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Breakfast Briefing

Time to Update Your Internal Controls:

**Take Steps Now to Limit Liability from Severe
Civil and Criminal Penalties**

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Summary of Small Business Size and Status Integrity Final Rule

- Statutory and Regulatory Basis:
 - Small Business Jobs Act of 2010 (Pub. L. 111-240)
 - Final Rule – 78 Fed. Reg. 125 (June 28, 2013)
- Presumption of loss based on total amount expended, not actual loss
- Submission of offer is deemed an affirmative, willful and intentional certification of size and status



Summary of Small Business Size and Status Integrity Final Rule

- Limitation of liability for unintentional errors, technical malfunctions or other similar situations demonstrating misrepresentation was not intentional
- Severe penalties (suspension and debarment, civil and criminal fraud penalties)
 - How will courts treat the “deemed intentional certification” with the state of mind requirements under the False Claims Act? Forfeiture of Fraudulent Claims Act? Common law fraud?



Why All Contractors Should Care

- Rule focused on SBs
 - Will be a particular burden to those growing firms that are continually straddling the line between small and large
- Rule also has implications for large businesses
 - Rule applies not only to SB set-asides, but also procurements where a portion of the work is intended for SBs (e.g., small business plan as part of source selection factors?)



Why All Contractors Should Care

- “SBA’s intent that the rule be broadly inclusive of set-asides, reserves, partial set-asides, price evaluation preferences, source selection factors, and any other mechanisms which are not specifically addressed by the FAR.”
- Even though rule says it is not the intent for prime contractors to be liable, prime contractors (large and small) will have to demonstrate “good faith” reliance on subcontractor’s representation. See FAR 19.703(b).



Why All Contractors Should Care

- SBA says this insulates prime contractors acting in good faith from liability, but what is “good faith” and how will a large or small prime contractor demonstrate it?



Need To Implement Or Update Internal Controls

- Whether you are a sub or prime, large or small, you need to implement or update internal controls.
- For small businesses misrepresenting your size, internal controls are key to ensure that any proposal submission or certification is 100% accurate.
 - Final rule establishes limitation of liability “in the case of unintentional errors, technical malfunctions, and ***other similar situations*** that demonstrate that a misrepresentation of size was not affirmative, intentional, willful.”



Need To Implement Or Update Internal Controls

- Note that final rule changed “shall” to “may” to ensure that a judge has discretion whether to limit liability – there is no guaranteed limitation.
- “[O]ther similar situations” are likely to be limited; ignorance of the law (i.e., the size standard or affiliation rules) is usually not a viable defense.
- The presence of strong internal controls are unlikely to mitigate against the presumption of loss and deemed certification if the controls do not prevent a misrepresentation.
 - Instead, it is imperative that businesses have controls in place to prevent a misrepresentation in the first place.



Need To Implement Or Update Internal Controls

- For prime contractors, the final rule gives guidance on when relying on a subcontractor's representation is in good faith:
 - “Relevant factors to consider in making this determination may include the firm's *internal management procedures governing size representation or certification*, the clarity or ambiguity of the representation or certification requirement, and the efforts made to correct an incorrect or invalid representation or certification in a timely manner.”
 - The rule suggests that primes need to take proactive steps and conduct due diligence to screen potential subcontractors in order to get the benefit of the “good faith” limitation on liability.



Type Of Controls To Implement

- Compliance begins with understanding the applicable law.
 - Identify the size standard at issue (NAICS code) and relevant status (8(a), small disadvantaged business, SDVO, HUBZone, and EDWOSB/WOSB)
 - Checklist of size and status eligibility requirements



Type Of Controls To Implement

- Verify size
 - Average annual receipts/total number of employees.
 - Are you accurately counting revenue for prior three completed fiscal years?
 - Are you tracking the number of employees over the preceding 12 months?
 - Are you including part-time employees in your employee count?



Type Of Controls To Implement

- Verify size –
 - Have you identified all of your affiliates?
 - Know rules of affiliation: control and negative control, common management, stock ownership, newly organized concern, ostensible subcontractor, family interests, etc.)
- Verify status –
 - Know eligibility requirements for socioeconomic programs
 - Do you still meet the requirements (e.g., HUBZone 35% residency requirement)



Type Of Controls To Implement

- Assign responsibility to senior executive or Ethics/Compliance Officer, especially someone that would have knowledge of potential affiliates to screen
 - Common for BD managers to make errors when representing size/status without any thorough understanding of possible affiliates involving the concern's management and ownership.



Type Of Controls To Implement

- Document basis for certifying your size/status. E.g., if affiliation is a close call, document justification for concluding that there is no affiliation, citing SBA regulations and OHA case precedent.
- For prime contractors or potential joint venture parties, you need to screen potential teaming partners.
- Continuing obligation. Verify size/status at time of proposal submission and any FPRs, task order proposals, options.



Type Of Controls To Implement

- Update your internal compliance program/ethics policy/code of conduct to reflect these processes.
 - Government contractors should already have a robust compliance program in place.
 - Do you have: Culture of Compliance? Hotline for anonymous tips? Anti-retaliation environment?



Type Of Controls To Implement

- It is in your best interest to foster environment of trust with your employees.
 - Allows you to timely report errors.
 - Discourages qui tam suits.
- New rule ties in to mandatory disclosure rule and suspension/debarment practice (e.g., liability may be limited if efforts made to correct incorrect representation in a “timely manner”)



Upcoming Events

- **Wednesday, September 25, “Cyber Sticks and Carrots – How the NIST Cybersecurity Framework, Incentives and the SAFETY Act Affect You,” featuring:**
 - The Honorable Jane Holl Lute, President and CEO of the Council on Cybersecurity, Former U.S. Deputy Secretary of Homeland Security
 - Dismas Locaria, Partner, Venable LLP
 - Jason Wool, Venable LLP

Program and luncheon will take place at Venable’s DC office, 12:00 p.m.-2:00 p.m. ET and will also be broadcast online via videocast.

[Please click here for more information and to register.](#)

- **Wednesday, October 9, “Building an Effective Cyber Risk Culture: An Overview of Cybersecurity Insurance & the Support Anti-Terrorism by Fostering Effective Technologies Act (‘SAFETY Act’)” at CyberMaryland 2013, featuring:**
 - Dismas Locaria, Partner, Venable LLP

Track B “Cyber Technology & Innovation” panel discussion will take place from 1:30 p.m.-2:15 p.m. ET in Baltimore, MD.

[Please click here for more information and to register.](#)

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