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Preventing Small Business Fraud, including Small Business Contracting Fraud Prevention Act

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“Preventing Small Business Fraud, including
Small Business Contracting Fraud Prevention Act”

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I. Introduction

“One bad apple can spoil the whole bunch,”\(^1\) summarizes the fraud and abuse of small business federal contractor misrepresentation of size and other qualifications to achieve eligibility for small business (SB) contracts, including Small Disadvantaged Business (SDB or 8(a)), Historically Underutilized Business Zone (HUBZone), Service Disabled Veteran Owned Small Business (SDVOSB), and Woman Owned Small Business (WOSB). While the vast majority of the small businesses that participate in these programs follow the rules and accurately represent their eligibility, a small minority of the firms misrepresent their eligibility thereby qualify for contracts that they would otherwise be ineligible for, fraud. Such actions allow individuals that commit fraud to be unjustly enriched, and if in coordination with large firm subcontractors, allow large firms to gain an unfair competitive advantage. Such fraud has been the subject to at least three General Accounting Office (GAO) audit reports since 2008 on 8(a), HUBZone, and SDVOSB. These audit reports and suspension of GTSI have likely caused the Senate to pass on September 21, 2011 the “Small Business Contracting Fraud Prevention Act”\(^2\) (SBCFA) and caused the Small Business Administration (SBA) to propose similar changes to small business regulations on October 7, 2011.\(^3\) This paper discusses the proposed legislation and regulation in light of the civil false claims act\(^4\) and other enforcement mechanisms, and provides recommendations for an on line access to recent tax returns of CCR registered small

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\(^4\) 37 USC 3729 and 37 USC 3730.
business by Federal acquisition and enforcement officials so that the officials may verify size certifications.

II. BACKGROUND: SMALL BUSINESS PROGRAMS: POLICY, ELIGIBILITY, AND GOALS

The Small Business Act declares that it is Congressional policy that the government should “aid, counsel, assist, and protect … the interest of small business in order to preserve the free competitive enterprise, to ensure a fair proportion of total purchases and contracts and subcontracts for property and services for the Government … be placed with small business enterprises.” Small business account for nearly half of private nonfarm Gross Domestic Product (GDP), highlights the importance of small business to the US economy. The discussion below reviews the small business policy, eligibility, and goals for the different small business programs.

II.A. Summary of Policy and Eligibility for SB, 8(a), WOSB, SDVOSB, and HUBZone

The discussion below summarizes policy, eligibility criteria for small business (SB), 8(a), HUBZone, SDVOSB, and WOSB. All these programs require small business size status. SB and WOSB are self-certified, while SBA determines eligibility for 8(a) and HUBZone, and Department of Veteran Affairs (VA) for SDVOSB. Unless there is a protest or challenge as to eligibility, Federal Agencies routinely rely on small business self-certification for size eligibility.

II.A.1 Small Business Eligibility

A business is considered a small business as determined by comparing either the business receipts or number of employees to the size standard of the North American Industry Classification System (NIACS). The Small Business Act requires SBA to establish NIACS

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5 15 USC 631(a).
7 13 CFR 121.104 (receipts); 13 CFR 121.106 (employees).
codes, where NIACS codes for manufacture are based on number of employees of concern during the past 12 months and NIACS codes for services are based on average annual receipts during the past three years.\textsuperscript{8} If the NIACS standard is based on number of employees the comparison is to the business’s number of employees over past 12 months.\textsuperscript{9} If the NIACS standard is receipts the business’s average annual receipts per the business’s tax returns during past three years.\textsuperscript{10}

Affiliates are included in calculation for determination of meeting size standards.\textsuperscript{11} Affiliation may be due to common ownership or management.\textsuperscript{12} Business self-certified by contractor eligibility as a small business.\textsuperscript{13} The self-certification is subject to protest by a disappointed bidder within 5 days of receipt of notice of the award.\textsuperscript{14} SBA determines whether a protested firm is small.\textsuperscript{15} When a firm is small when submitting a proposal for a small business IDIQ contract (such as GSA Alliant Small Business, GSA STARS II and FAA EFAST) the IDIQ contract remains small until the next size certification with an option or acquisition.\textsuperscript{16} This is known as the in industry as ‘grandfathering.” For small business contracts, the small business prime contractor has a limitation in subcontracting: 50% of costs of performance of the contract must be expended on the prime contractor’s employees for services and supplies

\textsuperscript{8} 15 USC 632(a).
\textsuperscript{9} 15 USC 632(a); 13 CFR 121.106
\textsuperscript{10} 13 CFR 121.104.
\textsuperscript{11} 13 CFR 103, 104, 106.
\textsuperscript{12} 13 CFR 121.103.
\textsuperscript{13} 13 CFR 405.
\textsuperscript{14} 13 CFR 1001, 1004.
\textsuperscript{15} 13 CFR 1008, 1009.
\textsuperscript{16} 13 CFR 121.404(g).
(excluding materials), and 15% of costs of performance for general construction and 25% for special trade construction (excluding materials).\textsuperscript{17}

\textbf{II.A.2. Socially Disadvantaged Business (SDB) and 8(a)}

The primary federal contacting program for socially and economically disadvantaged businesses is the 8(a) program, in which SBA determines eligibility of firms based on a rigorous application process based on pre-defined criteria.\textsuperscript{18} Congress believes certain groups in the US have little access to capital and ability to have small businesses.\textsuperscript{19} Broadening access to capital for these groups is in the national interest.\textsuperscript{20}

“Generally, a concern meets the basic requirements for admission to the 8(a) business development (BD) program if it is a small business which is unconditionally owned and controlled by one or more socially and economically disadvantaged individuals who are of good character and citizens of and residing in the United States, and which demonstrates potential for success.”\textsuperscript{21} “Socially disadvantaged individuals are those who have been subjected to racial or ethnic prejudice or cultural bias within American society because of their identities as members of groups and without regard to their individual qualities.”\textsuperscript{22} There is a rebuttable presumption that racial minorities are socially disadvantaged.\textsuperscript{23}

For economic disadvantaged, there are net worth limits of $250,000 for initial eligibility and $750,000 for continued eligibility (excluding 8(a) business, primary residence, and retirement accounts), income limits of $250,000 for initial eligibility and $350,000 for continued

\begin{footnotes}
\item[17] 13 CFR 125.6; FAR 52.219-14.
\item[18] 13 CFR 124.
\item[22] 13 CFR 124.103.
\item[23] 13 CFR 124.103.
\end{footnotes}
eligibility, and total asset limits of $4 million for initial eligibility and $6 million for continued eligibility. “An applicant or Participant must be at least 51 percent unconditionally and directly owned by one or more socially and economically disadvantaged individuals who are citizens of the United States.”

“An individual may not use his or her disadvantaged status to qualify a concern if that individual has an immediate family member who is using or has used his or her disadvantaged status to qualify another concern for the 8(a) BD program.” The disadvantaged individual must manage the 8(a) firm full time and hold the highest office in the firm and receives the most compensation from the 8(a) fame (unless demonstrated reason otherwise) such that the individual exercises control over the firm.

The applicant for 8(a) must demonstrate potential for success by having been in business for two years with successful performance history and having access to necessary capital, facilities, and licenses.” There is one time eligibility for 8(a) for US citizens of good character. SBA has published standard operation procedures for SBA’s management of 8(a) firms. For 8(a) contracts, the 8(a) prime contractor has a limitation in subcontracting: 50% of costs of performance of the contract must be expended on the prime contractor’s employees for services and supplies (excluding materials), and 15% of costs of performance for general construction and 25% for special trade construction (excluding materials).

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24 13 CFR 124.104.
26 13 CFR 124.105(g)(1).
27 13 CFR 124.106.
29 13 CFR 124.108.
31 13 CFR 125.6; FAR 52.219-14.
II.A.3 Women Owned Small Business (WOSB), Service Disabled Veteran Owned Small Business (SDVOSB), and HUBZone

“[W]omen, as a group, are subject to discrimination in entrepreneurial endeavors due to their gender.” 15 USC 631(h)(1)©. “[I]t is in the national interest to expeditiously remove discriminatory barriers to the creation and development of small business concerns owned and controlled by women.” 15 USC 631(h)(1)(E). WOSB is a small business that is at least “51 percent unconditionally and directly owned and controlled by one or more women who are United States citizens.” 13 CFR 127.200. “To qualify as a WOSB, the management and daily business operations of the concern must be controlled by one or more women.” 13 CFR 127.202. “The woman … who holds the highest officer position of the concern must manage it on a full-time basis and devote full-time to the business concern.” 13 CFR 127.300. WOSB status is self-certified. 13 CFR 127.9

“America honors the extraordinary service rendered to the United States by veterans with disabilities incurred or aggravated in the line of duty during active service with the armed forces.” Service Disabled Veteran Owned Small Business (SDVOSB) are SB at least 51% unconditionally owned and managed by a service disabled veteran who holds highest office in business. “Service-disabled veteran with a permanent and severe disability means a veteran

32 15 USC 631(h)(1)©.
34 13 CFR 127.200
35 13 CFR 127.202
36 13 CFR 127.202
37 13 CFR 127.300
39 13 CFR 125.9
40 13 CFR 125.10
with a service-connected disability that has been determined by the Department of Veteran’s Affairs (VA), in writing.” Eligibility for SDVOSB is determined by VA.

“The purpose of the HUBZone program is to provide federal contracting assistance for qualified SBCs located in historically underutilized business zones in an effort to increase employment opportunities, investment, and economic development in such areas.” A HUBZone company must be at least 51% owned by US Citizens, be a small business, have its principal office in a HUBZone, and at least 35% of concern’s employees must reside in a HUBZone. A Hubzone firm must expend at least 51% of costs of performance of a HUBZone contract on its own employees. A concern must apply to SBA for a certification for HUBZone status.

II.B. SMALL BUSINESS GOALS

Congress has mandated minimal small business goals for federal prime contracting, which the government has failed to meet. The table below summarizes the small business goals and actual performance. In 2009, The Federal government only meet the SDB or 8(a) goal.

<table>
<thead>
<tr>
<th>Category</th>
<th>Goal</th>
<th>2009 Actual Percentage</th>
<th>2009 Actual Dollars</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small Businesses (SB)</td>
<td>23%</td>
<td>21.89%</td>
<td>$96.8 billion</td>
</tr>
<tr>
<td>Women Owned Small Business (WOSB)</td>
<td>5%</td>
<td>3.68%</td>
<td>$16.3 billion</td>
</tr>
</tbody>
</table>

41 13 CFR 125.8
42 13 CFR 126.100.
43 13 CFR 126.200.
44 13 CFR 126.200(d).
45 13 CFR 126.300.
46 15 USC 644(g); SBA website, [http://www.sba.gov/content/small-business-procurement-scorecard-shows-progress-toward-meeting-23-percent-goal-small-business-contracting](http://www.sba.gov/content/small-business-procurement-scorecard-shows-progress-toward-meeting-23-percent-goal-small-business-contracting) (last visited December 12, 2011).
<table>
<thead>
<tr>
<th>Small Disadvantaged Businesses (SDB) 8(a)</th>
<th>5%</th>
<th>7.57%</th>
<th>$33.5 billion</th>
</tr>
</thead>
<tbody>
<tr>
<td>Service-Disabled Veteran Owned Small Business (SDVOSB)</td>
<td>3%</td>
<td>1.98%</td>
<td>$8.8 billion</td>
</tr>
<tr>
<td>Historically Underutilized Business Zone (HUBZone)</td>
<td>3%</td>
<td>2.81%</td>
<td>$12.4 billion</td>
</tr>
</tbody>
</table>

Agencies may restrict competition for procurements to ensure meeting small business goals when there are at least two eligible offerors and award will be made at fair market prices.\(^{47}\) In addition, some programs such as 8(a),\(^{48}\) HUBZone,\(^{49}\) and SDVOSB\(^{50}\) allow for sole sources to qualified firms. Accordingly, eligibility for the small business programs will likely have significant impact to a firm’s success.

### III. Analysis of the Problem: Small Business Programs Eligibility Fraud

As discussed above, to encourage entrepreneurship amongst socially and economically disadvantage individuals,\(^{51}\) service disabled veterans,\(^{52}\) in economically underdeveloped areas,\(^{53}\) women,\(^{54}\) and small businesses,\(^{55}\) Congress has established a contracting system with goals,\(^{56}\) set-a-sides\(^{57}\) and sole sources,\(^{58}\) for those firms who qualify for these small business programs.

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\(^{47}\) FAR 19.502-2(b) (small business); FAR 19.1305 (HUBZone); FAR 19.1405 (SDVOSB).

\(^{48}\) FAR 19.800.

\(^{49}\) FAR 19.1306.

\(^{50}\) FAR 19.1406.

\(^{51}\) 13 CFR 124.

\(^{52}\) 13 CFR 125.

\(^{53}\) 13 CFR 126.

\(^{54}\) 13 CFR 127.

\(^{55}\) 13 CFR 121.

\(^{56}\) 15 USC 644(g).

\(^{57}\) FAR 19.502-2(b) (small business); FAR 19.1305 (HUBZone); FAR 19.1405 (SDVOSB).
However, with opportunity, there are those who cheat by falsely claiming eligibility. As discussed below, there have been at least three GAO reports on fraud and abuse with regard to eligibility of 8(a), HUBZone, and SDVOSB since 2008. Such misrepresentations have allowed unjust enrichment of those who make such misrepresentations. SBA also suspended GTSI for failure to follow small business regulations.59

While those small businesses who cheat are likely few, their parade of horrors has not gone unnoticed and will likely cause some additional regulation, potential liability, and enforcement for all small businesses. The US Senate passed the Small Business Contract Fraud Prevention Act (SBCFPA) in part in response to these reports, and SBA proposed rule changes to implement parts of SBCFPA. The SBA has also modified the 8(a) regulations to implement many of GAO recommendations, with further modifications to come. However, while the proposed regulations have a prospective effect by increasing liability for wrong doing, the proposed changes do not provide a means for agencies to verify size eligibility in an automated efficient way using data the government already has available. This paper provides such a recommendation.

II1.A. 8(a) Program Fraud

In March 2010, GAO identified 14 ineligible firms participating in the 8(a) program, who received $325 million of 8(a) contracts.60 Eligibility issues included under reporting of net worth and salary, principal’s false claim of racial ethnicity, excessive withdraws from the 8(a) firm resulting in lack of economic disadvantage to principal, management by non-disadvantaged

58 FAR 19.8 (8(a)); FAR 19.1306 (HUBZone); FAR 19.1406 (SDVOSB).
60 GAO, 8(a) Program Fourteen Ineligible Firms Receive $325 Million Sole Source and Set a Side Contracts, GAO-10-425 (March 30, 2010), hereinafter, GAO-10-425.
individual, and failure to follow limitation in subcontracting under FAR 52.219-14. The GAO recommended that the SBA use third party data sources, fraud detection tools, and financial analysis for fraud; revise regulations to specify economic disadvantaged with respect to participant’s income and asset levels at time of application and annual recertification; adjust net worth limitations to include assets owned by spouses of 8(a) participants; propose regulation changes that would limit new firms from participating in 8(a) if an immediate family member is or has been 8(a) in the same or similar line of work; develop a more consistent enforcement strategy for suspension and debarment for those who knowing misrepresent 8(a) eligibility.

SBA agreed to all of these changes except the change relating to how family members’ assets are included in the 8(a) participant for eligibility determinations, which SBA was evaluating proposed rule change.

On February 11, 2011, SBA finalized changes to the 8(a) regulations that implemented many of these recommendations and other changes. A firm must be small to be in 8(a) under its primary industry classification (and is graduated if other than small for three consecutive years). Spouses’ assets are considered for eligibility. Person presumed not economic disadvantaged if income is above $250,000 or total assets above $4 million at time of application, and if income is above $350,000 or total assets above $6 million at time of continued

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62 GAO-10-425 page 37 and GAO, 8(a) Program The Importance of Effective Fraud Prevention Controls, GAO-11-440T (March 3, 2011), hereinafter, GAO-11-440T.
65 13 CFR 124.102(a)(2); 13 CFR 124.302(c)
66 13 CFR 124.104(b)(2)
participation in 8(a). An individual does not qualify for 8(a) if an immediate family member has qualified in the same or similar line of business. If SBA determines that a mentor has not provided required support per a mentor protégée agreement, SBA may terminate the agreement, and recommend to the procuring agency that has a contract with a joint venture (JV) resulting from the mentor protégée agreement terminate any contract with the JV. Note the 8(a) regulation changes do not identify use third party data sources, fraud detection tools, and financial analysis for fraud prevention and a more consistent enforcement strategy for suspension and debarment for those who knowing misrepresent 8(a) eligibility, which may be addressed through changes to SBA standard operating procedures.

**III.1.B. HUBZONE Program Fraud**

Per a GAO report, in fiscal years 2006 and 2007, federal agencies obligated nearly $30 million to 19 ineligible firms for performance as the prime contractor on HUBZone contracts and a total of $187 million on all federal contracts. Basis of ineligibility included failure to maintain principal office in HUBZone and failure to have required percentage of employees living in a HUBZone. GAO recommended SBA conduct a risk based approach for unannounced site visits; incorporating policies and procedures to ensure enforcement of limitation on subcontracting such that at least 50% of costs on small business employees; and ensure policies and procedures are in place for prompt reporting of fraud to the SBA Office of Inspector General

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67 13 CFR 124.104©
68 13 CFR 124.105
69 13 CFR 124.520(h)
71 GAO, *HUB Zone Program Fraud and Abuse Identified in Four Metropolitan Areas*, GAO-09-440 (March 2009), hereinafter, GAO-09-440.
and SBA Suspension and Debarment Official. SBA argued that contracting officers should perform this verification to enforce limitation on subcontracting. When SBA confirmed ineligibility, SBA removed the firms from the HUBZone program (4 out of 10 at date of report).

II.3. SDVOSB Program Fraud

GAO “identified 10 case-study examples of firms that did not meet SDVOSB program eligibility requirements, which received approximately $100 million in SDVOSB contracts, and over $300 million in additional … federal government contracts.” Basis of ineligibility included, majority owner not a service-disabled veteran, subcontracting beyond the limitation in subcontracting, not being a small business, and non-service disabled veteran manages and controls the firm. GAO noted that SBA does not have processes in place for SBA to verify eligibility, and does not have access to the ‘VA service-disabled veteran’s database listing individuals that are valid service-disabled veterans.”

GAO also noted “even when firms are found ineligible to receive a contract, they can still retain it because current regulations do not require that the contracting agency terminate the contract. In addition, none of the firms found ineligible by the SBA through SDVOSB-status protests were suspended or debarred from receiving SDVOSB and other government contracts.” GAO recommends Congress and Office of Federal Procurement Policy (OFPP) expand the Department of Veteran Affairs (VA)

73 GAO-09-440, page 25.
75 GAO-09-440, page 20.
76 GAO, Service-Disabled Veteran Owned Small Business, Case Studies Show Fraud and Abuse Allowed Ineligible Firms to Receive Millions of Dollars in Contracts, GAO-10-255T (November 19, 2009) page 3, hereinafter GAO-10-255T.
77 GAO-10-255T page 5-8.
78 GAO-10-255T page 9.
79 GAO-10-255T page 9.
maintained Vetbiz, database of verified SDVOSB from only VA use to government wide use. GAO also recommended that SBA require that all contractors who knowingly misrepresent their status as an SDVOSB be debarred for a reasonable period of time and be referred to the SBA OIG for investigation. VA agreed with the recommendations but recommended that specific authority be granted to other agencies to rely on VetBiz.

III.D. GTSI Suspension

On October 1, 2010, the Small Business Administration (SBA), suspended GTSI for performing more than 50% of work for small business set asides as a large business subcontractor despite the requirement that small business subcontractor perform at least 50% of the work of the contract with its employees. Per the administrative agreement between SBA and GTSI dated October 19, 2010, SBA lifted the suspension of GTSI. Per the agreement, the GTSI Chief Executive Officer (CEO) and Chief Counsel resigned from GTSI. GTSI agreed to submit to SBA for approval prior to submitting for small business contracts as a prime contractor or subcontractor. GTSI also agreed to comply with the small business limitation on subcontracting under 13 CFR 125.6 (which means as a large business subcontractor GTSI could not perform more than 50% of the work). GTSI was to implement an independent monitor on

80 GAO-10-255T page 11.
81 GAO-10-255T page 11.
82 GAO-10-255T page 11.
84 13 CFR 125.6; FAR 52.219-14.
86 GTSI Agreement, page 3.
87 GTSI Agreement, page 6.
88 GTSI Agreement, page 5.
ethics and subcontracting compliance to review GTSI requests to submit proposals as a subcontractor or prime contractor for small business contracts and monitor GTSI compliance with limitation in subcontracting. GTSI was to implement a Contractor Code of Business Ethics and Conduct per a FAR 52.203-13, including an Ethics Officer, Code of Ethics, training, hotline, and internal audits of ethics compliance program. Since FAR 52.203-13 became final in 2008, it is surprising it took until GTSI suspension occurred in 2010 to implement a compliance program. The SBA suspension of GTSI for deliberate and repeated violations of small business rules, while harsh, was appropriate. It is unfair to a large contractor intentionally perform more than 50% of the work for small business contracts, in violation of the small business regulations.

IV. Congressional and SBA Solution: Small Business Contracting Fraud Prevention Act

On September 21, 2011, the US Senate passed the Small Business Contract Fraud Prevention Act (SBCFPA) of 2011. The bill is pending at the US House of Representatives for a vote. An overview of the SBCFPA follows.

Under SBCFPA, a person who makes a misrepresentation of small business eligibility including SB, SDB/8(a), HUBZone, SDVOSB, and WOSB is liable under the False Claims Act under 31 USC 3729-3733. Note, currently, such a misrepresentation may result in criminal liability under 15 USC 645(d)(2) and administrative remedies under the Program Fraud Civil Remedies Act (31 USC 3801-3812). The certification must be in writing or through the Online

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89 GTSI Agreement, page 7-9.
90 GTSI Agreement, page 9-11.
92 S 633 (passed Senate September 21, 2011) http://www.opencongress.org/bill/112-s633/show, hereinafter, SBCFPA.
93 15 USC 645, SBCFPA proposed section 3(d) and 3(g).
Representation and Certifications Application (ORCA). A person’s liability for misrepresentation shall be for contract funds paid to the person as a result of representation, without regard to fair market value of property of services provided. A person who submits an invoice for a SB, SDB/8(a), HUB, SDVOSB, and WOSB includes an implied certification that the small business prime contractor performed the required percentage of work (50% for services). A false certification results in liability of person making such representation under 15 USC 645(d)(2).

For 8(a), SBCFPA requires SBA to evaluate the feasibility of use of third party sources, unannounced visits, fraud detection tools, and financial analysis to verify 8(a) eligibility. SBCFPA requires SBA to evaluate amending regulations to include spouse’s assets to determine net worth, and develop more consistent enforcement strategy regarding suspension and debarment for knowing misrepresentation of 8(a) eligibility. SBCFPA requires SBA to include income and asset limits for 8(a) firms, and limit ability of small business owners to get 8(a) if immediate family member received 8(a) in same or similar line of business. SBA revised the regulations for these two items with the final rules on February 11, 2011.

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94 SBCFPA proposed section 3(e).
95 SBCFPA proposed section 3(d)(3)(B) and (C); Note: this change where there is no reduction in damages for value received by the government was requested by SBA OIG prior to March 2011, http://www.sba.gov/content/peggy-e-gustafson-inspector-general-us-small-business-administration-before-small-business-and-entrepreneurship-committee (last visited December 12, 2011).
96 SBCFPA proposed section 3(h).
97 15 USC 645, SBCFPA proposed section 3(h).
98 15 USC 637(a); SBCFPA proposed section 5(b)(1).
99 SBCFPA proposed section 5(b)(1).
100 SBCFPA proposed section 5©.
For SDVOSB, SBCFPA requires annual certification for SDVOSB on ORCA and to register on Central Contractor Representation (CCR) and VetBiz. The SBCFPA requires VA to determine SDVOSB eligibility for those firms registered on VetBiz, including whether the firm is owned and controlled by a veteran or service disabled veteran. VA and OFPP shall ensure that data from Vetbiz is integrated with CCR.

For HUBZone, SBCFPA requires SBA to implement policies to ensure that only small business that qualify as HUBZone companies participate in the program. SBA is to file annual suspension and debarment report with Congress including whether actions based on indictments or convictions.

On October 24, 2011, the SBA proposed similar rules to the US Senate passed SBCFPA entitled “Small Business Size and Status Integrity.” The SBA proposed SBSASI imposes similar false claims act liability for misrepresentation of small business program eligibility as the SBCFPA. Per the SBSASI, SBA proposes, for all small business contracts there is irrefutable presumption of loss to the US government of the total amount expended on the contract under the False Claims Act, if it is established that the business concern was other than small and willfully sought and received award by signed misrepresentation. The regulations include a deemed certification by proposal for small business solicitation or registration in federal electronic database for purpose of being considered for award as a small business

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102 15 USC 633, SBCFPA proposed section 4(b)(g)(1).
103 15 USC 633, SBCFPA proposed section 4(b)(g)(2).
104 SBCFPA proposed section 4©.
105 15 USC 632(p), SBCFPA proposed section 6(b)(2).
106 SBCFPA proposed section 7.
The regulations include a limitation of liability for unintentional errors where misrepresentation was not willful, but due to ambiguity or failure to timely correct error. This is appropriate because sometimes there could be good faith erroneous misrepresentations based on misinterpretation of law. Small business must annually certify size eligibility annually on ORCA. Penalties for misrepresentations include suspension and debarment, False Claims Act (31 USC 3729-3733), Program Fraud Civil Remedies Act (31 USC 2801-3733), Criminal False Statements (18 USC 1001) and 15 USC 645. In SBSASI, SBA proposed similar regulations for 8(a), SDB, SDVOSB, HUBZone, and WOSB.

V. Primary Small Business Fraud Enforcement Mechanism False Claims Act

If SBCFPA or SBSASI becomes law, small businesses will jeopardize their survival with a contract award based on an eligibility misrepresentation, with possible damages of gross invoices. Actions for damages will primarily be by Civil False Claims, including Qui Tam Suit. For 2010, there were $3 billion recovered under Civil False Claims, $2.4 billion by Qui Tam, and balance by Department of Justice (DOJ). For 2010, there were 573 Qui Tam actions and 136 DOJ actions.

110 SBSASI proposed 13 CFR 121.108(d), 76 Fed. Reg. at 62317.
112 SBSASI proposed 13 CFR 121.108(e), 76 Fed. Reg. at 62317.
118 John, T. Boese, Fundamentals of the Civil False Claims Act and Qui Tam Enforcement, June 2011, American Conference Institute, Life Sciences Qui Tam & False Claims Litigation.
119 Id.
V.A. Civil False Claims Act 37 USC 3729

Under the Civil False Claim Act (CFCA), “[a]ny person who … knowingly makes, uses, or causes to be made or used, a false record or statement material to a false or fraudulent claim; is liable to the United States Government for a civil penalty of not less than $5,000 and not more than $10,000, plus three times the amount of damages which the Government sustains because of the act of that person….the terms “knowing” and “knowingly”[includes] in reckless disregard of the truth or falsity of the information… Please note that the Small Business Contract Fraud Prevention Act says that liability is to the extent of invoice, not three times the amount of damages which the Government sustains.

Prior to SBCFPA an 8(a) company was held liable under CFCA for withholding subcontract information that would have rendered 8(a) company ineligible for 8(a) contract for $10,000 per invoice only. Please note that the government requested but did not receive three times invoice amounts because contract was performed.

V.B. Qui Tam Suit 37 USC 3730

Qui Tam Suit allows action by a private person under 37 USC 3729 (civil false claims). If SBCFPA or SBSASI becomes law, competitors and disgruntled former employees may use Qui Tam to bring false claims for small business fraud. The private party must provide the government with a "complaint and written disclosure of substantially all material evidence and information" possessed. The government should either intervene or not with 60 days of

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120 37 USC 3729.
121 SBCFPA proposed section 3(d).
122 37 USC 3729.
125 37 USC 3730(b)(2).
receipt of the complaint"126 DOJ internes in 22% of cases.127 Range of recovery 15-25% to relator if government intervenes,128 or 25-30% plus reasonable costs, if government does not intervene.129 No Qui Tam allowed for matters or transactions if government already a party to a civil suit or administrative proceeding, or investigation by GAO, Congress or Attorney General, or if public disclosure of fraud, unless Qui Tam brought by original source, who has direct and independent knowledge of allegations.130

VI. Other Enforcement Mechanisms

Other enforcement mechanisms include protests, suspension and debarment, and criminal penalties. Protest is a onetime eligibility event. While suspension and debarment may result from criminal prosecution, criminal penalties are the most severe of the other enforcement mechanisms for the contractor.

VI.A. Protest (13 CFR 1001-1010) and Possibly Voiding Contract

Small Business size and eligibility protest are a means for industry to police itself. Offeror, contracting officer (CO), or SBA may file size protest,131 and protest must be filed with CO within 5 working days of notice of award.132 CO refers protest to SBA.133 SBA requests protested firm complete SBA Form 355 (form asks for gross receipts from tax returns but not actual tax returns).134 SBA to decide protest with 15 business days if possible.135 SBA performs a

126 37 USC 3730(b)(4).
128 37 USC 3730(d)(1).
129 37 USC 3730(d)(2).
130 37 USC 3730(e).
131 13 CFR 121.1001.
132 13 CFR 121.1004.
133 13 CFR 121.1006.
134 13 CFR 121.1008.
135 13 CFR 121.1009.
fact specific inquiry when size appeal is based on affiliation, based on SF 355. Where there is “no [common] current stockholders, directors, officers, key employees, secretaries, or office space … [nor], financial, technical, or subcontracting assistance [and] no contractual relationships,” there is no affiliation. Other grounds for protest include SDVOSB eligibility and HUBzone eligibility.

For example, during a protest of eligibility, SBA’s basis of company failure to meet HUBZone requirement that the principal office be in a HUBZone at time of proposal. SBA decertified the company as ineligible as a HUBzone contracts and eliminated the company from competition of the HUBZone solicitation. The ordering agency may also terminate the contract that was awarded based on HUBZone solicitation. When a government contract is tainted from the beginning by fraud such as misrepresentation of small business status, the contract is voidable by the agency without additional compensation or claim by the contractor.

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137 CS-360, LLC v. United States, 94 Fed. Cl. 488 (2010) (An agency may require a company to be registered in the VetBiz Vendor Information Page (VIP) to submit a proposal to a SDVOSB solicitation, and VA determination that company is not a SDVOSB is grounds for exclusion of the company from the solicitation).
138 Mark Dunning Indus. v. United States, 64 Fed. Cl. 374 (2005) (Where SBA determines a company is qualified as a HUBZone, and the determination is rational and supported by the record, the determination will be upheld); Aeolus Sys., LLC v. United States, 79 Fed. Cl. 1 (2007) (SBA may rule that person who deferred compensation from company is not an employee for determining HUBZone eligibility, and company does not meet the requirement that at least 35% of employees live in HUBZone).
139 RCD Cleaning Serv. v. United States, 97 Fed. Cl. 582, 599 (2011).
140 RCD Cleaning Serv. v. United States, 97 Fed. Cl. 582 (2011).
141 RCD Cleaning Serv. v. United States, 97 Fed. Cl. 582, 585 (2011).
142 J.E.T.S, Inc. v. United States, 838 F.2d 1196, 1200 (Fed. Cir. 1988); See also, 45 S. Tex. L. Rev. 23, 51.
VI.B. Suspension and Debarment (FAR 9.4)

SBA OIG suspended or debarred 26 contractors from FY 2009 to March 2011.\footnote{143 SBA IG Gustafson Testimony, \url{http://www.sba.gov/content/peggy-e-gustafson-inspector-general-us-small-business-administration-before-small-business-and-entrepreneuship-committee} (last visited December 12, 2011).}

SBA Inspector General Peggy Gustafson said “[m]ost of our investigations of procurement fraud involve false statements by those who seek to exploit SBA programs for their personal gain by either: (1) falsely claiming to meet eligibility criteria; or (2) fraudulently using an eligible business as a “pass-through” so that an ineligible company will actually perform the work and receive most of the profits.”\footnote{144 Id.}

SBA OIG has only 110 employees, including criminal investigators, auditors, or attorneys.\footnote{145 Id.} Note there is also a short fall of the number of acquisition professionals relative to need.\footnote{146 Judi Hassan, \textit{Head of the Class: the VA Solution for Acquisition Talent Shortage}, AOL Government (October 3, 2011), \url{http://gov.aol.com/2011/10/03/head-of-the-class-the-vas-solution-for-acquisition-talent-shor/} (last visited December 12, 2011).} The short falls of government enforcement and acquisition professionals has caused the FAR Council to place more duties on contractors to have ethics compliance programs,\footnote{147 Federal Contractor Business Ethics Compliance Program and Disclosure Requirements, 73 Fed. Reg. 67064, 67091 (FAR Case 2007-006) (Nov. 12, 2008) (codified at FAR Subpart 3.10, Part 9, and FAR 52.203-13).} OCI avoidance systems,\footnote{148 Federal Acquisition Regulation: Organizational Conflicts of Interest, 76 Fed. Reg. 23236 (FAR Case 2011-001) (Apr. 26, 2011) (to be codified at FAR 2, 3, 4, 7, 9, 11, 12, 13, 14, 15, 16, 18, 37, 42, 52, and 53) [Proposed OCI regulations].} and PCI avoidance systems,\footnote{149 Preventing Personal Conflicts of Interest for Contractor Employees Performing Acquisition Functions, 74 Fed. Reg. 58584 (Nov. 13, 2009) (FAR Case 2008-025) (to be codified at FAR 3.1100 and 52.203-16) [Proposed PCI regulations].} and to increase the penalty for failure to follow the FAR and small business regulations. The FAR Council should also look to ways to

\begin{flushright}
144 Id.
145 Id.
148 Federal Acquisition Regulation: Organizational Conflicts of Interest, 76 Fed. Reg. 23236 (FAR Case 2011-001) (Apr. 26, 2011) (to be codified at FAR 2, 3, 4, 7, 9, 11, 12, 13, 14, 15, 16, 18, 37, 42, 52, and 53) [Proposed OCI regulations].
149 Preventing Personal Conflicts of Interest for Contractor Employees Performing Acquisition Functions, 74 Fed. Reg. 58584 (Nov. 13, 2009) (FAR Case 2008-025) (to be codified at FAR 3.1100 and 52.203-16) [Proposed PCI regulations].
\end{flushright}
automate enforcement by providing enforcement and acquisition government officials’ access to online tax returns for companies claiming to be small businesses through CCR.

For a company that relies heavily on government contracts for revenue, suspension and debarment can be business threatening event. As we saw with GTSI and IBM (on week suspension in April 2008)¹⁵⁰ suspension and debarment for large companies tend to be short, where as for small companies, a death sentence. “Contractors debarred, suspended, or proposed for debarment are excluded from receiving contracts.”¹⁵¹ Debarment is for three years.¹⁵² Notwithstanding the debarment, suspension, or proposed debarment of a contractor, agencies may continue contracts or subcontracts in existence.”¹⁵³ Causes of debarment include “conviction of or civil judgment for— (1) Commission of fraud or a criminal offense in connection with— (i) Obtaining; (ii) Attempting to obtain; or (iii) Performing a public contract or subcontract,”¹⁵⁴ false statement,¹⁵⁵ “[c]ommission of any other offense indicating a lack of business integrity or business honesty that seriously and directly affects the present responsibility of a Government contractor.”¹⁵⁶ Per 15 USC 645(d)(2)© misrepresentation of small business, 8(a), HUBZone, or WOSB eligibility is grounds for debarment as lack of business integrity.

Debarring agency is to provide notice of debarment to the contractor and provide an opportunity to respond by the contractor.¹⁵⁷ In “actions based upon a conviction or civil judgment, or in which there is no genuine dispute over material facts, the debarring official shall

¹⁵¹ FAR 9.405(a).
¹⁵³ FAR 9.405-1(a).
¹⁵⁷ FAR  9.406-3 (b) and (c).
make a decision on the basis of all the information in the administrative record.”\textsuperscript{158} The debarring official should consider “the seriousness of the contractor’s acts or omissions and any remedial measures or mitigating factors should be considered in making any debarment decision.”\textsuperscript{159} Please note for a small business frequently the owner is the primary business manager who make small business representations, so effective mitigating factors may include cooperation and disciplining employees but less likely to effectively include disciplining management, training, and internal control.

“Suspension is a serious action to be imposed on the basis of adequate evidence, pending the completion of investigation or legal proceedings, when it has been determined that immediate action is necessary to protect the Government’s interest.”\textsuperscript{160} Causes for suspension are similar to debarment.\textsuperscript{161} Suspension procedures include notice to the suspended contractor followed by an opportunity to respond, which may occur after the contractor is suspended.\textsuperscript{162}

\textbf{VI.C. Criminal False Statements (15 USC 645 and 18 USC 1001)}

15 USC 645 appears to be the primary criminal enforcement tool for small business misrepresentations. 15 USC 645(d) states that a person who misrepresents the status of a concern as a small business, HUBZone, woman owned and controlled, or owned and controlled by socially and economically disadvantaged individuals to obtain these type of prime or subcontracts shall “be punished by a fine of not more than $500,000 or by imprisonment for not

\textsuperscript{158} FAR 9.406-3(d)(1).
\textsuperscript{159} FAR 9.406-1(a) (Mitigating factors include the contractors internal control system, degree of cooperation by the contractor with the government, whether the contractor paid for all liability caused by the improper activity, whether the contractor took appropriate remedial action to avoid further violations, including discipline employees involved in violations, updating ethics training, and updating internal controls).
\textsuperscript{160} FAR 9.407-1(b)(1).
\textsuperscript{161} FAR 9.407-2.
\textsuperscript{162} FAR 9.407-3.
more than 10 years, or both.” Such person shall also “be subject to the administrative remedies prescribed by the Program Fraud Civil Remedies Act of 1986 (31 U.S.C. 3801–3812) [$5,000 per claim or two times claim].” The representation must be in writing.\textsuperscript{163} 18 USC 1001 also outlaws criminal false statements and also states that whoever knowingly and willfully makes any materially false, fictitious, or fraudulent statement or representation in a matter within the jurisdiction of the Federal government shall be fined and imprisoned not more than 5 years. These statutes have been used to prosecute eligibility misrepresentations of HUBZone, SDVOSB,\textsuperscript{166} and small business.\textsuperscript{167} It appears that the most severe cases of small business fraud are criminally prosecuted.

\textbf{VII. Recommendations}

Small business eligibility fraud prevention would be improved if the SBA and other Federal procurement officials could have online access to tax records maintained by the IRS for CCR

\textsuperscript{163} 15 USC 645(d)(2)(B).
\textsuperscript{164} 15 USC 645(e).
\textsuperscript{165} United States v. Richards, 393 Fed. Appx. 266, 2010 U.S. App. LEXIS 17964 (6th Cir. 2010) (A person submitting a false application for a HUBZone firm, including statement that firm had two employees, one of whom lived in the HUBZone, when in fact the firm had no employees, may be convicted under 15 USC 645(a) for a fine of $5000 or two years of prison or both ).
\textsuperscript{166} Busted, Vol. 2, No. 3, May-June 2011, \url{http://www.bluepointgov.com/newsletter/May-June2011.pdf} (last visited December 12, 2011) (On April 11, 2011, a Brooklyn man was convicted for falsely claiming SDVOSB status on bids to the VA and Army, even though he never actually served in the military, but the man claimed to hurt his back in the Navy ROTC and special forces).
\textsuperscript{167} SBA OIG Newsletter (June 2011), \url{http://www.sba.gov/sites/default/files/June%202011%20Monthly%20Update.pdf} (last visited December 12, 2011) (“The indictment [of two Florida men] alleges that the subjects devised a scheme whereby they created a company for the purpose of obtaining a $100 million small business set-aside contract with the Department of Defense (DoD). The subjects used a nominee owner to create the appearance that their company was not affiliated with a consultant firm that they controlled. Their firm had been the incumbent contractor on a previous DoD contract. The subjects allegedly submitted false and misleading information concerning the relationship between the two companies after the affiliation was challenged in the course of a size protest submitted to the SBA Office of Government Contracting.”)
registered companies. Such a tool could be integrated in with small business evaluation procedures such that COs are required to verify through tax return information a small business eligibility prior to award of a small business or other social economic contract.

The approach would create an IRS portal whereby Federal contracting officers, SBA, and OIG can look up the most recent three years of tax returns for businesses registered in CCR. The portal could be by interface to CCR, limiting access of data for CCR registered companies by government officials. The FAR would need to require that the contracting officers and SBA confirm eligibility of the firm prior to award of a small business contracts. The technical approach would involve a data refresh of CCR databases based on existing IRS databases. The effort would need funding. Privacy concerns would be mitigated by limiting access to Federal procurement officials, SBA and OIG and by limiting companies that can be researched to CCR participants that claim to be small businesses. Benefits would include increase reliability of size certifications and would catch parent – subsidiary affiliation as part of tax returns, but not informal affiliation.

This approach of on line tax return confirmation system for small business certifications would be enhanced if small business statutes and regulations were amended as follows:

- Amend small business size eligibility to be based on one year tax return not three years for revenue based eligibility.\(^{168}\)
- Require on time filing of tax returns without extension for those companies claiming to be small business.\(^{169}\)
- Convert employee based size standards to receipt based size standards.\(^{170}\)

\(^{168}\) 15 USC 632(a)(2)(C); 13 CFR 121.104©.
\(^{169}\) 13 CFR 121.104 (needs amendment).
\(^{170}\) 15 USC 632(a)(2)(C); 13 CFR 121.102; 13 CFR 121.106.
Amend the rule that if a firm is small when submitting a proposal for a small business IDIQ contract (such as GSA Alliant Small Business, GSA STARS II and FAA EFAST) the IDIQ contract remains small until the next size certification with an option or acquisition to require small business certification with every small business proposal under a small business IDIQ for the contractor to receive task order award under the IDIQ.\textsuperscript{171}

US Senator Claire McCaskill has introduced the “Fairness for Small Business in Federal Contracting Act of 2011,” which would require SBA to replace the current NIACS code size standards with a more streamlined 20 industry based system.\textsuperscript{172} If this bill passes the Senate and House, SBA could base all size standards on receipts. A receipts based standard is preferred as more verifiable through federal tax returns than an employee based standard.

By automating online review of tax returns, requiring that Federal procurement official’s review these tax returns prior to award of a small business contract, and tighten the small business regulations and size standards, the integrity of the small business regulations can be improved.

VIII. Conclusion

The Small Business Contract Fraud Prevention Act (SBCFPA) of 2011\textsuperscript{173} as passed by the Senate in September 2011 adds civil false claims act liability to companies that false certify eligibility for small business contracts and compliance with limitation in subcontracting,

\textsuperscript{171} 13 CFR 121.404(g); “Small Business Size Regulations; Size for Purposes of Government Wide Acquisition Contracts, Multiple Award Schedule Contracts and Other Long Term Contracts; 8(a) Business Development / Small Disadvantaged Business; Business Status Determinations,” 71 Fed. Reg. 66434 (November 15, 2006)

\textsuperscript{172} S.1590 (introduced to Senate September 20, 2011) http://www.opencongress.org/bill/112-s1590/show.

including liability to the gross amount paid under the contact without deduction for value received. SBCFPA is in response to a series of recent GAO audit reports on 8(a), HUBZone, and SDVOSB, where GAO found that some small businesses were misrepresenting their eligibility for contracts and compliance with limitation in subcontracting. The SBA also proposed the “Small Business Size and Status Integrity” regulations\(^{174}\) that implement SBCFPA as well as 15 USC 645, which criminalizes small business eligibility misrepresentation. These efforts are intended to put the fear of God\(^{175}\) in small business and their principals and management to incentive compliance while there is a shortfall of acquisitions and enforcement personnel to otherwise enforce compliance. This paper recommends an automated tool whereby government officials can verify small business eligibility by reviewing tax returns. Such an approach would require minor changes to small business statutes and regulations and the FAR, but would efficiently improve the integrity of small business size certifications.


\(^{175}\) Commandment 8, “You shall not steal,” Exodus 20:3-17.