THE GOVERNMENT CONTRACTOR®

THOMSON REUTERS

Information and Analysis on Legal Aspects of Procurement

Vol. 60, No. 45 **December 12, 2018**

Focus

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FEATURE COMMENT: Small Business Status Advisory Opinions: A Safe Harbor From The Presumed Loss Rule, Or A Fata Morgana?

On Sept. 27, 2010, President Obama signed the Small Business Jobs Act of 2010 (Jobs Act of 2010). P.L. 111-240, 124 Stat. 2504. It amended the Small Business Act to impose new, potentially severe penalties on contractors that make misrepresentations regarding small business status. These penalties include a statutory presumption that the loss suffered by the Government because of a small business misrepresentation is the total value of all contracts awarded based on the misrepresentation(s). See generally Schaengold and Prusock, "The Small Business Jobs Act's Presumption of Loss: It's Rebuttable on the Basis of Value Received by the Government," 29 NC&R ¶ 67 (December 2015). This statutory presumption is typically referred to as the "Presumed Loss Rule."

In an attempt to ameliorate the potentially overbroad application of the Presumed Loss Rule, § 1681 of the National Defense Authorization Act for Fiscal Year 2013, P.L. 112-239, 126 Stat. 1632, 2085–86 created a statutory exemption, or "safe harbor," from the application of the rule if a contractor's misrepresentation results from good faith reliance on a "small business status advisory opinion" issued by a Small Business Development Center or a Procurement Technical Assistance Center. See Schaengold and Deschauer, "Feature Comment: The Impact Of The FY 2013 NDAA On Federal Procurement," 55 GC ¶ 57.

In February 2015, the Small Business Administration published a final rule detailing the process associated with the issuance of small business status advisory opinions. However, a close reading of the final rule and the absence of information on the issuance of any advisory opinions raise questions about whether small business status advisory opinions provide an attainable safe harbor, or are a fata morgana (a type of maritime mirage).

The Presumed Loss Rule—Historically, it was difficult for the Government to prove that it suffered damages from awarding contracts based on false assertions or misrepresentations regarding business status.

In *Ab-Tech Constr., Inc. v. U.S.*, 31 Fed. Cl. 429 (1994), the U.S. Court of Federal Claims found that a contractor violated the False Claims Act, 31 USCA § 3729 et seq., by making false assertions regarding its 8(a) status to obtain set-aside contracts. The Government argued that the damages resulting from its award of a set-aside contract to an ineligible business were equal to the total amount of progress payments received by the contractor under the contract. However, the court rejected this formulation of damages, finding that the Government suffered no loss or injury because the contractor had fully performed the contract. Id. at 434–435. As a result, the court held that the Government was entitled to statutory penalties ($10,000 per claim, which was the maximum at the time), but not damages. (Currently, statutory penalties under the FCA range from a minimum of $11,181 to a maximum of $22,363 per claim. See 28 CFR § 85.5; Civil Monetary Penalties Inflation Adjustment, 83 Fed. Reg. 3,944 (2018).)

The drafters of the Jobs Act of 2010 specifically recognized this difficultly in proving loss where contract awards are induced by fraud and misrepresentations regarding business size or status. See S. Rep. No. 111-343, at 8 (2010). To increase civil and criminal prosecutions of small business size and status misrepresentations, the Jobs Act of 2010 amended the Small Business Act to include the Presumed Loss Rule, which eliminates the Government's initial burden of proving damages in such cases.

The Presumed Loss Rule provides that

> [i]n every contract, subcontract, cooperative agreement, cooperative research and development agreement, or grant which is set aside, reserved, or otherwise classified as intended for award to small business concerns, there shall be a presumption of loss to the United States based on the total amount expended on the contract, subcontract, cooperative agreement, cooperative research and development agreement, or grant whenever it is established that a business concern other than a small business concern willfully sought and received the award by misrepresentation.

15 USCA § 632(w)(1); 13 CFR §121.108(a).

Under the FCA, the Government can recover treble damages, plus penalties ranging from $11,181–$22,363, for each false claim (e.g., for each invoice or request for payment submitted under the contract). Ordinarily, the Government has the burden of proving damages "by a preponderance of the evidence." 31 USCA § 3731(d).

But under the Presumed Loss Rule, the Government is not required to prove actual damages (i.e., that it did not get what it paid for). Instead, there is a presumption that the Government suffers a loss equal to the entire value of the contract when it relies on a contractor's misrepresentation of its size or status to award a set-aside contract to an ineligible business or count an award towards the Government's small business contracting goals. In 2017, the U.S. District Court for the Eastern District of Washington held that a contractor could not offset the presumed damages by proving the value of the products or services it provided to the Government. See *U.S. ex rel. Savage v. Washington Closure Hanford LLC*, 2017 WL 3667709, at *4 (E.D. Wash. Aug. 24, 2017); but see Schaengold and Prusock, "The Small Business Jobs Act's Presumption of Loss: It's Rebuttable on the Basis of Value Received by the Government," 29 NC&R ¶ 67 (based on the statutory text and the legislative history, "the better (and correct) view is that, while the Government is entitled to a presumption that it suffered a loss equal to the amount expended on a contract, the contractor may rebut this presumption by presenting evidence of the value conferred by the contractor on the Government.").

As a result, a contractor found to have misrepresented its size or status to obtain a Government contract could be liable for three times the total value of the contract, plus penalties ranging from $11,181–$22,363 for each claim, even if it successfully performed the contract. For example, if a contractor obtained a $10 million small business set-aside contract by misrepresenting its size or status, and fully performed the contract in accordance with all specifications, the contractor could nevertheless be liable for $30 million in damages plus penalties of up to $22,363 per claim.

The Presumed Loss Rule applies only to "willful" misrepresentations. However, this limitation provides little comfort—the statute states that the following "*shall* be deemed affirmative willful, and intentional certifications of small business size and status:"

> (1) the submission of a bid or proposal for a federal grant, contract, subcontract, cooperative agreement or cooperative research and development agreement that is reserved, set aside or otherwise classified as intended for award to small business concerns;
> (2) the submission of a bid or proposal for a federal grant, contract, subcontract, cooperative agreement or cooperative research and development agreement which in any way encourages a federal agency to classify the bid or proposal, if awarded, as an award to a small business concern; or
> (3) registration on any federal electronic database for the purpose of being considered for award of a federal grant, contract, subcontract, cooperative agreement or cooperative research and development agreement.

15 USCA § 632(w)(2) (emphasis added); 13 CFR §121.108(b).

The "Unintentional" or Good Faith Error Exception—The Jobs Act of 2010 attempted to limit the potentially overbroad application of the Presumed Loss Rule and its severe consequences by directing the SBA to "promulgate regulations to provide adequate protections to individuals and business concerns from liability under this subsection in cases of unintentional errors, technical malfunctions, and other similar situations." 15 USCA §632 (w)(4).

In accordance with this directive, the SBA promulgated regulations intended to limit the liability of contractors in cases in which a mischaracterization of small business size or status resulted from a good faith error or was otherwise "unintentional." See Small Business Size and Status Integrity, 78 Fed. Reg. 38,811 (2013). The final regulation provides that the Presumed Loss Rule "may be determined not to apply in the case

of unintentional errors, technical malfunctions, and other similar situations that demonstrate that a misrepresentation of size was not affirmative, intentional, willful or actionable under the False Claims Act." 13 CFR §121.108(d).

The applicability of this exception is determined by a finder of fact in judicial or administrative proceedings. 78 Fed. Reg. 38,812–13. As a result, contractors acting in good faith may still be subject to whistleblower qui tam and FCA litigation, or suspension and debarment proceedings, before there is an opportunity to evaluate whether the unintentional or good faith error exception applies. Several comments submitted in response to SBA's proposed rule noted this problem. See id. at 38,812. Despite these concerns, SBA declined to clarify what constitutes a willful misrepresentation, and simply noted that "whether a representation is willful or should result in liability or criminal penalty is a fact-based decision that will be made by a judge, jury or other decider of fact." Id. at 38,813. Consequently, the implementing regulations did little to provide certainty or predictability regarding whether a particular representation might expose a contractor to damages under the Presumed Loss Rule.

Seeking Safe Harbor: Small Business Status Advisory Opinions—The House expressly identified the lack of certainty regarding the application of the unintentional or good faith exception to the Presumed Loss Rule as the reason for including the "safe harbor" amendment to the Small Business Act in FY 2013 NDAA § 1681. The report accompanying the House version of the FY 2013 NDAA specifically noted:

> This section is intended to allow the firm or individual to establish that they acted in good faith in attempting to comply with current laws related to small business concerns. The committee believes this provision is necessary in order to aid firms or individuals who may not have absolute certainty as to whether or not they are considered a small business and are fully intending to comply with law.

H.R. Rep. 112-479 (2012) at 296–97. As a result, the final version of FY 2013 NDAA § 1681 (codified at 15 USCA § 645(d)(3)) amended the Small Business Act to include a "safe harbor" that exempts contractors from liability when misrepresentations of small business size or status are made in good faith reliance on a "written advisory opinion" (advisory opinion) from a Small Business Development Center (SBDC), or an entity participating in the SBA's Procurement Technical Assistance Cooperative Agreement program (PTAC).

However, § 1681 further amended the Small Business Act to explain that "nothing in this chapter shall obligate either entity to provide such a letter," and if an entity does provide such a letter, it must remit a copy of the opinion to the SBA general counsel, who may reject the advisory opinion. 15 USCA § 645(d)(3). As many commentators noted at the time, the absence of any obligation for SBDCs or PTACs to issue advisory opinions raised serious questions about the utility of the safe harbor provision.

The SBA's February 2015 release of a final rule implementing the safe harbor raised further questions about the utility of advisory opinions. 80 Fed. Reg. 7,533; 13 CFR § 121.109. The final rule provided the following details regarding the issuance of advisory opinions.:

1. SBDCs and PTACs are not required to issue advisory opinions.
2. There is no limit on the time SBDCs or PTACs may take to prepare advisory opinions.
3. Advisory opinions prepared by an SBDC or PTAC must:
   (a) Provide a written analysis explaining the reasoning for the determination that the contractor, along with its affiliates, does or does not exceed the size standard(s). This analysis must be dated and signed by an SBDC or PTAC business counselor or similarly qualified individual.
   (b) Include a completed copy of an SBA Form 355 (information for small business size determination) for the covered contractor and its affiliates.
   (c) Attach copies of the evidence (such as payroll records, time sheets, federal income tax returns, etc.), provided by the covered concern to the SBDC or PTAC, that clearly document its annual receipts and/or number of employees.
4. SBA will decide within 10 business days of receiving an advisory opinion from an SBDC or PTAC to accept or reject the opinion, and SBA will provide written notification of that decision to the SBDC or PTAC that issued the advisory opinion as well as to the covered contractor.
5. Any firm that receives a negative determination from the SBDC or PTAC may request a formal size determination.

6. A firm can rely on an affirmative advisory opinion for purposes of responding to federal procurement opportunities unless SBA rejects the opinion.
7. A firm's size status may still be protested by interested parties for specific procurements.

Advisory Small Business Size Decisions, 80 Fed. Reg. 7,533, 7,533–34 (2015) (codified at 13 CFR § 121.109 and 13 CFR § 121.1001(b)(11)).

Accordingly, the final rule on advisory opinions makes it clear that (a) SBDCs and PTACs have no obligation to issue advisory opinions when requested; (b) a contractor seeking an advisory opinion will need to submit a SF 355; and (c) even if a SBDC or PTAC agrees to provide an advisory opinion, since there is no deadline for issuing an opinion, obtaining one may be a lengthy process that is unlikely to provide timely guidance.

Safe Harbor or Mirage?—It has been nearly four years since the release of the final rule regarding advisory opinions. As noted above, the final rule contains provisions that raise serious questions about the availability and actual utility of the advisory opinions. Not surprisingly, there is little indication that advisory opinions have been used to shield contractors from the Presumed Loss Rule.

Because SBDCs and PTACs have no obligation to issue advisory opinions when requested, it is unclear whether *any* SBDCs or PTACs actually offer this service. An informal survey of several SBDCs and PTACs revealed that none of those contacted intended to offer contractors small business status advisory opinions. Similarly, the SBA has not published any information regarding the availability and actual issuance of advisory opinions, and there do not appear to be any reported decisions by SBA's Office of Hearings and Appeals regarding formal size determinations issued under the authority of 13 CFR § 121.1001(b)(11) (size determinations initiated by SBA for firms relying on an advisory opinion or by a firm that received an advisory opinion determining that it is other than small). It is possible that some SBDCs or PTACs have issued advisory opinions, but the available information suggests that any such issuances are rare.

While the "safe harbor" amendment to the Small Business Act held the promise that contractors could mitigate the risks associated with the Presumed Loss Rule, there is little evidence that the legislation, as implemented, has provided contractors with any meaningful protection. Instead, to date, it appears that the initial promise of a safe harbor from the Presumed Loss Rule has proven to be nothing more than a fata morgana.

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