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The Government's Big Stick For Fighting Small Biz Fraud

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While high-dollar False Claims Act settlements often grab the headlines, 2017 saw significant and steady FCA enforcement activity on the small business front — ensnaring large and small businesses alike. Among the settlements highlighted in the U.S. Department of Justice's annual recoveries report was a $16 million settlement with ADS Inc. to settle allegations that the company violated the FCA by conspiring with purported 8(a) and service-disabled, veteran-owned small businesses to obtain set-aside contracts by misrepresenting their eligibility. The settlement with ADS ranks as one of the largest recoveries ever on an FCA case alleging fraud in connection with small business contracting eligibility.

One reason the DOJ, in tandem with the Small Business Administration's Office of Inspector General, was likely able to extract such a large settlement is because of a powerful tool at the government's disposal during negotiations — the Small Business Act's presumption-of-loss rule. This rule provides that if a concern willfully seeks and receives an award by misrepresenting its small business size or status, there is a presumption of loss to the United States equal to entire value of the contract, subcontract, cooperative agreement, or grant. This article examines the origins of the presumption-of-loss rule and analyzes the likely impact of a recent court decision on FCA cases in 2018 and beyond.

The Challenge of Quantifying Harm to Public Policy Goals

Prior to the passage of the Small Business Jobs Act of 2010, courts were split on the question of damages in FCA cases involving small business set-asides, and judges grappled with the question of how to quantify the intangible societal goal of awarding money to deserving small businesses. On the one hand, there were cases — such as Ab-Tech Construction v. United States — where the Court of Federal Claims found that the defendant had misrepresented its status to win the contract, but found that the government was not entitled to damages because the defendant had fully performed the contract:

Damages represent compensation for a loss or injury sustained. Here, however, no proof has been offered to show that the Government suffered any detriment to its contract interests because of Ab-Tech's falsehoods. Rather, viewed strictly as capital investment, the

Government got essentially what it paid for — an automated data processing facility built in accordance with the contract drawings and specifications. Thus, the court can discern no basis upon which to uphold the Government's demand for treble damages.[1]

On the other hand, there were cases such as Longhi v. Lithium Power Technologies, where the defendant allegedly misrepresented its eligibility to receive federal grants under the Small Business Innovation Research program.[2] There, the Fifth Circuit determined that Lithium Power had frustrated a societal goal of increasing small business participation because it was not qualified for the set-aside. The court concluded that because the government received no benefit from the bargain, the damages consisted of all payments made under the grant.

The Small Business Jobs Act's Paradigm Shift

Congress addressed the uncertainty surrounding damages in small business fraud cases when it passed the Small Business Jobs Act of 2010. The legislation amended the Small Business Act and created a presumption-of-loss equal to the "total amount expended on the contract ... whenever it is established that a business concern other than a small business concern willfully sought and received the award by misrepresentation."[3] In 2011, the Small Business Administration promulgated a proposed rule implementing the provisions from the Small Business Jobs Act that established the presumption of loss.[4] Notably, the proposed rule referred to an "irrefutable" presumption. However, when the final rule was promulgated in 2013, the word "irrefutable" was eliminated, and the agency's comments to the final rule made clear that the presumption was rebuttable.[5]

By creating a rebuttable presumption, the rule shifted the evidentiary burden from the government to the contractor. Before enactment of the presumption-of-loss rule, the government had to prove at trial that it actually suffered economic harm as a result of a misrepresentation by a contractor regarding size or status. The new rule shifted the burden of producing evidence with respect to damages to the contractor. It would, however, take several years to see how the rule would be applied in practice.

Application to Criminal Context

The Small Business Administration's regulations implementing the presumption-of-loss rule made clear that it was intended to be applied in all manner of criminal, civil, administrative actions. Until recently, the presumption-of-loss had only been applied in criminal cases in the sentencing context when determining the loss suffered by the government. For example, in United States v. Singh,[6] the parties disputed the total loss amount to the government stemming from the defendant's fraudulent procurement of several Section 8(a) program contracts. Applying the presumption-of-loss rule, the court concluded that the full amount of the contracts must be used in calculating the defendant's sentence under the U.S. sentencing guidelines.

In United States v. Crummy, the court reached a different result. In that case, the defendant pled guilty to fraud involving the improper procurement of contracts set aside for small, disadvantaged businesses.[7] At the sentencing stage, the DOJ relied upon the presumption-of-loss rule to calculate "loss" under the Sentencing Guidelines based on the full value of the particular contract at issue. But here, the Crummy court diverged from the analysis in Singh. While recognizing that the presumption of loss set the baseline for loss calculation, the court found that the "credits-against-loss rule" in the sentencing guidelines[8] required consideration of the value of the services rendered by the defendant. In other words, the court found that the presumption is not irrefutable and can be rebutted by demonstrating the value of the services the government received.

Presumption-of-Loss Gets Its Day in (Civil) Court

After the passage of the Small Business Jobs Act, a key question was left open about how the presumption-of-loss would be applied in civil FCA cases — namely, would a defendant be able to successfully rebut the presumption at trial or on a motion summary judgment by showing that the goods or services in question had substantial value to the government?

2017 saw the first application of the presumption-of-loss rule in a civil FCA case in United States ex rel. Savage v. Washington Closure Hanford LLC.[9] In Savage, the DOJ intervened in a qui tam suit against defendant Washington Closure Hanford (WCH), which held a multibillion contract for the environmental cleanup and closure of a portion of the U.S. Department of Energy's Hanford Site. WCH's contract included a 65 percent small business subcontracting goal and incorporated Federal Acquisition Regulation clause 52.219-16, under which the government is entitled to liquidated damages if a contractor fails to meet its subcontracting goals and fails to make a good faith effort to comply with its subcontracting plan.

The DOJ alleged that WCH used pass-through businesses in order to meet certain targets for subcontracting with small businesses, including a woman-owned small business. The DOJ sought the full value of the subcontracts that had been awarded to the pass-through companies that did not perform any significant work on the project, or failed to qualify under the requisite small business eligibility rules. WCH moved for partial summary judgment on the permissible scope of the government's damages and argued that the damages should be limited to the remedies provided by the contract which included the liquidated damages provision set out in FAR 52.219-16. WCH also took the position that the presumption of loss could only apply to a putative small business that willfully misrepresents its size or status. Lastly, WCH argued that any damages must be offset by the value received and retained by the government.

The district court rejected these arguments, finding that the liquidated damages provision was not an exclusive remedy. The court also found that no language in the statute limited the application of the presumption to claims against a putative small business, and no language required that the misrepresentation be made by the putative small business. More importantly, the court rejected the defendant's argument that any damages must be offset by the value received and retained by the government. The court reasoned that the harm was not related to whether or not the government received the services it bargained for under the contract, but rather the loss of business and experience going to eligible small businesses: "[a]ccordingly the value received by the government through the contractor's performance is irrelevant to calculating damages."

Conclusion

Even before enactment of the presumption-of-loss rule, it was common for the government to take the position in small business fraud cases that, if forced to go to trial, it would seek the full contract value as loss or damages. The new rule gave the government even more leverage in this regard. And while the defense bar may have been on watch for a defendant to overcome the presumption in litigation, Savage is not the result that defendants have been waiting for. Far from blunting the presumption-of-loss's strength as a negotiating tool, the court's ruling in Savage will likely embolden the government to aggressively pursue cases involving set-aside fraud. As a result, civil and criminal defendants will be confronted with heightened litigation risk due to damages and loss calculations based on the full value

of the contracts at issue.

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[1] 31 Fed. Cl. 429 (Fed. Cl. 1994), aff'd 57 F.3d 1084 (Fed. Cir. 1995).

[2] 575 F.3d 458, 473 (5th Cir. 2009).

[3] 15 U.S.C. § 632(w)(1).

[4] 76 Fed Reg. 62313, 62314 (October 7, 2011).

[5] 78 Fed. Reg. 38811, 38816 (June 28, 2013).

[6] 195 F. Supp. 3d 25 (D.D.C. 2016).

[7] 249 F.Supp.3d 475 (D.D.C. 2017).

[8] U.S.S.G. § 2B1.1 cmt. n.3(E)(i).

[9] See 2:10-cv-05051 (Aug 24, 2017 E.D. Wa).