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Government Contractor Advisory

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The Federal Government's Suspension of Contractor GTSI Holds Several Important Lessons for All Government Contractors Operating in Today's Ever-Intensifying Enforcement Environment

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Most small businesses in the United States naturally aspire to become larger and more profitable businesses. But for small business government contractors who enjoy substantial success and expansion, the usually welcome development of escalating revenues and a growing workforce can create a dilemma: if my company's success means it soon will no longer be a small business, how can I continue to benefit from generous small business set-aside programs in government contracts?

Federal contractor GTSI Corp., a Virginia-based software company, asked itself this question several years ago as its growth—occurring mainly as a result of increasingly lucrative contracts with the federal government via small business set-aside programs—began to skyrocket. GTSI started small in 1983, and then grew into a publicly-traded company with over 600 employees and nearly $400 million in federal government contracts in 2009 alone, making it one of the 50 largest federal contractors in the U.S. GTSI's solution to its dilemma, according to a filing it made with the Securities and Exchange Commission (SEC), was to "mitigate any potential adverse effect … from the loss of our small business status" by developing a plan to enter into "strategic relationships with small businesses that benefit from the small business benefits." On the surface, this seemed like a sensible course of action, especially for a company that relied on the federal government for approximately 90% of its sales. But the manner in which GTSI allegedly undertook its strategy—laid out for all to see in incriminating internal e-mails obtained and published by the *Washington Post*—led the U.S. Small Business Administration (SBA) last week to disqualify GTSI from participating in all federal contracts. The GTSI case yields important lessons for all government contractors, not just those benefitting from SBA programs.

In suspending GTSI from federal work, SBA determined that there was adequate evidence to support an allegation that GTSI had committed fraud, false statements, "or other offenses indicating a lack of business integrity," under the broad standards by which a federal agency may suspend a contractor. (Note: GTSI will have the opportunity to contest SBA's suspension and any forthcoming proposal for debarment brought by SBA or other federal agency).

The alleged fraudulent conduct centers on GTSI's possible circumvention of regulations governing small business participation in federal contracts which require, for example, that the small business "perform a significant portion of the proposed contract with its own facilities, equipment, and personnel." [1] In other words, if GTSI were to legitimately partner with a company who, unlike GTSI, was small enough to still qualify as a small business, then that small business must perform a "significant" amount of the contract work with its own resources. "Significant"

is a subjective term, of course, and given the wiggle room inherent in that standard, GTSI was certainly not the first contractor who developed small business “partnerships” that may have pushed the envelope within a regulatory gray area (to put GTSI’s alleged conduct charitably).

The GAO Report Criticizing SBA’s Lack of Compliance Monitoring

In March 2010, the Government Accounting Office (GAO) released a report critical of SBA’s monitoring of contractors participating in one high-profile small business set-aside program, the 8(a) program (for Section 8(a) of the Small Business Act). 8(a) contractors are those who qualify both as small businesses and disadvantaged business enterprises (entities with majority ownership by a member or members of a designated minority group). The GAO report pointed to specific weaknesses in SBA’s track record in verifying that those firms enjoying the benefits of 8(a) participation were actually eligible as legitimately small businesses. Indeed, GTSI was one such firm participating in the 8(a) program, but through the auspices of a subsidiary it established with a small Alaska company which, as an “Alaska Native Corporation” with a majority of shareholders from the native Eyak tribe, qualified under 8(a)’s disadvantaged business enterprise prong. GTSI’s joint venture was called EyakTek.

SBA responded to the March report with stepped-up scrutiny of those participating in not just the 8(a) program, but all small business set-aside programs. GTSI is the first victim of that crackdown by officials at SBA, though is certainly not alone among those federal contractors whose practices have been put under the microscope of more intensive compliance monitoring by federal agencies.

GTSI’s Paper Trail

SBA’s suspension of a federal contractor as large as GTSI is unprecedented in recent times. While it is true that the disqualification is due in large part to SBA redoubling its enforcement efforts, it also results from the paper trail left by GTSI officials. For example, and as reported by the *Post*, one GTSI vice president said in an e-mail that the small business contractor with which GTSI was to work as a subcontractor on a federal contract was “very open to the concept of GTSI doing ALL the work” (emphasis in original)—with the small business contractor acting as the front. In another e-mail, a GTSI executive wrote to GTSI employees who allegedly were doing all the work for the small business contractor who had won the SBA set-aside, “it is ABSOLUTELY CRITICAL that we continue to represent ourselves to [the federal agency] as MultimaxArray JV, not GTSI. We are subcontractors to MultimaxArray” (again, emphasis in original). “Do NOT,” said another GTSI manager in an e-mail to subordinates, “identify yourselves as GTSI in phone conversations with customers” (once again, emphasis in original).

Other records generated by GTSI revealed that the company was to receive 99.5% of the profits on a large federal contract on which it was purportedly the subcontractor and the certified small business was purportedly the prime contractor. And, again according to the *Post*, in yet another company e-mail, between the CEO of GTSI and the CFO of the 8(a) contractor EyakTek in which GTSI was proposing a 75% share of the 8(a) contract profits for itself, the EyakTek executive wrote, in words weirdly prescient: “We can not put our Company at risk of being accused of [being] a front for a large company, end up on the front pages of the Washington Post, [accused of] contractual fraud or worst *[sic]*.”

Needless to say, if SBA regulators were concerned that to rehabilitate their enforcement reputation they had better ferret out an example of a firm wrongfully benefitting from SBA set-aside programs, GTSI did not make that task difficult for them—especially when many of the incriminating statements are written in capital letters in company e-mails.

Lessons Learned

For federal contractors in particular, there are several lessons to be drawn from the GTSI case—apart from obvious ones about the wisdom of putting statements concerning questionable business practices in writing, especially in e-mails to employees, some of whom are whistleblowers-in-waiting. These more salient lessons include:

1. Recognize that federal agencies, by no means only SBA, are intensifying their monitoring and enforcement efforts, and these efforts are occurring in concert with an activist Justice Department and a newly-invigorated SEC. In today's climate, the government is looking to make examples of more federal contractors than just GTSI, whether through suspension, debarment, civil claims, or criminal prosecution.

2. Small business and disadvantaged business enterprise set-aside programs (both of which exist across the federal contracting landscape) are ones that the federal government recognizes as particularly susceptible to fraud. If you are a participant in such a program, or partner with a firm that is, carefully and confidentially assess your compliance with relevant regulations.

3. Implement and enforce a robust compliance program that both deters and detects misconduct, with clearly-communicated standards of conduct, regular employee training, an internal complaint mechanism, and consistent remedial responses to demonstrated misconduct, among other key elements. Most federal contractors are **required** to have such a program under the Federal Acquisition Regulation, just as they are required to voluntarily disclose to their federal contracting agency certain violations of law or contract they discover, upon threat of suspension or debarment.

Endnotes

1 13 CFR § 125.5(b)(ii)

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