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Small Business

Big Risks for Small Businesses: Increased Enforcement Activity Against Size and Status Misrepresentations



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Earlier this year it was announced that, for the first time since 2006, the federal government met its statutory goal of directing 23 percent of federal contracting dollars to small businesses. Efforts are being made in the U.S. House of Representatives to increase this statutory goal from 23 percent to 25 percent. In short, small business government contracting is trending upward. However, along with this upward trend in allocation of federal contracting dollars, there is an increase in enforcement activity, particularly under the False Claims Act (FCA), against companies and individual owners misrepresenting their small business size or status in order to obtain these government contract awards.

Moreover, there is little reason to expect the enforcement efforts to subside. In fact, they may become more robust on the back of recent Small Business Administration regulations implementing parts of the Small Business Jobs Act (SBJA).[1] As many commentators have noted, the ''Presumed Loss Rule'' and ''willful certification'' provisions in the SBJA regulations will provide new opportunities and significant monetary incentives for government regulators and whistleblowers pursuing FCA cases. To avoid the devastating repercussions from misrepresenting small business size or status, companies need to be aware of the types of enforcement actions being pursued and the measures available to minimize the risk of enforcement activity.

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Recent FCA Enforcement Efforts. A review of recent civil FCA enforcement activity demonstrates that the government and relators have been pursuing—and succeeding in—actions involving various types of misrepresentations (e.g., location, presence of disadvantaged individuals, independence from larger companies) within several different small business contracting contexts.

In April 2014, five subcontractors and two individuals settled with the United States for nearly $1.9 million to resolve two *qui tam* actions alleging that defendants engaged in multiple schemes to misrepresent their disadvantaged small business status in order to appear compliant with a subcontracting plan required under mili-

[1] 78 Fed. Reg. 38811 (June 28, 2013).

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tary construction contracts.[2] The small business concerns were alleged to be ''shams'' that were heavily intertwined with and controlled by a larger business. Notably, the government intervened as to the relator's claims against the subcontractors, not the prime contractors.

Also in April 2014, a construction company and its owner reached a confidential settlement agreement to resolve two consolidated *qui tam* actions in the U.S. District Court for the Northern District of Ohio. The two cases involved allegations that the construction company received more than $28 million in government contracts based on false statements made regarding the company's principal place of business to receive a Historically Underutilized Business Zone certification.[3] In August 2014, the government intervened in a similar *qui tam* action, *U.S. ex rel. Hopson v. Air Ideal, Inc., et al.*, alleging that a construction company and its co-owner used a false address to receive a HUBZone certification to obtain more than $11 million in contracts from multiple government agencies.[4]

Not all settlements have involved *qui tam* actions where the government intervened. In August 2013, the parties in *A1 Procurement, LLC v. Hendry Corp., et al.* agreed to enter into a confidential settlement agreement to resolve a *qui tam* action in which the government declined to intervene in May 2012.[5] The settlement, which the parties reached after fourteen months of active litigation, resolved FCA allegations that the defendants misrepresented a defendant-contractor as a Service-Disabled Veteran-Owned Business Concern in order to secure U.S. Coast Guard contracts.

And not all settlements have required whistleblower-initiated action. In December 2012, two defense contractors and their individual owners agreed to pay $6.25 million to resolve a government-initiated FCA investigation into allegations that one of the contractors made false statements about its business location and status to procure a HUBZone certification that was used to receive U.S. Army Corps of Engineers contracts. The contractor identified a business location in a SBA application that was actually a vacant lot, and identified itself as an independent company, without disclosing that it shared equipment, personnel, and insurance with the larger contractor.

A case to watch involving the SBA's 8(a) program is *United States ex rel. Sansbury, et al. v. LB&B Associates, Inc., et al.*[6] The government intervened in *Sansbury* as to FCA claims against a contractor (and two of its executives) that graduated the SBA's 8(a) program, alleging that the contractor made false statements to receive and maintain its eligibility in the 8(a) program. The defendants purportedly misrepresented, on numerous occasions, the level of control and authority that a disadvantaged individual had within the company to conceal the fact that several non-disadvantaged individuals were effectively in charge. In July 2014, the U.S. District Court for the District of Columbia denied the defendants' motion to dismiss, allowing the government to proceed to discovery on these claims.

Finally, individual owners misrepresenting their company's size or status have also been subject to recent criminal prosecutions. For example, in connection with a $1 billion steel contract at the World Trade Center, owners of a prime contractor, a minority-owned business, and a woman-owned business constructed pass-through arrangements giving the impression that the contractor was in compliance with requirements to subcontract with minority- and woman-owned businesses. The owners of the small business recently pled guilty to their roles in this scheme. Criminal charges can also follow from an FCA investigation, as was the case for TAB Construction's owner, who was charged with wire fraud in April 2014 based on the false representations he made regarding the company's location that formed the basis for two civil FCA cases.

Safeguarding Against the Risk of Enforcement. To minimize enforcement risk, companies need to understand that representations regarding size or status to participate in the numerous federal procurement programs for small and disadvantaged businesses should not be taken lightly. Companies must review and understand the specific program requirements – e.g., ownership and control for 8(a) program and definition of principal place of business for HUBZone program. They also need to consider whether they have any ''affiliates'' for purposes of determining their size for revenue or employee purposes. The regulations and requirements can be overwhelming, but in situations of uncertainty, companies should seek advice of counsel prior to making incorrect or inaccurate representations.

Companies eventually will be able to request an advisory opinion from the SBA on which they can rely in making representations for small business awards. In response to concerns that the ''willful certification'' provisions in the recent SBJA regulations did not provide for an exception for good faith certifications, Congress included a provision in the National Defense Authorization Act of 2013 amending Section 645 of the Small Business Act, 15 U.S.C. § 645(d), to create a safe harbor for ''good faith reliance on a written advisory opinion from a Small Business Development Center . . . or an entity participating in the Procurement Technical Assistance Cooperative Agreement Program[.]'' The SBA has issued a proposed rule regarding Advisory Small Business Decisions.[7] However, the proposed rule as written will provide little comfort to businesses, as it lacks a review process for unfavorable opinions and does not require the SBA to issue any opinions.

Regardless of the utility of the proposed rule, companies certifying to size or status need to confirm that primary (and secondary) responsibility is assigned to the accuracy, clarity, and completion of size and status certifications, and that robust internal protocols exist to govern the review (or any subsequent correction) of size or status representations. Companies should also pay careful attention to the information included in the System for Award Management and ensure that the representations are updated concurrent with changes in a company's size or status. Taking these steps can help

[2] *United States ex rel. Howard v. Harper Construction Co., et al.*, No. 12-215 (E.D.N.C.); *United States ex rel. Howard v. RQ Construction LLC, et al.*, No. 13-48 (E.D.N.C.).

[3] *United States ex rel. Fairbrother, et al. v. TAB Construction Co., Inc., et al.*, No. 11-1432 (N.D. Ohio); *United States ex rel. Hopson, et al. v. TAB Construction Co., Inc.*, No. 12-135 (N.D. Ohio).

[4] No. 13-775 (M.D. Fla.).

[5] No. 11-23582 (S.D. Fla.), Dkt. No. 226.

[6] No. 07-251 (D.D.C.).

[7] 79 Fed. Reg. 35965 (June 25, 2014).

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to ensure that misrepresentations, if any, are considered unintentional—and, therefore, not actionable under the FCA (or new SBJA regulations).