontract under a Set-Aside Prime Contract

In a recent decision, the United States District Court for the Eastern District of Virginia refused to enforce a subcontract between an 8(a) prime contractor and its large business subcontractor because the court found that the parties deliberately obtained a government contract in violation of SBA's small business size regulations. *Morris-Griffin Corp. v. C&L Serv. Corp.*, Civ. No. 10cv298, 2010 U.S. Dist. LEXIS 83540 (Aug. 16, 2010). The court found that the parties were affiliated under the ostensible subcontractor rule, which provides that a prime contractor and a subcontractor are considered to be affiliated when the subcontractor performs the primary and vital requirements of a contract or when the prime contractor is unusually reliant on the subcontractor. Since the parties were affiliated, the prime contractor did not qualify for the award under the applicable size standards.

The court also declared the prime contract with the Federal Government void for fraud. It found that the prime contractor had falsely certified that it was a small business in order to obtain the government contract. Since the contract was "conceived in fraud," the court declared it illegal.

Finally, the court commented on what it called the "perverse" incentives created by the small business program. According to the court, small businesses have incentives to enter into teaming agreements where their primary contribution is their 8(a) eligibility. While the owners of these small businesses may profit from these arrangements, the arrangements do not meet the Federal Government's goal of allocating work to the small businesses. The court concluded that, without an effective mechanism to verify a small business' capability to perform its 8(a) contracts, the SBA has invited the very problems found by the court.



Conclusion

With the increased scrutiny on fraud in the small business program, it is more vital than ever that small business contractors understand and comply with SBA's size regulations when they compete for set-aside contracts. Large and small contractors who seek to work together under teaming agreements need to understand the limitations of these arrangements and ensure that their agreements comply with federal laws and regulations. Contractors who disregard applicable laws and regulations may find themselves subject to a number of consequences including false claims actions, suspension/debarment, termination of their contracts, and non-enforcement of their contractual and subcontractual relationships.