

LEGAL ADVISOR

A PilieroMazza Update for Federal Contractors and Commercial Businesses

Small Business

CROSSING THE RUBICON: HAS CONGRESS GONE TOO FAR IN TRYING TO PREVENT FRAUD IN THE SBA'S SMALL BUSINESS CONTRACTING PROGRAMS?

By Devon Hewitt

Representations and certifications always have been a fact of life in government contracts. Most government contractors, furthermore, understand the gravity of such representations and certifications. In case they don't, the actual text of the representation or certification may remind them. Many representations explicitly state that the submission of a false, fictitious or fraudulent certification may subject the contractor, and its principals, to prosecution under Title 18 U.S.C. § 1001 (the criminal code). With respect to size and status certifications related to small business contracting programs, the language is more specific. The text of FAR clause 52.219-1, Small Business Program Representations, states that any person who misrepresents a firm's size or status in connection with a preferential contracting program authorized by the Small Business Act shall be: punished by imposition of fine, imprisonment, or both; subject to suspension and debarment; and ineligible for future participation in the preferential contracting programs. The statute authorizing set-asides for veterans by the Department of Veterans Affairs goes even further, stating that a contractor that misrepresents its veteran status shall be debarred.

Congress, however, does not believe the threat of these penalties has been effective in fighting fraud, waste and abuse in small business contracting programs. To be fair, Congress may be right. In the last two years, the Government Accountability Office has published a number of reports identifying fraud in the Section 8(a), HUBZone, and SDVOSB programs. As a result, Congress included some stringent provisions in the Small Business Jobs Act signed by the President last September targeting fraud in these contracting programs. One of these provisions states that a contractor who certifies that it is "small" will be "deemed" to have made an affirmative, willful and intentional misrepresentation as to its size if it is determined to be other than "small." Another provision states that there will be a "presumed loss" to the Government as a result of a false certification or misrepresentation. This article discusses the "deemed certification" provision; the next *Legal Advisor* will include part two of this article and will discuss the "presumed loss" rule.

To most people, the new "deemed certification" provision does not appear to be a significant change. It is. Before the Act, in order to make a criminal case against a contractor alleged to have misrepresented its size or status, the Government had to demonstrate that the contractor possessed a certain "state of mind" at the time of certification. Specifically, the Government had to make a showing of the contractor's intent and knowledge at the time of certification with respect to the matters to which it certified. For example, section 1001 of Title 18 provides that whoever "knowingly and willfully" makes any false, fictitious or fraudulent statement to the Government shall be fined and imprisoned for not more than five years. The same standard applies under the Small Business Act; the SBA's regulations state that the Small Business Act provides severe penalties for "knowingly" misrepresenting a small business' size status in connection with the SBA's preferential procurement programs.

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PREVENTING FRAUD . . .

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The terms “knowingly” and “willfully” included in the criminal code and the SBA’s regulations require the Government to prove that a contractor *knew* its certification was false at the time of certification and that the contractor *intended* to make the false certification at that time in order to defraud the Government. If a contractor demonstrated that it made the certification in good faith, it was safe under this standard. Under the new certification provisions of the Small Business Jobs Act, the “state of mind” of the contractor is no longer important. Instead, the Act imposes “strict liability” on contractors by providing that a contractor will be “deemed” to have made an “affirmative, willful and intentional” certification of size and status each time it makes a certification. Given the serious penalties associated with criminal acts, strict liability is the exception, not the rule, in criminal law. The most well known exception is statutory rape. In most states, a person who has sex with a minor will be held culpable in the eyes of the law even if the person did not *know* the person with whom he or she had sex was a minor and even if the person did not *intend* to have sex with a minor. The rationale for imposition of strict liability in this context is that any unfairness to a defendant charged with this crime is more than outweighed by society’s interest in protecting minors from sexual predators.

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The ostensible purpose of the new “deemed certification” provision is to ensure that small businesses actually receive the benefits of the preferential contracting programs established for their benefit. The SBA’s Standard Operating Procedures (SOPs) for Size Determinations states a similar rationale: “Appropriate responses either in the form of prosecution or debarment can have a deterrent effect and can enhance the ability of legitimate small businesses to obtain contracts set aside for them.” The imposition of a strict liability standard in the context of federal small business contracting programs, however, is both unfair and draconian. The “deemed certification” provision only applies to small business size or status certifications; other certifications routinely made by contractors, primarily “large” contractors, still will be

subject to the “knowing” and “willful” standard described above. In addition, whether or not a business is small or qualifies as an 8(a), SDVOSB or HUBZone business is not a simple question with an obvious answer. One of the most common issues raised in size protests is whether a business alleging it is small is “affiliated” with another business such that the revenues or employee numbers of both businesses should be combined for size purposes. A determination of affiliation depends on a “totality of the circumstances” test applied by the the SBA, which can be very subjective. Indeed, the SBA’s Size Determination SOPs acknowledge this fact. The SOPs instruct the SBA personnel tasked with making size determinations to refer an adverse size determination to the the SBA Office of Inspector General where there is a reasonable suspicion that the business knew or should have known that its self-certification was not accurate. The SOPs also state, however, that a referral “would probably not be appropriate” if the business is found to be other than small based on a “nuanced interpretation of the affiliation rules of which a business would not likely be aware.”

The new certification provision does not allow for this type of distinction in assessing liability for a false certification. The Small Business Jobs Act does state that the SBA should promulgate regulations “to provide adequate protection” to individuals and businesses that make “unintentional errors, technical malfunctions, or other similar situations” affecting certifications or representations. This exception appears to be far narrower than that contemplated in the SBA’s SOPs regarding “nuanced interpretations” of the law or than the “knowing” and “willful” standard discussed above applicable to government contractors generally. Accordingly, a small business’ continued viability as a government contractor now depends on the views of a single SBA size specialist and, possibly, a single judge at the SBA’s Office of Hearings and Appeals (OHA). If an OHA judge affirms the finding made by a size specialist that a business did not correctly certify as small, per the new “deemed certification” provision, both the business and the individual making the certification may be prosecuted. This risk exists even if another judge could reasonably have come

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to a different conclusion on the issues presented in the size appeal. This “one strike, you’re out” policy also will lead to more size protests because the new certification provision provides a protester with the opportunity to eliminate a competitor not only from a single procurement, but also from federal contracting altogether.

The uncertainty inherent in many of the SBA’s program eligibility requirements, combined with the increased incentive to protest set-aside awards provided by the new “deemed certification provision,” will make participation in these preferential programs a risky business. Yet, small businesses are the least equipped to understand and manage these types of risks because they have far less experience and resources than “large” contractors. Thus, while Congress may have intended to help legitimate small business contractors in passing the new “deemed certification” provision, the result may be the exact opposite. □

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Government Contracting

UPDATE: OHA OVERTURNS “CURIOUS” PRECEDENT REGARDING SDVO JOINT VENTURES

By Jon Williams

Last summer, the *Legal Advisor* (Volume 11, Issue 3) featured an article entitled “The Curious Case of SDVO Joint Ventures.” In this article, we wrote about two OHA decisions pertaining to service-disabled veteran-owned (SDVO) joint ventures. The two “curious” cases, *IITS-Nabholz, LLC*, SBA No. VET-114 (2007) and *Cooper-Glory, LLC*, SBA No. VET-166 (2009), held that SDVO firms could not form joint ventures as “separate legal entities.” As a result, SDVO firms have been unable to take advantage of the protections in a limited liability company (LLC) or corporation when forming a joint venture.

The *IITS-Nabholz* and *Cooper-Glory* decisions were based on the requirement in the SDVO regulations that legal entities such as LLCs must be directly owned by a service-disabled veteran (SDV). When two companies form a joint venture as an LLC, the two companies (rather than an SDV) own the LLC. Thus, OHA concluded that a joint venture LLC does not satisfy the direct SDV ownership requirement and is not eligible for contracts set aside for SDVO firms.

As we wrote last summer, we have long believed that the *IITS-Nabholz* and *Cooper-Glory* cases were wrongly decided. But until recently, we did not have an opportunity to challenge the *IITS-Nabholz* and *Cooper-Glory* decisions on appeal to OHA.

Earlier this year, we filed an appeal with OHA challenging the SBA’s finding that an SDVO joint venture was ineligible for an SDVO set-aside contract with the Navy because the joint venture was set up as an LLC. The SBA had determined the joint venture to be ineligible based on the *IITS-Nabholz* and *Cooper-Glory* precedent. In response, we made many of the arguments that we wrote about in “The Curious Case of SDVO Joint Ventures.” Namely, the appeal argued that the SBA did not properly interpret the SDVO regulations because its decision was based solely on the rules found at 13 C.F.R. §§ 125.9 and 125.10, which contain the eligibility criteria for SDVO firms. The SBA improperly ignored the separate regulation, found at 13 C.F.R. § 125.15(b), which specifically addresses the eligibility of SDVO joint ventures for contracting purposes. Notably, the joint venture regulation at 13 C.F.R. § 125.15(b) does not require an SDV to have direct ownership in a joint venture.

Additionally, our appeal challenged the suggestion in *IITS-Nabholz* and *Cooper-Glory* that an SDVO can create a joint venture that is not a separate legal entity. Many states treat joint ventures as separate legal entities regardless of the parties’ intention or what is stated in the joint venture agreement. We also asserted that the SBA’s interpretation of the SDVO joint venture regulations was not in harmony with the similar regulations for 8(a) joint ventures; the SBA has long permitted 8(a) and small business joint ventures to be formed as LLCs. Lastly, we argued that the SBA was wrong to prevent SDVO firms from forming joint ventures as LLCs because doing so diminishes the usefulness of joint ventures for SDVO firms, thereby undermining the statutory goal of “enabling [veterans] to realize the American dream that they fought to protect.”

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The SBA opposed our appeal on the grounds that this issue had already been settled by OHA in *IITS-Nabholz* and *Cooper-Glory*. The SBA also asserted that its interpretation of the SDVO rules was reasonable.

On March 30, 2011, OHA issued its decision granting our appeal. The ruling, cited as *Construction Engineering Services, LLC*, SBA No. VET-213 (2011), reversed OHA's prior holdings in *IITS-Nabholz* and *Cooper-Glory* and held that,

[P]ursuant to 13 C.F.R. § 125.15(b), a joint venture between an eligible SDVO SBC and another small business – regardless of whether the venture is structured as a separate legal entity – need not meet the SDVO eligibility requirements in Subpart B of Part 125 to obtain an SDVO contract, but must only meet the specific requirements governing joint ventures set forth in 13 C.F.R. § 125.15(b).

(Emphasis added.) This means that the SBA can no longer find that an SDVO joint venture is ineligible for an SDVO contract simply because the joint venture is an LLC or a corporation.

OHA got it right and we applaud the ruling in *Construction Engineering*. Now that the erroneous OHA precedent has been reversed, SDVO firms and their prospective joint

Now that the erroneous OHA precedent has been reversed, SDVO firms and their prospective joint venture partners will have greater flexibility when making business decisions regarding the formation of their joint ventures.

Maximizing Your Time as a Small Business A PilieroMazza Breakfast Seminar

Speakers: Jon Williams and Dean Nordlinger

May 26, 2011 - 7:30 a.m. to 10:00 a.m.
The City Club at Franklin Square, Washington, DC

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venture partners will have greater flexibility when making business decisions regarding the formation of their joint ventures. Most importantly, such firms can now take advantage of the protections and other benefits of using an LLC or a corporation for their joint venture. If you are considering a joint venture and have questions about how this decision might impact you, or if you would like a copy of OHA's ruling, please do not hesitate to contact us. □

About the Author: Jon Williams, a partner with PilieroMazza, counsels clients in a broad range of federal procurement matters, including compliance with the Federal Acquisition Regulation and the rules governing small and minority business procurement programs (including the 8(a), SDB, HUBZone, SDVOSBC, and woman-owned small business programs. Mr. Williams can be reached at jwilliams@pilieromazza.com.

Regulations

WOSB FAR INTERIM RULE AND OTHER REGULATORY ACTIONS

By Ryan Bradel

On April 1, the FAR published an interim rule to implement the newly created Woman-Owned Small Business (WOSB) Federal Contract Program. The interim rule gives effect in the FAR to the SBA regulations that created the WOSB program, which became final on October 7, 2010.

The stated purpose of the FAR rule is to establish “procedures [that] will assist Federal agencies in eliminating barriers to the participation by WOSB concerns in Federal contracting.” To that end, the interim rule: creates mechanisms for contracting officers to set-aside solicitations only for WOSBs; allows contracting officers to make sole-source awards to WOSBs; outlines requirements for contracting officers to verify a firm's WOSB status through an online repository; and establishes procedures by which a firm's status as a WOSB may be protested. Comments on the interim rule must be received before May 31, 2011.

Additionally, the SBA has created a Web-based repository through which WOSB firms may submit documents proving their eligibility for the program which can then be accessed by the SBA and contracting community. That repository is currently online and can be accessed through the SBA's website. Both the SBA regulations and the FAR allow for third-party certifiers to verify the eligibility of WOSB firms, however, the third-party certifiers must first apply and be approved by the SBA. The deadline for the applications for the first round of third-party certifiers was March 1, 2011, thus, the SBA's first list of approved third-party certifiers is expected to be published soon.

In addition to the interim rule discussed above, the FAR Council and the SBA have recently published additional regulations that will impact government contractors:

On February 11, 2011, the SBA published a final rule in the *Federal Register* amending its small business size and 8(a) Business Development Program regulations. The final rule made some technical changes to the regulations, and implemented several of the SBA's current policies that were not expressed in the regulations. However, the final rule also made significant changes to the SBA's rules governing joint ventures, the mentor/protégé program, the nonmanufacturer rule, participation of Tribes, Alaska Native Corporations and Native Hawaiian Organizations in the 8(a) Program, size issues, economic disadvantage, and other miscellaneous 8(a) eligibility issues.

On March 16, 2011, the FAR Council published an interim rule implementing a new law requiring the justification and approval of sole-source contracts over \$20 million awarded under the 8(a) Business Development Program. Another significant revision of the FAR is an interim rule reestablishing parity among all socioeconomic programs, including the 8(a), HUBZone, and SDVOSB programs. Lastly, the FAR Council issued an interim rule mandating enhanced competition requirements for orders placed against multiple-award contracts, including the General Service Administration's Federal Supply Schedules. Interested parties may submit written comments by May 16, 2011, for consideration in the final rule.

Also on March 16, 2011, the SBA issued proposed changes to the small business size standards for several industries under Sectors 54 and 81 of the North American Industry Classification System (NAICS). The SBA analyzed 45 industries and three sub-industries in Sector 54, Professional, Scientific, and Technical Services, as well as one industry in Sector 81, Other Services. As a result of the SBA's review, the SBA has proposed increases to 35 industries and one sub-industry in Sector 54, plus the one industry in Sector 81. Comments are due on or before May 16, 2011, and may be submitted electronically at www.regulations.gov.

If we can assist you in preparing comments or answering questions about the above regulations, please contact us at 202-857-1000. □

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Labor and Employment

THE SCA AND COLLECTIVE BARGAINING AGREEMENTS

By Kevin Allis

The McNamara-O'Hara Service Contract Act of 1965 (SCA), requires the payment of specified minimum wage rates and fringe benefits to employees working on service contracts and subcontracts within the United States. The SCA requires that certain provisions be included in every contract with the Federal Government in excess of \$2,500 and for the "principle purpose" of furnishing services. A contractor who does not comply with the provisions could face a variety of sanctions such as having to provide back pay and interest to their service employees. In addition, the Government may withhold payments, and could terminate (for default) the contract upon written notice. Furthermore, the Government may bar contractors for three years from being awarded any other government contracts.

With stakes high, contractors must understand all obligations, including those pertaining to unionization matters and collective bargaining agreements (CBA). The SCA's 1972 amendments make service contractors subject to the "successor employer" doctrine. A contractor who replaces a contractor subject to a collective bargaining agreement is required to pay its employees not less than the wage rates and fringe benefits that the predecessor would have had to pay under the CBA. This includes any prospective increases provided by the CBA. In other words, CBA rates supersede the prevailing wage and fringe benefit rates. However, the regulations provide that if an applicable area wage determination contains wages or fringe benefits higher than that specified in a CBA, the higher wage determination rates apply.

A contractor's successorship obligation is self-executing. As such, this obligation is not contingent upon the incorporation of a wage determination based upon the predecessor's CBA. However, DOL regulations provide that a CBA is only self-executing if the procuring agency has been timely notified of the CBA and its contents. Under DOL regulations, a new CBA entered into after the award of a negotiated procurement, execution of a contract option, or an extension of a contract period will not be recognized for the purpose of applying successorship obligations provided that performance begins within 30 days of the award, option, or extension. If contract performance is to start more than 30 days after award, execution of a contract option, or an extension of a contract period, the CBA will be effective if received by the Government no later than 10 days prior to the start of performance.

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There is an important pitfall contractors should avoid in the application of the successor contractor rule. The effective date of a CBA and/or future wage or benefit increases is critical in determining applicability of CBA rates. If a contractor wishes to ensure that CBA rates will apply in future contract periods, it must make the effective date of the CBA precede the expiration of the contract or option year. The contract should also consider the use of a savings clause to ensure the CBA survives past the current contract period.

For example, if a new CBA is entered into during the base year of the contract, it is advantageous to save the wage and fringe benefit increases for the option year. If wages or fringes are increased during the base year, it will be at the contractor's expense because it is not subject to a price adjustment until the option year. In addition, a CBA must be the result of an "arms-length" negotiation. Clauses such as "the rates of this CBA only apply should the Government modify the contract" are not an "arms-length" negotiation since third-party actions are required to trigger the increased rates. This renders the CBA, for the purposes of the SCA, null and void, but arguably valid under the National Labor Relations Act. Using the provision as an attempt to increase rates during the base year is a mistake. Since the rules for

recognizing new or revised CBAs are the same as those governing when a contracting officer is obligated to obtain revised wage determinations, new and revised CBA rates are only recognized when: (i) an option is exercised; (ii) on the anniversary of any contract funded by annual appropriations; and (iii) in a contract funded with multi-year appropriations, not less than every three years.

Clearly, dealing with the interplay between the SCA and a CBA can be tricky. Therefore, it is important to understand the above-referenced concepts to avoid litigation before DOL regarding a violation of the SCA, or even worse, the National Labor Relations Board as a result of the filing of an unfair labor practice. □

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Collective Bargaining & the SCA A PilieroMazza Human Resources Workshop

Speaker: Kevin Allis

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