3 Trouble Spots For Government Contractors

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In the current economy, contractors are being forced to expand what work they do and enter new areas of work. This includes, for many companies, bidding for federal contracting work for the first time, seeking preference certifications from public entities (such as Small Business Enterprises (SBE), Minority or Women-Owned Business Enterprises (MBE/WBE), Hub Zones, 8(a) or Disabled Veteran Owned Small Business Enterprises (DVOSBE)); or partnering/mentoring/teaming with companies that have those certifications to bid for public projects.

While federal work has been (particularly given the federal stimulus program) very important to many contractors over the past few years, doing federal work also subjects contractors to additional legal and contractual requirements that may cause an unwary contractor to get into serious trouble.

According to the U.S. Government Accountability Office, a large percentage of contractors have misrepresented facts to the government related to their size, location, ownership status or other relevant details to either obtain, or maintain, their preference certifications, ostensibly committing what the federal government may consider to be a fraud on the government.

Similarly, some large prime contractors have obtained work by promising to institute certain subcontracting plans designed to increase small and minority business involvement in the community and then, after the contract is awarded, failed to comply with their own plans.

As a result, the federal government has started taking a much harder look at federal contractors to ensure they are not misrepresenting facts, and Congress has enacted legislation making it easier for prosecutors to pursue people who are acting fraudulently. See Small Business Jobs Act of 2010.

This article highlights three areas that have been identified by the federal government that, if not properly addressed, can lead to substantial problems for contractors performing federal work: 1) submitting false claims; 2) improper certification related to being a "preferred" contractor; and 3) failing to follow the subcontractor plans with regard to preferred-status subcontractors.

Hopefully, by highlighting the fact that these issues are being scrutinized more heavily, contractors can take the extra effort to ensure that their companies not only get the work, but that they comply with the federal laws and avoid prosecution or other repercussions.

Payment applications on federal projects are certified by contractors submitting them, and any false or misleading statements can be violations of the federal False Claims Act — making the contract voidable.

Payment applications on federal projects must be certified as being proper and accurate at the time submitted. See Federal Acquisition Regulation (FAR) 52.232-5(c). Submitting a false or misleading statement in a payment application constitutes a violation of the federal False Claims Act, which gives the federal government the right to seek damages for the false claim and void the contract in question. See 31 U.S.C. 3729.

Thus, a contractor submitting payment applications on federal projects must ensure the applications accurately reflect the condition of a project at the time the application is submitted. Contractors cannot, as they may have on private projects, seek reimbursement for

expenditures that have not yet been paid or otherwise seek to manipulate the process to obtain reimbursement for uncompleted work.

For example, in Morse-Diesel v. United States, 74 Fed. Cl. 601 (2007), a contractor sought to recover approximately $53 million for claims it submitted to the government related to several change-order claims on a number of federal courthouse projects. The federal government counterclaimed, alleging that the contractor had violated the False Claims Act by submitting certified payment applications indicating it had paid for surety bonds before it had actually paid for the bonds.

The U.S. Court of Federal Claims agreed with the government, holding that the contractor had submitted false claims when it submitted certified payment applications for items it had not paid. The court thus denied the contractor's entire $53 million claim because the contractor submitted a payment application seeking reimbursement for purchasing bonds that it had not yet purchased (though it did eventually purchase them) too early, it allowed the government to recover damages for the false claims against the contractor.

In sum, in submitting payment applications on federal projects, contractors must be particularly cautious in ensuring that all of the issues outlined in a payment application are valid and appropriate at the time, and should be very careful if there is any question about he appropriateness of a claim. More to the point, if there is a real question about when and how to submit a claim, contractors should consider consulting with experienced legal counsel to ensure that a minor issue does not result in a major loss.

Contractors must ensure that when they submit information to obtain a particular certification for a governmental preference, the certification is true and correct.

In obtaining any of the certifications that entitle contractors to obtain preferences for economically disadvantaged entities in bidding for federal work, contractors are required to make numerous affirmative representations about their company to the federal government.

For example, they may have to certify that a particular person is of a particular minority status, is a majority owner of a company, or that the person has a certain net worth entitling them to a particular certification. Similarly, they may be required to certify the amount of work that the company has done over the last year, particularly to qualify as an SBE.

Recently, a number of studies by the GAO have found that entities all over the country that have submitted information related to obtaining these certifications did not, in fact, meet the underlying requirements of these programs. Moreover, they were in fact submitting false and/or misleading statements to the government.

The GAO also found a number of other entities were failing to timely update certifications, failing to note when they no longer qualified for preferences, and/or were not operating as they represented they were when they obtained the certifications.

As a result, there has been a substantial effort by the federal government to identify companies that are acting as SBEs/DBEs/WBEs when they are not entitled to do so and to punish those entities, both by requiring reimbursement of funds improperly paid to these entities for work they obtained as a result of the "certification," and possible criminal prosecution.

Additionally, in adopting the Small Business Jobs Act of 2010, Congress and the president strengthened the legal tools that can be used by procurement officers and federal prosecutors when companies are found to have improperly obtained certification and obtained contracts as a result.

Under the new law, there are increased reporting requirements placed on any entity seeking certification as an economically disadvantaged company that will

require a contractor to affirm its status on a regular basis. The act also changes the burden of proof for demonstrating that an improperly certified company has acted illegally, creating the legal status of "presumption of loss" for each project that is improperly obtained, and making it much easier for the federal government to prove that the money was obtained inappropriately.

This will allow federal agencies, including the U.S. Department of Justice, to claim a loss on a purchase as a matter of law and vigorously pursue fraudulent firms for reimbursement.

Cracking down on large prime contractors who are failing to comply with set-aside programs, including their own subcontracting plans.

On the other end of the spectrum, larger prime contractors who are submitting bids for large projects that include subcontracting plans need to make sure that those plans to afford small and minority businesses opportunities are not only submitted to the government, but are (to the extent possible) actually performed on the project.

Large contractors bidding regularly submit plans in which they agree to subcontract portions of their work on certain projects to small or minority-owned business entities. The recent GAO reports (and certain anecdotal evidence), however, indicate that after being awarded projects, some prime contractors fail to follow through on their plan and do not provide adequate opportunities to certified subcontractors. There appear to be at least three ways in which prime contractors may be failing to comply with their obligations under subcontractor plans.

First, sometimes, because of the current economy, a contractor with the best of intentions is simply unable to meet its subcontracting plan goals on a project for various reasons, such as an SBE sub going out of business or a shortage of MBE companies in a particular area. In these cases, if properly documented and explained, contractors can usually avoid substantial penalties from the federal government.

Second, some prime contractors are ignoring the requirements and just hoping not to get caught. These entities are pledging to ensure that a certain percentage of their work will go to SBE/MBE/WBE companies but do not make an adequate effort to meet those percentages.

Third, certain general contractors have been working out deals with minority entities in which the smaller entity acts as a pass-through company, essentially acting solely as a payroll or other service for the prime while employing the prime's employees to perform work.

In all instances, the federal government is starting to look much more seriously at the way that prime contractors are meeting their subcontractor plans, and starting to prosecute companies that do not do what they said they would do. In the past six months, two major construction companies in New York have been prosecuted for fraud because they were awarded contracts based on promises of small business participation that they did not provide on the project.

One of those companies has already entered into a settlement that includes changing internal policies to ensure compliance with subcontracting goals, plus paying a $20 million fine.[1] In other words, the federal government is starting to crack down on this type of activity.

1 A Subcontracting Plan is a defined term within the Federal Acquisition Regulations ("FAR"). Subcontracting Plans are required by the general contractors who bid for federal projects of a certain size, and require the contractor to develop a plan for providing opportunities to smaller disadvantaged businesses by providing them with subcontract work on various federal projects. See; Subpart 19.7 (Small Business Subcontracting Program). Generally, that plan involves committing to recruit a certain percentage of subcontractors/suppliers who are small or disadvantaged businesses for work. Plans can be organized by project, by division or by company, depending upon your company's size and involvement in federal contracting. For more information on establishing a Subcontracting Plan, including how and why to do so, please contact an experienced construction attorney.

To assist in this crackdown, the Small Business Jobs Act strengthens requirements related to subcontractor plans in projects and reporting for large companies. The new act mandates additional reporting related to small business participation in federal projects, requires any contractor who fails to meet their own agreed-to subcontractor plan to explain why they are unable to meet their own plan, and allows for certain penalties to be issued, including disclosure of the failure to comply with these requirements to other public entities (making it more difficult for them to get future work), on a going-forward basis.

Any company that fails to comply with its own subcontracting plan will likely face substantial new risks as a result of the Small Business Jobs Act, and must take adequate steps to protect itself in those instances. If this is a concern for your company, you should contact an experienced construction attorney before bidding on federal work or if a problem arises later.

Conclusion

It is important for all contractors doing federal work to understand that it is not enough to just provide the lowest bid and perform the work. Federal contractors also have to perform the work in compliance with federal laws. Compliance with federal guidelines related to these programs is being strictly enforced, and companies that fail to meet the applicable statutes and the FAR do so at their own peril.

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