

AN A.S. PRATT PUBLICATION

JULY 2019

VOL. 5 • NO. 7

PRATT'S  
**GOVERNMENT  
CONTRACTING  
LAW**  
REPORT



LexisNexis

**EDITOR'S NOTE: SUPPLY CHAIN  
DEVELOPMENTS AND COMPLIANCE**

Victoria Prussen Spears

**CYBERSECURITY AND SUPPLY CHAIN  
DEVELOPMENTS AND TRENDS FOR  
COMPANIES THAT CONDUCT BUSINESS  
WITH THE U.S. GOVERNMENT**

Michael J. Scheimer, Michael F. Mason,  
Robert Taylor, Stacy Hadeka, and Rebecca  
Umhofer

**SIGNIFICANT CHANGES TO SUPPLY CHAIN  
COMPLIANCE**

Eric S. Crusius

**PREPARING FOR A DOD OIG AUDIT:  
DOD'S FOCUS ON SMALL BUSINESS SET-  
ASIDE CONTRACTS AND CERTIFICATIONS**

Sarah M. Hall, Joseph Berger, and  
John O'Hara

**WRONGFUL ACTS INSURANCE POLICIES  
AND THE FALSE CLAIMS ACT: THE SIXTH  
CIRCUIT REJECTS THE "PUT UP OR SHUT  
UP" DEFENSE**

Joshua Schnell and Christian Robertson

**WHAT'S HAPPENING WITH DRUG  
MANUFACTURER PRICING DISCLOSURE LAW?**

Merle M. DeLancey Jr

# PRATT'S GOVERNMENT CONTRACTING LAW REPORT

---

VOLUME 5

NUMBER 7

JULY 2019

---

**Editor's Note: Supply Chain Developments and Compliance**

Victoria Prussen Spears

205

**Cybersecurity and Supply Chain Developments and Trends for  
Companies That Conduct Business with the U.S. Government**

Michael J. Scheimer, Michael F. Mason, Robert Taylor, Stacy Hadeka,  
and Rebecca Umhofer

207

**Significant Changes to Supply Chain Compliance**

Eric S. Crusius

219

**Preparing for a DoD OIG Audit: DoD's Focus on Small Business  
Set-Aside Contracts and Certifications**

Sarah M. Hall, Joseph Berger, and John O'Hara

224

**Wrongful Acts Insurance Policies and the False Claims Act: The  
Sixth Circuit Rejects the "Put Up or Shut Up" Defense**

Joshua Schnell and Christian Robertson

230

**What's Happening with Drug Manufacturer Pricing Disclosure  
Law?**

Merle M. DeLancey Jr.

233

**QUESTIONS ABOUT THIS PUBLICATION?**

---

For questions about the **Editorial Content** appearing in these volumes or reprint permission, please call:

Heidi A. Litman at ..... 516-771-2169  
Email: ..... heidi.a.litman@lexisnexis.com  
Outside the United States and Canada, please call ..... (973) 820-2000

For assistance with replacement pages, shipments, billing or other customer service matters, please call:

Customer Services Department at ..... (800) 833-9844  
Outside the United States and Canada, please call ..... (518) 487-3385  
Fax Number ..... (800) 828-8341  
Customer Service Website ..... <http://www.lexisnexis.com/custserv/>

For information on other Matthew Bender publications, please call

Your account manager or ..... (800) 223-1940  
Outside the United States and Canada, please call ..... (937) 247-0293

---

Library of Congress Card Number:

ISBN: 978-1-6328-2705-0 (print)

Cite this publication as:

[author name], [article title], [vol. no.] PRATT’S GOVERNMENT CONTRACTING LAW REPORT [page number] (LexisNexis A.S. Pratt).

Michelle E. Litteken, GAO Holds NASA Exceeded Its Discretion in Protest of FSS Task Order, 1 PRATT’S GOVERNMENT CONTRACTING LAW REPORT 30 (LexisNexis A.S. Pratt)

Because the section you are citing may be revised in a later release, you may wish to photocopy or print out the section for convenient future reference.

This publication is designed to provide authoritative information in regard to the subject matter covered. It is sold with the understanding that the publisher is not engaged in rendering legal, accounting, or other professional services. If legal advice or other expert assistance is required, the services of a competent professional should be sought.

LexisNexis and the Knowledge Burst logo are registered trademarks of RELX Inc. Matthew Bender, the Matthew Bender Flame Design, and A.S. Pratt are registered trademarks of Matthew Bender Properties Inc.

Copyright © 2019 Matthew Bender & Company, Inc., a member of LexisNexis. All Rights Reserved. Originally published in: 2015

No copyright is claimed by LexisNexis or Matthew Bender & Company, Inc., in the text of statutes, regulations, and excerpts from court opinions quoted within this work. Permission to copy material may be licensed for a fee from the Copyright Clearance Center, 222 Rosewood Drive, Danvers, Mass. 01923, telephone (978) 750-8400.

Editorial Office  
230 Park Ave., 7th Floor, New York, NY 10169 (800) 543-6862  
[www.lexisnexis.com](http://www.lexisnexis.com)

MATTHEW  BENDER

# *Editor-in-Chief, Editor & Board of Editors*

---

**EDITOR-IN-CHIEF**

**STEVEN A. MEYEROWITZ**

*President, Meyerowitz Communications Inc.*

**EDITOR**

**VICTORIA PRUSSEN SPEARS**

*Senior Vice President, Meyerowitz Communications Inc.*

**BOARD OF EDITORS**

**MARY BETH BOSCO**

*Partner, Holland & Knight LLP*

**DARWIN A. HINDMAN III**

*Shareholder, Baker, Donelson, Bearman, Caldwell & Berkowitz, PC*

**J. ANDREW HOWARD**

*Partner, Alston & Bird LLP*

**KYLE R. JEFCOAT**

*Counsel, Latham & Watkins LLP*

**JOHN E. JENSEN**

*Partner, Pillsbury Winthrop Shaw Pittman LLP*

**DISMAS LOCARIA**

*Partner, Venable LLP*

**MARCIA G. MADSEN**

*Partner, Mayer Brown LLP*

**KEVIN P. MULLEN**

*Partner, Morrison & Foerster LLP*

**VINCENT J. NAPOLEON**

*Partner, Nixon Peabody LLP*

**STUART W. TURNER**

*Counsel, Arnold & Porter*

**ERIC WHYTSELL**

*Partner, Stinson Leonard Street LLP*

**WALTER A.I. WILSON**

*Senior Partner, Polsinelli PC*

PRATT'S GOVERNMENT CONTRACTING LAW REPORT is published twelve times a year by Matthew Bender & Company, Inc. Copyright 2019 Reed Elsevier Properties SA., used under license by Matthew Bender & Company, Inc. All rights reserved. No part of this journal may be reproduced in any form—by microfilm, xerography, or otherwise—or incorporated into any information retrieval system without the written permission of the copyright owner. For permission to photocopy or use material electronically from *Pratt's Government Contracting Law Report*, please access [www.copyright.com](http://www.copyright.com) or contact the Copyright Clearance Center, Inc. (CCC), 222 Rosewood Drive, Danvers, MA 01923, 978-750-8400. CCC is a not-for-profit organization that provides licenses and registration for a variety of users. For subscription information and customer service, call 1-800-833-9844. Direct any editorial inquires and send any material for publication to Steven A. Meyerowitz, Editor-in-Chief, Meyerowitz Communications Inc., 26910 Grand Central Parkway Suite 18R, Floral Park, New York 11005, [smeyerowitz@meyerowitzcommunications.com](mailto:smeyerowitz@meyerowitzcommunications.com), 646.539.8300. Material for publication is welcomed—articles, decisions, or other items of interest to government contractors, attorneys and law firms, in-house counsel, government lawyers, and senior business executives. This publication is designed to be accurate and authoritative, but neither the publisher nor the authors are rendering legal, accounting, or other professional services in this publication. If legal or other expert advice is desired, retain the services of an appropriate professional. The articles and columns reflect only the present considerations and views of the authors and do not necessarily reflect those of the firms or organizations with which they are affiliated, any of the former or present clients of the authors or their firms or organizations, or the editors or publisher. POSTMASTER: Send address changes to *Pratt's Government Contracting Law Report*, LexisNexis Matthew Bender, 630 Central Avenue, New Providence, NJ 07974.

# Preparing for a DoD OIG Audit: DoD’s Focus on Small Business Set-Aside Contracts and Certifications

*By Sarah M. Hall, Joseph Berger, and John O’Hara\**

*The Department of Defense is auditing contractors’ compliance with set-aside and sole source requirements for Service-Disabled Veteran-Owned Small Business contractors. This audit, along with a steady stream of enforcement actions, signals increased scrutiny of contractor eligibility certifications. This article summarizes the Department’s initiative, along with recent criminal and civil government enforcement actions targeting allegations of fraud related to these contractor certifications, and provides guidance for contractors to prepare for audits and further reviews.*

The U.S. Department of Defense (“DoD”) is taking action to validate and assess contractor and subcontractor compliance with set-aside or sole source contracts awarded to Service-Disabled Veteran-Owned Small Businesses (“SDVOSB”). DoD announced this audit initiative amidst several recent enforcement actions in which contractors have been indicted and convicted for defrauding the Small Business Administration (“SBA”) and U.S. military branches by fraudulently bidding on set-aside contracts, and for violating the False Claims Act (“FCA”). As illustrated by these recent enforcement actions, companies that self-certify as qualifying for one of the small business classifications discussed in this article and prime contractors submitting a subcontracting plan as part of a government contract should conduct the appropriate level of due diligence to satisfy regulatory obligations and reduce the possibility of FCA liability and criminal investigations.

## **BACKGROUND**

On October 9, 2018, the DoD Office of Inspector General (“DoD OIG”) announced that it was initiating an audit to evaluate whether DoD properly

---

\* Sarah M. Hall is a senior counsel in Thompson Hine LLP’s White Collar Criminal Practice, Internal Investigations & Government Enforcement group, as well as the firm’s Government Contracts group. A former federal prosecutor, she represents corporations and individuals in government investigations and prosecutions of alleged white collar crime. Joseph Berger is a counsel in the firm’s Government Contracts group advising clients on a full range of government contract matters. John O’Hara is an associate in the Government Contracts and International Trade groups handling a wide range of government contract and trade-related matters. The authors can be reached at sarah.hall@thompsonhine.com, joseph.berger@thompsonhine.com, and john.ohara@thompsonhine.com, respectively.

awarded set-aside or sole source contracts to businesses classified as SDVOSB.<sup>1</sup> This audit comes six years after the DoD OIG released a report detailing an earlier audit, which found that over \$300 million was set aside to “potentially ineligible contractors.”<sup>2</sup> The 2012 report highlighted inadequate controls that DoD employed at that time for awarding and managing contracts, while finding that the DoD Office of Small Business Programs did not adequately verify contractor status before awarding set-aside and sole source contracts to SDVOSB contractors.<sup>3</sup>

The Government Accountability Office (“GAO”) echoed the DoD OIG’s sentiment in its own report released later in 2012, titled *Service-Disabled Veteran-Owned Small Business Program Vulnerability to Fraud and Abuse Remains*. The GAO report cited many issues, ranging from the inability of the Department of Veterans Affairs (“VA”) to track its inventory of eligible firms, to inconsistent reporting and inefficient processes to verify contractor status.<sup>4</sup>

Although the DoD OIG audit that commenced in 2018 focuses on SDVOSB contract awards, it serves as a reminder for all small business and set-aside contract award holders to confirm their current status and ensure the validity of certifications previously made (and the underlying details surrounding their classification).

## **SMALL BUSINESS SET-ASIDE AND SOLE SOURCE CLASSIFICATION TYPES**

The Small Business Act established a government-wide goal that 23 percent of all prime contracts be awarded to small businesses each year.<sup>5</sup> Small businesses include the following major types:

*Service-Disabled Veteran-Owned Small Businesses.* The Veterans Benefit Act of 2003 created the procurement program for small business

---

<sup>1</sup> Dep’t. of Def. Office of the Inspector Gen., *Audit of DoD Service-Disabled Veteran-Owned Small Business Contract Awards (Project No. D2019-D000AX-0019.000)* (Oct. 9, 2018) <https://media.defense.gov/2018/Oct/12/2002050607/-1/-1/1/D2019-D000AX-0019.000.PDF>.

<sup>2</sup> Dep’t. of Def. Office of the Inspector Gen., Report No. DODIG-2012-059, *Inadequate Controls Over the DoD Service-Disabled Veteran-Owned Small Business Set-Aside Program Allow Ineligible Contractors to Receive Contracts* (Feb. 29, 2012).

<sup>3</sup> *Id.* at i.

<sup>4</sup> United States Government Accountability Office, Report to Congressional Committees No. GAO-12-697, *Service-Disabled Veteran-Owned Small Business Program Vulnerability to Fraud and Abuse Remains* (Aug. 2012) <https://www.gao.gov/assets/600/593238.pdf>.

<sup>5</sup> See 15 U.S. Code § 644 (g)(1)(A)(i).

concerns owned and controlled by service-disabled veterans.<sup>6</sup> The program requires that an SDVOSB company must be at least 51 percent unconditionally and directly owned by one or more service-disabled veterans.<sup>7</sup> Further, the program requires that the management and daily business operations be controlled by one or more service-disabled veterans.<sup>8</sup>

*Women-Owned Small Businesses* (“WOSB”). This program was created by Section 8(m) of the Small Business Act with the intention to ensure that women-owned small business concerns have an equal opportunity to participate in federal contracting.<sup>9</sup>

*Historically Underutilized Business Zone* (“HUBZone”). The Historically Underutilized Business Zone Act of 1997 established the HUB-Zone program, which was intended to provide federal contracting assistance to qualified small business concerns located in historically underutilized areas in order to increase employment and economic development in those locations.<sup>10</sup>

*8(a) Business Development Program*. Section 8(a) of the Small Business Act was created to assist eligible small disadvantaged businesses to compete through business development activities.<sup>11</sup> Businesses unconditionally owned or controlled by one or more socially or economically disadvantaged individuals in good standing qualify for the program.<sup>12</sup>

## RECENT ENFORCEMENT ACTIONS

While the DoD has been independently verifying contractor status for contracts it has selected for internal audits, the Department of Justice (“DOJ”) continues its investigations into fraud allegations across a variety of small business set-aside contract types. Over the past two years, there have been many so-called “rent-a-vet” enforcement actions targeting contractors who hire a veteran with the sole intention of securing SDVOSB set-aside contracts.

Earlier this year, a Kansas man was criminally charged with program fraud and lying to investigators after falsely holding out his company as owned by a

---

<sup>6</sup> FAR 19.1401–1407.

<sup>7</sup> See 13 CFR § 125.12.

<sup>8</sup> See 13 CFR § 125.13(a).

<sup>9</sup> FAR 19.1500–1507.

<sup>10</sup> FAR 19.1301–1309.

<sup>11</sup> See 13 CFR § 124.1.

<sup>12</sup> See 13 CFR § 124.101.

disabled veteran. Prosecutors alleged that the company hired a service-disabled veteran with the intention of holding the individual out as the business owner. Prosecutors also alleged that the business ultimately served as a “pass-through” to earn DoD SDVOSB set-aside contracts valued at more than \$12.7 million, while other non-veteran employees made all management decisions.<sup>13</sup>

Another example involving allegations of criminal SDVOSB fraud occurred in 2017 when the owners of a construction company and a telecommunication company were indicted in the Southern District of California. The indictment alleged that the two companies formed a joint venture to falsely claim SDVOSB eligibility, allowing them to obtain \$11 million in federal construction contracts. As alleged by DOJ, the individual who was legitimately classified as a service-disabled veteran did not control the joint venture’s day-to-day management or long-term decision-making, as was represented to the VA and the Army Corps of Engineers.<sup>14</sup>

In a recent non-veteran-related case, a Colorado construction firm and a Maryland-based consulting firm agreed to pay the United States \$3.6 million to resolve civil allegations that they defrauded the 8(a) Business Development Program. The Maryland consulting firm had previously been a participant in the 8(a) program, but had not been eligible to bid for 8(a) set-aside contracts since 2011. The government established that the Maryland firm essentially took over day-to-day management of the Colorado-based construction firm, knowingly misrepresented to the SBA who was controlling the company and was subsequently awarded contracts by the U.S. Department of Agriculture, U.S. Army, and U.S. Navy.<sup>15</sup>

---

<sup>13</sup> Dep’t. of Justice, U.S. Attorney’s Office—District of Kansas, *Kansas Man Charged in Government Contract Fraud Scheme* (Jan. 18, 2019) [https://media.defense.gov/2019/Jan/22/2002081693/-1/-1/1/190118\\_KANSAS%20MAN%20CHARGED%20IN%20GOVERNMENT%20CONTRA%20FINAL.PDF](https://media.defense.gov/2019/Jan/22/2002081693/-1/-1/1/190118_KANSAS%20MAN%20CHARGED%20IN%20GOVERNMENT%20CONTRA%20FINAL.PDF).

<sup>14</sup> Dep’t. of Justice, U.S. Attorney’s Office—Southern District of California, *Government Contractors Indicted in \$11 Million Veteran Set-Aside Fraud Scheme* (Apr. 21, 2017) <https://www.justice.gov/usao-sdca/pr/government-contractors-indicted-11-million-veteran-set-aside-fraud-scheme>.

<sup>15</sup> Dep’t. of Justice, U.S. Attorney’s Office—District of Colorado, *\$3.6 Million Settlement Resolves Procurement Fraud Investigation Against Colorado and Maryland Construction Companies Involved With SBA’s Minority Disadvantaged Business Development Program* (Feb. 6, 2019) [https://media.defense.gov/2019/Feb/12/2002088921/-1/-1/1/190206\\_\\$3.6%20MILLION%20SETTLEMENT%20RESOLVES%20PROCUR\\_.PDF](https://media.defense.gov/2019/Feb/12/2002088921/-1/-1/1/190206_$3.6%20MILLION%20SETTLEMENT%20RESOLVES%20PROCUR_.PDF).

## HOW CONTRACTORS SHOULD PREPARE

Prime contractors should have an ongoing process in place to validate their subcontractors' status representations, and they should be able to articulate to the DoD OIG or another investigating entity how such due diligence was performed.

Maintaining appropriate records is key. For larger contracts that require subcontracting plans, contractors need to ensure compliance with FAR 19.704 and 52.219-9, which establish subcontracting plan requirements. Contractors who must appoint a subcontracting plan administrator, as required by FAR 19.704(a)(7), should ensure that the position is not a figurehead and is actively involved in vetting subcontractors who are incorporated into the larger plan.

Prime contractors should carefully vet all subcontractors before contract award. Conducting due diligence prior to and during the proposal stage is a best practice when creating a subcontracting plan. The due diligence should include reviews of the subcontractor's corporate structure and previous work performed on behalf of the U.S. government, along with site visits and audits, where appropriate, to verify the subcontractor's representations regarding its small business status and management structure. Pre-award due diligence should be undertaken to accurately identify the circumstances that would cause a contractor to no longer be able to certify to its small business status. Due diligence should not stop after contract award, and prime contractors should develop a routine recertification process.

SDVOSB contractors, or prime contractors who utilize SDVOSB subcontractors, should be prepared for inquiries from the DoD OIG. Government outreach might include an informal interview or a formal request for documentation that the prime contractor collected and reviewed when evaluating and making an award to a SDVOSB subcontractor. The DoD OIG may visit SDVOSB locations and attempt to validate who is managing the day-to-day business operations to confirm contractor compliance.

Prime contractors and subcontractors who have previously certified compliance with any of SBA's small business programs should ensure that all prior representations are still valid and they have documentation to support their small business status and set-aside certifications. If the business has evolved over time to meet the contract's performance requirements (e.g., additional personnel were hired), the contractor must maintain documentation verifying that the growth happened after the contract offer and award. Although the size standard may apply at the time of contract offer, prime contractors and subcontractors

need to be able to demonstrate that they met the size standard corresponding to the NAICS code designated in the contract.<sup>16</sup>

As evident in the criminal enforcement actions and civil settlements discussed above, allegations of violations can arise when an agency determines that a contractor misclassified itself to bid on and secure contracts awarded for a certain set-aside category. Contractors found to be ineligible may face consequences including potential prison time, contract termination, or financial penalties if it is determined that they fraudulently sought government contracts through misrepresentations. By proactively identifying eligibility issues in their supply chain or in their own performance, contractors may be able to mitigate potential liability by disclosing the issues to their contracting officer and, where appropriate, to the DoD OIG.

Contractors can protect themselves and ensure compliance with all applicable regulations by conducting due diligence prior to contract award and during performance. Being aware of status representation issues and their pitfalls can help a contractor avoid or at least be prepared for the possibility of a DoD OIG audit.

---

<sup>16</sup> See 13 CFR § 125.14(a).