

The FCA Impact Of DOJ's Increased Focus On Small Business

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In 2014, the Small Business Administration reported that almost a quarter of approximately \$367 billion of eligible funding for small business contracting, or roughly \$91.7 billion, was awarded to small businesses as prime contractor, exceeding the federal government's goal.[1] These latest numbers reflect a growing trend and mirror similarly strong numbers for fiscal year 2013.[2] The general increase in small business contracting has tracked across all of the SBA's business assistance programs, including programs designed to assist disabled veterans, economically disadvantaged business owners, and women to compete in the federal marketplace.[3] By most accounts, fiscal year 2015 saw similarly robust contracting activity with small businesses.

Not surprisingly, as federal contracting dollars awarded to small businesses increase, so has the government's focus on identifying and prosecuting small business certification fraud. As demonstrated by a number of recent cases and studies, the U.S. Department of Justice has ramped up efforts to identify and punish false certifications made in connection with SBA programs and is using the wide net of the False Claims Act to do so. In light of these trends, now, more than ever, small businesses seeking out these federal dollars and contracting opportunities, and large businesses working with them, are best served by understanding the lasting impacts of running afoul of the FCA.

Settlements Related to Businesses Owned by Disabled Veterans

In fiscal year 2015, the DOJ secured settlements from small businesses falsely asserting eligibility for the service-disabled veteran-owned small business program.[4] The DOJ's scrutiny focused on whether the companies performing the work were front companies, with larger, affiliated companies receiving the benefits of the contract. Key settlements include:

- In March 2015, Gilbane Building Company agreed to pay \$1.1 million to resolve FCA allegations that a company with which it merged had created a front, Veterans Constructors Incorporated (VCI), to obtain a Coast Guard contract designated for SDVOSBs.[5] In addition to being owned and operated by a service-disabled veteran, in order to qualify as an SDVOSB, a company cannot be affiliated with a large company. The government alleged that VCI was improperly created merely as a contracting vehicle. The settlement included five annual contingency payments that equal one percent of VCI's total annual revenues.
- Late in 2014, North Florida Shipyards and its president agreed to pay \$1 million to settle claims brought by a qui tam relator under the FCA that they created a front company to obtain Coast Guard contracts set aside for SDVOSBs.[6] Although the front company appeared to meet SDVOSB requirements, North Florida Shipyards was, in fact, performing all of the work and receiving all of the profits, rendering the invoices submitted to the federal government fraudulent. In addition to the monetary penalties, in December 2013, the SBA suspended North Florida Shipyards, its president, the front company and three other individuals from all government contracting.

FCA Settlements Related to 8(a) and HUBZone Programs

The SBA's 8(a) and HUBZone programs for disadvantaged businesses also served as the basis for FCA settlements in the past fiscal year.[7] Contractors eligible for the 8(a) and HUBZone programs may receive sole-source contracts.

In July 2015, LB&B Associates Inc. and its two principals agreed to pay \$7.8 million to settle allegations that it falsely certified to the federal government that it was eligible to participate in the SBA's 8(a) program.[8] Two former employees, qui tam relators who will receive \$1.5 million as part of the settlement, alleged that LB&B had falsely represented that its operations were controlled by a socially and economically disadvantaged person. As a result, each invoice submitted for payment under LB&B's 8(a) set-aside contract constituted a false claim under the FCA.

In April 2015, Air Ideal Inc. and its majority owner agreed to pay \$250,000 plus 5 percent of gross revenues over the next five years to settle FCA violations related to false certifications that Air Ideal was a HUBZone company.[9] Air Ideal secured various contracts by falsely claiming that its principal office was in a HUBZone designated area when it only maintained a "virtual office" in the designated area where no employees worked. As part of its efforts to establish HUBZone certification, Air Ideal fabricated lease agreements and other documents. The complaint, also brought by a qui tam relator, alleged violations of the FCA and the Financial Institutions Reform, Recovery and Enforcement Act of 1989.

Focus on Women Majority-Owned Small Businesses in Fiscal Year 2016

Although there were no recorded settlements concerning WOSB[10] fraud in fiscal year 2015, government reports and recent FCA activity suggest that the DOJ will pay close attention to such majority-owned women businesses that qualify under these programs in the coming fiscal year. As of

Oct. 14, 2015, WOSBs are eligible for sole-source contract awards.[11]

On May 14, 2015, the SBA Office of Inspector General published a report which reviewed, among other things, whether WOSB awards complied with set-aside requirements.[12] Based on a sample set, the OIG concluded that a significant percentage of awards was made to companies that failed to provide required documentation establishing eligibility. Of the remaining awards reviewed, a majority were made to companies that did not provide required documentation demonstrating that the contracting officers had verified they completed the requirements to be considered for the WOSB program, including that the company was controlled by women.

The OIG's report came on the heels of a study conducted by the U.S. Government Accountability Office in October 2014 that concluded the SBA "has yet to develop procedures that provide reasonable assurance that only eligible businesses obtain WOSB set-aside contracts." [13] In so finding, the GAO noted that in 2012 and 2013, "SBA found that more than 40 percent of businesses (that previously received contracts) it examined for program eligibility should not have attested they were WOSBs."

The OIG and GAO reports are likely to thrust the WOSB program into the spotlight moving forward. Just this month, the DOJ intervened in an FCA action alleging that an aerospace contractor falsely certified that it was a WOSB to obtain a competitive advantage in securing subcontracts funded by the federal government.[14] As a result of the misrepresentation, the DOJ asserted that the defendant was paid approximately \$48 million from prime contractors that originated from the federal government as a result of fraudulently certified claims for payment. The contractor and its former president recently agreed to settle the allegations for approximately \$20 million.[15]

Lessons for Small and Large Businesses Alike

In the past year alone, the DOJ has demonstrated its sustained interest in small businesses by investigating and securing FCA settlements against companies that made false certifications under various SBA programs that assist businesses owned or operated by veterans, economically disadvantaged individuals, and/or women. As the DOJ continues to find fertile ground in false certification settlements, small businesses and their individual owners and operators will face growing scrutiny under the FCA and be subject to the ripple effect of the various penalties that companies face under that statute.

The DOJ's inquiries are not limited to small businesses directly benefiting from the false certifications. The DOJ is looking at larger companies that act as prime contractors and that are suspected of setting up front companies or other improper relationships to take advantage of SBA program benefits. At a minimum, large businesses must take care to ensure that small businesses that serve as subcontractors have met and properly certified these requirements because DOJ is taking actions against both the prime contractors and subcontractors to which federal dollars flow. This exposes large businesses to FCA liability for a small business subcontractor's certification fraud if they had actual knowledge of the fraud or acted with reckless disregard for the truth of the small business certification.

When one examines (1) the growing availability of federal contracting dollars for businesses that qualify for SBA program benefits; (2) the DOJ's recent settlements and investigations; and (3) the DOJ's increased focus on whether companies are properly submitting documentation and certifying that they meet statutory requirements, certain key takeaways emerge:

- Small businesses seeking to qualify for SBA programs must understand not only the statutory requirements they must meet to qualify for the program, but also the broad criminal and civil ramifications of violating the FCA for improper or false certifications related to those program contracts. For example, small businesses should understand that a company can violate the FCA even if it does not have actual knowledge that a certification submitted to the federal government is false.
- Small business contractors should be vigilant when certifying their status for various SBA programs. They should also update their status periodically and when necessary to ensure that they remain in compliance with SBA requirements.
- Large contractors should verify the eligibility of any small business subcontractors prior to including those subcontractors in proposals for government work.
- Large contractors should also ensure that all subcontracts contain indemnification clauses that shield the large contractor from civil liability for misrepresentations, false statements or claims, or false certifications perpetrated by subcontractors.
- Even if the large contractor lacks the requisite scienter to be found liable under the FCA, larger businesses (with larger balance sheets) are still likely to be targeted by relators and the DOJ in allegations of potential fraud. They will face significant litigation costs to establish that they did not have the necessary knowledge of a subcontractor's fraudulent certifications. Thus, large contractors must be careful and diligently select as subcontractors only those small businesses that definitively can establish their proper certification under SBA programs.

As federal dollars continue to be made available under these programs, and as the federal government strives to meet its own goals for awarding eligible funding for small business contracting, both small and large businesses will continue to find themselves at risk for exposure to the many pitfalls of the FCA. Watching the evolution of government enforcement and prosecution trends under these programs will be an important aspect of staying ahead of those trends.

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[1] Fiscal Year 2014 Annual Scorecard, U.S. Small Business Administration, 2014 Small Business Procurement Scorecard Overview, available at https://www.sba.gov/sites/default/files/files/FY14_Government-Wide_SB_Procurement_Scorecard_Public_View_2015-04-29.pdf.

[2] In Fiscal Year 2013, 23.39 percent (approximately \$83.1 billion) of total eligible dollars was awarded to small businesses, again exceeding the 23 percent goal set by the government. U.S. Small Business Administration, 2013 Small Business Procurement Scorecard Overview, available at https://www.sba.gov/sites/default/files/files/FY13_Government-Wide_SB_Procurement_Scorecard_Public_View_2014-04-28.pdf.

[3] For example, over the past two fiscal years, the government has surpassed its 3 percent contracting goal for Service Disabled Veteran-Owned Small Businesses (SDVOSB), awarding 3.38 percent of eligible dollars in 2013 and 3.68 percent in 2014. The government also aims to award 5 percent of total eligible dollars in each fiscal year to Women-Owned Small Businesses (WOSB). Although it has missed these goals in the last two years, in 2014, the federal government awarded 4.68 percent (up from 4.32 percent in 2013) of eligible dollars to WOSBs. Finally, the government similarly sets a 3 percent goal for small businesses qualifying for the Historically Underutilized Business Zones (HUBZone) program, and the amounts awarded in 2014 (1.82% of eligible dollars) were higher than the amounts awarded in Fiscal Year 2013 (1.76%).

[4] To qualify as an SDVOSB, a contractor must be a small business controlled and operated by a service-disabled veteran who owns at least 51% of the company and who occupies the highest officer position within the company. Contractors within the SDVOSB program are eligible for sole-source contract awards.

[5] Press Release, Office of Pub. Affairs, U.S. Dep't of Justice, Gilbane Building Company to Pay \$1.1 Million to Resolve False Claims Allegations (Mar. 18, 2015), available at <http://www.justice.gov/opa/pr/gilbane-building-company-pay-11-million-resolve-false-claims-allegations>.

[6] Press Release, Office of Pub. Affairs, U.S. Dep't of Justice, North Florida Shipyards to Pay \$1 Million to Resolve False Claims Allegations (Oct. 29, 2014), available at <http://www.justice.gov/opa/pr/north-florida-shipyards-pay-1-million-resolve-false-claims-allegations>.

[7] To be eligible to participate in the 8(a) program, a business must be owned and controlled at least 51 percent by socially and economically disadvantaged individuals. To be eligible for the HUBZone program, the contractor must be a small business; the business must be owned and controlled at least 51 percent by U.S. citizens, or a Community Development Corporation, agricultural cooperative, or Native American

tribe; and have its principal office in a HUBZone. Additionally, 35 percent of the contractor's employees must reside in a HUBZone.

[8] Press Release, Office of Pub. Affairs, U.S. Dep't of Justice, LB&B Associates Inc. Agrees to Pay \$7.8 Million for Alleged False Claims Related to Small Business Administration Set Aside Contracts (July 6, 2015), available at <http://www.justice.gov/opa/pr/lbb-associates-inc-agrees-pay-78-million-alleged-false-claims-related-small-business>.

[9] Press Release, Office of Pub. Affairs, U.S. Dep't of Justice, Florida Company and Owner Agree to Resolve Alleged False Claims Act Violations Regarding Historically Underutilized Business Zone Program (Apr. 8, 2015), available at <http://www.justice.gov/opa/pr/florida-company-and-owner-agree-resolve-alleged-false-claims-act-violations-regarding>.

[10] To obtain WOSB certification, at least 51 percent of the small business concern must be owned by one or more women, and the management and daily business operations of the business must be controlled by one or more women. The women must be U.S. citizens to be eligible for the program, and a woman must occupy the highest officer position within the company.

[11] Although the WOSB program previously did not allow for sole source contract awards, the National Defense Authorization Act for Fiscal Year 2015 – as implemented by the final rule (80 Fed. Reg. 55019) issued by the SBA on September 14, 2015 – has since granted such authority.

[12] "Improvements Needed in SBA's Management of the Women Owned Small Business Federal Contracting Program," Office of Inspector General, U.S. Small Business Administration, Improvements Needed in SBA's Management of the Women Owned Small Business Federal Contracting Program (May 14, 2015), available at https://www.sba.gov/sites/default/files/oig/Report_15-10_Improvements_Needed_in_SBAs_Management_of_WOSBP.pdf.

[13] Government Accountability Office, Women-Owned Small Business Program, Certified Oversight and Additional Eligibility Controls Are Needed (Oct. 2014), available at <http://www.gao.gov/assets/670/666431.pdf>.

[14] United States v. UFC Aerospace LLC et al., No. 12 Civ. 2594 (WHP) (S.D.N.Y. Oct. 5, 2015) (Amended Complaint in Intervention of the United States of America).

[15] Press Release, Office of Pub. Affairs, U.S. Dep't of Justice, Manhattan U.S. Attorney Files And Settles Civil Fraud Lawsuit Against UFC Aerospace And Douglas B. Davis For Engaging In Fraudulent Conduct In Violation Of The Small Business Act (Oct. 8, 2015), available at <http://www.justice.gov/usao-sdny/pr/manhattan-us-attorney-files-and-settles-civil-fraud-lawsuit-against-ufc-aerospace-and>.