5 Areas Of Growing Debarment Risk For Contractors

By Dietrich Knauth

Law360, New York (January 13, 2014, 10:49 PM ET) -- As Congress continues to press for broader use of suspension and debarment, federal agencies have already begun to step up their enforcement efforts by pursuing a wider range of violations than in years past.

Lawmakers are increasingly focused on preventing taxpayer dollars from flowing to companies with questionable ethics or track records, and Congress is considering a major overhaul of the government's approach to suspension and debarment through the Stop Unworthy Spending Act, or SUSPEND Act. The bill would create a new, governmentwide suspension and debarment board, and allow some civilian agencies and the U.S. Department of Defense to opt out of the planned consolidation if they can demonstrate they already have strong suspension and debarment offices.

Even in the absence of a legislative revamp, the current rules in the Federal Acquisition Regulation give agencies the broad discretion to pursue debarment for any offense “indicating a lack of business integrity or business honesty that seriously and directly affects the present responsibility of a government contractor or subcontractor.” For contractors, the new scrutiny, combined with the flexibility enjoyed by debarring agencies, means that practically any violation could raise the specter of debarment.

“There are so many risk areas these days,” said Todd Canni, a former Air Force debarment attorney who now represents contractors at McKenna Long & Aldridge LLP. “I think contractors, more than ever, big or small, are likely to at some point experience something that could give rise to a cause for debarment, whether it’s very serious criminal conduct, or billing errors, or issues with business capture.”

Here are five areas where contractors may see increased enforcement risk in 2014:

Small Business Programs

Contracting rules intended for the benefit of small businesses are often complex to navigate and difficult for agencies to oversee, and the competitive advantage they offer companies can make them ripe targets for fraud. The recently proposed debarment of Micro Technologies LLC, which boasted of its success as the “biggest of the smalls,” showcases some of the complexities.

Several rivals had challenged MicroTech's status as a small business contractor, but the U.S. Small Business Administration sided with MicroTech until Washington Post reports about the company's outsize growth and ties to wealthy benefactors caused it to reconsider.
“There's increased attention on the part of the SBA and other agencies to compliance with small business regulation, and there seems an increased willingness on the part of SBA to take actions against companies that are not compliant,” said Richard Arnholt, a counsel with Crowell & Moring LLP.

Smaller companies tend to be at higher risk for suspension and debarment. They are easier for the government to cut ties with than large companies with a lot of government business, and they tend to have less-developed compliance and ethics programs than companies with better-funded risk mitigation, Arnholt said. On the other hand, violation of small business contracting rules can ensnare larger companies as well, such as the 2010 debarment of GTSI Corp., which improperly used small Alaska Native Corporations to get “pass-through” work in the form of subcontracts.

“As a large business, you need to be very cognizant of these rules as well,” Arnholt said. “While small businesses are likely to bear the brunt of increased focus on these small business programs, large businesses certainly aren't going to get a pass.”

**Contract Performance**

One area that's seeing increased scrutiny from agencies is contract performance. The FAR allows agencies to debar contractors for “a history of failure to perform, or of unsatisfactory performance of, one or more contracts,” and agencies are increasingly willing to pull the trigger on a proposed debarment even if one contract is a failure, according to Arnholt and Canni.

Part of that attention stems from efforts to improve coordination between contracting staff and debarring officials, and many agencies now report all terminations for default to debarring officials, Arnholt said.

For Canni, issues around poor contract performance are one of the busiest parts of his practice.

“That is my bread and butter right now,” Canni said. “Performance on a government contract, beyond anything else, is the most important element of a contractor's responsibility. ... I've seen those actions for untimely deliveries, [or] for failing to deliver the products the government wanted, and some agencies are taking a very hard-line approach to that.”

The government may be tempted to cut off small suppliers that aren't reliable, even in situations where issues would previously resolved through warranties, Arnholt said.

“There has been a perception on the part of the government that it's too onerous to work through warranty issues with small suppliers of parts,” Arnholt said. “If the parts are faulty, the government may simply consider excluding them.”

**Labor Violations**

While some contractor-specific laws allow for statutory debarment for contractors who fail to pay required wages, other employment violations are coming onto the radar screen for Congress and debarring officials. U.S. Immigration and Customs Enforcement has been active in seeking to debar companies that use illegal immigrant labor, and activists and members of the Senate have pushed for greater scrutiny of a range of workplace safety violations.
In December, the Senate Committee on Health, Education, Labor and Pensions released a report on contractors with labor violations, finding that almost 30 percent of companies that were given the harshest penalties for violating federal labor laws were contractors. The report identified 35 contractors that were cited for violating both federal wage laws and federal health and safety laws but continued to be eligible for contracts.

The Senate report recommended strengthening suspension and debarment of companies that violate labor law, a call that was echoed by activist groups like the Project on Government Oversight and the Center for American Progress Action Fund. Few of the companies listed in the report were suspended or debarred, although the most prominent violator, BP PLC, was suspended from contracting in November 2012.

“The report contains many astonishing statistics that will hopefully spur the White House and Congress to reform federal contracting practices,” said Neil Gordon, an investigator with POGO. “One of the most disturbing statistics is that 42 American workers died as a result of the workplace health and safety violations of eight federal contractors, including BP.”

CAP Action released its own report in December, following up on a 2010 U.S. Government Accountability Office study on the companies with the 50 largest workplace health and safety penalties between 2005 and 2009. CAP Action reviewed those same 50 companies and concluded that the companies “with the worst records of harming workers were also often guilty of shortchanging taxpayers through poor performance on government contracts and similar business agreements in ways that defraud the government or otherwise provide a bad value for taxpayers.”

Veterans' Certifications

Similar to the scrutiny on small-business contracting more generally, contractors face heightened risk when attempting to get U.S. Department of Veterans Affairs certification as veteran-owned small businesses or service-disabled veteran-owned small businesses. A new VA certification process was created by the Veterans Benefits, Health Care and Information Technology Act of 2006, and that law calls for a five-year period of debarment for companies that attempt to misrepresent themselves as being owned and controlled by service-disabled veterans. The five-year period is harsher than most debarments, which generally have a three-year limit.

The VA has been aggressive in referring cases for debarment, according to Arnholt. In many cases, it will follow up a denial of a company's application with a notice of proposed debarment, raising the risk that the VA could cut off companies that mistakenly believed they qualified as SDVOSBs, in addition to companies that were trying to game the system, Arnholt said.

Affiliates' Behavior

Contractors have always been at risk for suspension or debarment based on the actions of affiliated companies, but a recent decision from the Eleventh Circuit, combined with broad approaches to affiliate suspensions in recent high-profile cases, underscores some of the unique risk that affiliate companies face during a suspension.

In the suspension of BP over the Deepwater Horizon oil spill and the suspension of Agility/Public Warehousing Co. over allegations of fraudulent billing on military food contracts, the government has taken a broad-brush approach to suspending affiliates, including companies that were not accused of
being involved in their parent company's alleged wrongdoing. The affiliates of BP and Agility challenged their suspensions in court, but the Eleventh Circuit came down hard on contractors when deciding the Agility affiliates case.

While the FAR section that governs suspension and debarment is ambiguous about whether the 18-month limit applies separately to an indicted company and its affiliates, the Eleventh Circuit left no room for doubt in a terse decision, saying: "So long as they are affiliates of Public Warehousing, they can be suspended." That kind of hard line raises the risks that affiliate contractors may face lengthy suspensions while their parent companies fight an indictment, with few options other than proving that they've severed ties with the indicted company.

**What's Next for Contractors?**

Because of the broad range of risks that raise suspension and debarment concerns, companies need to be aware that there's no way to inoculate themselves completely, Canni said. Instead, the best defense is a strong ethics and compliance program, good training, and proactive dialogue with suspension and debarment officials when any problem arises, he said.

“SDOs understand that you can't always prevent misconduct, but they will ask you, 'What did you do to mitigate it?’” Canni said. “You need to be prepared to make a proactive disclosure to your SDO. You really can't run away from these things because they will catch up to you.”

--Editing by Elizabeth Bowen and Philip Shea.

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