

**DIVING INTO
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Ounce of Prevention Seminar (OOPS)



Small Business Status, Investigations, and Consequences

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Agenda

- An environment ripe for fraud and abuse
- Key sources of small business regulatory missteps
- Common schemes and red flag indicators
- Enforcement tools and trends
- The wide net of consequences for entities and individuals
- Illustrative case examples

An Environment Ripe for Fraud and Abuse

- SB status necessary (or beneficial) to access prime and subcontracts (\$100B in prime contracts alone for FY16)
- Complex regulatory overlay applicable to inexperienced contractors
- Fewer checks and balances
 - Control by one or a few individuals
 - Limited or no investment on compliance
 - Pressure from investors, customers, large businesses
 - Heightened diligence needed by teaming partners and buyers

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Key Regulatory Missteps

- Size status requires self certifications
- Dramatic industry variations on “small” based on NAICS Code:
 - Number of employees (100 to 1,500); or
 - Average annual receipts (\$750K to \$38.5M)
- Size accounts for employees/receipts of business and all “affiliates”
 - Centered around concept of control
 - “Totality of the circumstances” analysis that is highly fact intensive
 - Date-specific determinations

Key Regulatory Missteps - Affiliation

Misunderstanding/Misrepresenting “Control”:

- Control refers to ability to control and may be affirmative or negative
- Red flags on quorums or supermajority/unanimous voting requirements
- Control due to terms associated with loans/bonding or “side agreements”

Affiliation Based on “Identity of Interest”:

- Economic dependence based on contractual or other interests
- All/most subcontracts from one entity
- Financial arrangements (loans, bonding, etc.)

Key Regulatory Missteps - Status

Missteps Impacting Status:

- Do the necessary individuals manage the company, control day-to-day operations and long-term decision-making?
- Does the President/CEO have managerial experience of the extent and complexity needed to run the company?
- Do the necessary individuals “directly” and “unconditionally” own at least 51% of the company?

Key Regulatory Missteps - Workshare

Limitations on subcontracting – SB prime

- Currently two sets of calculations (FAR and SBA regulations) and limits vary based on type of work
- Period for compliance – base period and each individual option period

Added complexity to DOT DBE Program – SB sub

- DBE must perform “commercially useful function”
- Count only value of work performed by DBE
- Additional specific requirements based on type of subcontract

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Common Schemes/Red Flag Indicators

- Straw owners who sell their status
- Pass-through fraud
- Affiliation with larger companies
- Companies that recently outgrew small size status
- Misrepresentations regarding economic disadvantage, etc.
- Inexperienced owner/business dependent on another

Enforcement Tools and Trends

- Enhanced sanctions and penalties
 - Presumption of loss (15 U.S.C. § 632(w)(1); 13 C.F.R. § 121.108(a))
 - Liquidated damages (FAR 52.219-16)
 - SBA Program Fraud and Civil Remedies Act, 31 U.S.C. §§ 3801-12
- Size protests
 - Elimination from competition
 - Can serve as start of investigation
- False Claims Act
- Criminal Prosecution
- Suspension & Debarment



Wide Net of Consequences

Investigations and cases reflect harsh consequences for multiple companies and individuals

- Large businesses involved tend to get the media spotlight (*i.e.*, GTSI)
- Multiple named defendants with varying roles in the scheme
 - Central bad actors typically have familiarity with SBA requirements
 - Increases complexity of scheme due to measures to avoid detection
- False Claims Act liability sought for large businesses through increasingly attenuated connections (deep pockets)
- Disproportionately large percentage of entities suspended or debarred are small businesses (well over 50% for most agencies)

Recent Cases

U.S. ex rel. Savage (E.D.Wa. 2017)

- Large prime contractor, accused of misrepresenting status of small businesses to meet small business subcontracting plan goals
- Lost motion for partial summary judgment on damages
- Court found that under "presumption of loss" rule damages should be based on the **full value** of the improperly awarded subcontracts.

Recent Cases

U.S. ex rel. Scollick (D.D.C. 2017)

- Motion to dismiss denied where surety bond issuers allegedly caused presentment of false claims by bogus SDVOSBs where:
 - Proposals were dependent upon the issuance of surety bonds; and
 - Issuers allegedly knew their clients were shell companies

Recent Cases

ADS, Inc. (2017)

- \$16 million FCA settlement by large prime accused of "conspiring with and causing purported small businesses to submit false claims . . ." due to undisclosed affiliation
- Scheme involved different affiliates
- Ranks as one of the largest recoveries involving alleged fraud in connection with small business contracting eligibility
- "OIG will aggressively pursue companies that, through false statements, wrongfully benefit from small business set-aside contracts."

Recent Cases

U.S. ex rel. Cherwenka (D. Minn. 2018)

- Relator alleged that large primes knew a subcontractor supply distributor did not qualify as small because it was affiliated with its large supplier
- But SBA had investigated and blessed that relationship through an approved mentor-protégé agreement
- Defendants won motion to dismiss
- Mentor-protégé program, if utilized properly, can be a vehicle to provide support between companies free from consequences of affiliation

Recent Cases

U.S. v. Dial (D. Kansas 2018)

- Criminal prosecution of service-disabled veteran "who received payments in exchange for use of his name, signature and veteran status in order to make his role in the business appear legitimate, while doing little actual work" on \$40 million worth of DOD contracts
- Company was instead run by "Person A" and Dial was rarely even present in the office

Headliner Cases

GTSI Corp. (2010)

- Large contractor that had grown from small suspended by SBA for participating in a classic pass-through scheme under which GTSI would receive virtually all of the revenue on set-aside contracts
- CEO and GC removed and independent monitor imposed as part of administrative agreement

MicroTechnologies, LLC (2014)

- MicroTech and its CEO suspended due to affiliation with two other entities through common investors and related misrepresentations when applying for 8(a) status
- Suspension lifted (1) for MicroTech after CEO relinquished control during investigation and (2) for CEO after ethics and compliance training and sit-out period from management



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DBE Fraud Cases March On

- DBE cases represent around 30% of DOT OIG active procurement and grant fraud investigations
- *United States v. Nagle*, 09-CR-00384-001, (M.D.PA July 26, 2013)
 - Co-owners of Schuylkill Products, Inc. set up sham company (Marikina) – 15 year scheme involved over \$130M in contracts (largest DBE fraud scheme in history)
 - Sham owner paid small fee but SPI employees performed all work and covered up SPI name on equipment
 - Co-owners served jail time and fined; other SPI executives and Marika owners sentenced to prison and ordered to pay restitution

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QUESTIONS?

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