



It's Time for
INTEGRITY
in Government
Contracting

Enforcing FAR Part 3 and
FAR 52.219-14 against the
business community.

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Over the past few years, the U.S. federal government has flexed its muscle and continues to intensify the pressure on government contractor lawbreakers. This is in response to congressional scrutiny demanding that such action be taken.

There are numerous examples of this pressure, including:

- The temporary suspension of IBM in March 2008, by the Environmental Protection Agency (EPA) in relation to an EPA investigation of possible violations of the procurement integrity provisions of the Office of Federal Procurement Policy regarding a specific bid for business with EPA originally submitted in March 2006¹;
- The investigation of NetApp's compliance with price reduction clauses under its General Services Administration Federal Supply Schedule, which resulted in a \$128 million settlement;²

- The "HP kickback case," which resulted in a \$55 million settlement³;
- The Dell accounting fraud claim, which resulted in a \$100 million settlement⁴; and
- The claims of overcharging the American taxpayer by the Louis Berger Group for contracts in Afghanistan, which resulted in a \$69 million settlement.⁵

The stakes could not be higher for businesses which refuse to take business ethics seriously. The government has shown that it is willing, more so than ever, to enforce procurement laws and regulations (as evidenced by the above actions under the False Claims Act of 1986 as amended, the Procurement Integrity Act of 1997 as amended, and the Anti-Kickback Act of 1986 as amended, etc.).

Contractors must Conduct Themselves with the Highest Integrity and Honesty

One thing that all the above-mentioned cases have in common is that the parties involved—in some way or another—violated *Federal Acquisition Regulation (FAR)* Part 3 requirements, which cover in detail the standards of conduct that are expected from government officials and government contractors in order to keep the integrity of the procurement process intact. As the *FAR* states:

- a) Government contractors must conduct themselves with the highest degree of integrity and honesty.
- b) Contractors should have a written code of business ethics and conduct. To promote compliance with such code of business ethics and conduct, contractors should have an employee business ethics and compliance training program and an internal control system that—
 - 1) Are suitable to the size of the company and extent of its involvement in government contracting;
 - 2) Facilitate timely discovery and disclosure of improper conduct in connection with government contracts; and
 - 3) Ensure corrective measures are promptly instituted and carried out.⁶

The message could not have been stronger, again, when on December 8, 2010, the U.S. Agency for International Development (USAID)⁷ suspended the Academy for Educational Development—a nonprofit organization that works globally to improve education, health, civil society, and economic development—from receiving new government awards pending an ongoing investigation by the USAID Office of the Inspector General regarding evidence of serious corporate misconduct, mismanagement, and a lack of internal controls.⁸

This occurred just two months after the Small Business Administration (SBA) surprised the business community by suspending GTSI—a leading government contractor—for allegedly violating the Small Business Contracting Program. These decisions should be seen as warning signs of things to come if the business community does not pull its act together. These are clear notifications that the continued violation of procurement integrity will not be tolerated any longer. From the government perspective, these were robust messages that it intends to enforce rules and regulations that have long been ignored, as well as a chance to remove the loophole that allows large businesses to cut corners and violate federal procurement laws.

Frankly, it was no surprise for other government contractors to learn of GTSI's violations. However, three things in particular were markedly surprising about SBA's actions:

- 1 | The timing. Just 24 hours after the closing of the government fiscal year and the release of an article in the *Washington Post* about GTSI's relationship with EaykTek—an Alaskan native corporation which started in 2002 and which earlier proposed a hostile takeover of GTSI.
- 2 | The fact that SBA decided to take action against a company of GTSI's size and status (over 500 employees and 99 percent of its revenue derives from U.S. government contracts) for the first time.
- 3 | Finally, the fact that GTSI is not the only one guilty of using loopholes in this way.

As stated by SBA, "There is evidence that GTSI's prime contractors had little to no involvement in the performance of contracts, in direct contravention of all applicable laws and regulations regarding the award of small business contracts."⁹ Does this mean that GTSI did not cover its bases as well as the "big guys" in the industry?

It is no secret to anybody in the federal contractor community that there is a culture within the industry whereby many of the set-aside opportunities awarded to small businesses are performed by large businesses. As one such blogger commented, "not only is GTSI a well-known company, but...if this stands, there are a couple of hundred other large businesses that face the same dilemma."¹⁰

However, this is not as simple as some might think. Depending on any given contract requirement, many small businesses do not have the bandwidth or skills to perform the required specialized tasks. Though the contract is awarded to them to perform, some small businesses have to subcontract out a substantial portion of the work, if not the entire amount of work to be performed, to large businesses that possess the necessary skills and capabilities to perform the work in return for a fee.

Analyzing and Interpreting the FAR Requirements

At issue is the fact that many businesses seem confused by or knowingly ignore the FAR 52.219-14 requirement that a "small business concern" must perform at least 50 percent of the labor work with its own employees for an awarded set-aside contract. With this requirement clearly stated in the *FAR*, why has it been so difficult for small businesses to comply with the requirements and so easy for large businesses to find ways around the rules? Can the government penalize only large businesses when small businesses are obligated to comply with the requirements as well?

Let's take a closer look at this requirement and its interpretation. As section (b) of FAR 52.219-14, "Limitations on Subcontracting," states:

- b) By submission of an offer and execution of a contract, the offeror/contractor agrees that in performance of the contract in the case of a contract for—
 - 1) *Services (except construction)*. At least 50 percent of the cost of contract performance incurred for personnel shall be expended for employees of the concern.
 - 2) *Supplies (other than procurement from a non-manufacturer of such supplies)*. The concern shall perform work for at least 50 percent of the cost of manufacturing the supplies, not including the cost of materials.
 - 3) *General construction*. The concern will perform at least 15 percent of the cost of the contract, not including the cost of materials, with its own employees.
 - 4) *Construction by special trade contractors*. The concern will perform at least 25 percent of the cost of the contract, not including the cost of materials, with its own employees.¹¹

In layman's terms, Section (b)(1) means that if the awarded contract is for services and it is not a construction contract, the small business concern must use its own employees to perform no less than 50 percent of the total cost of the contract. For example, if the total contract value is \$1 million, the concern must use more than \$500,000 for its own personnel to perform the work. It also means that the concern can subcontract out a portion of the work to be performed, up to 49 percent of the total funded contract value (\$490,000).

Section (b)(2) means that if the concern *makes* the products, it must perform no less than 50 percent of the total cost required to make the products with its own employees, excluding the cost of materials. In other words, Section (b)(2) does not apply if the concern is not the maker of the products. For example, if the concern has to buy a product made by an original equipment

manufacturer, such as Cisco, IBM, Dell, or HP, the concern is not required to follow the percentage requirement under the non-manufacturer rule. The “non-manufacturer rule” means that a contractor under a small business set-aside or 8(a) contract shall be a *small business* under the applicable size standard and shall provide either its own product or that of another domestic small business manufacturing or processing concern.¹² FAR 19.102(f)(4) states that in the case of acquisitions set aside for small business or awarded under section 8(a) of the Small Business Act, when the acquisition is for a specific product (or a product in a class of products) for which SBA has determined that there are no small business manufacturers or processors in the federal market, then the SBA may grant a class waiver so that a non-manufacturer does not have to furnish the product of a small business.¹³ Contracting officers may also request that SBA waive the non-manufacturer rule for a particular class of products.¹⁴

Section (b)(3) means that if the awarded contract is for general construction, the concern is required to perform no less than 15 percent of the total cost of the contract with its own employees, excluding the cost of material. The concern may retain a construction labor force or use subcontractors to perform the remaining 84 percent of the total cost of the contract.

Section (b)(4) means that if the awarded contract is for construction by special trade contractors, the concern is required to perform no less than 25 percent of the total cost of the contract with its own employees, excluding the cost of materials. A few good examples of this include:

- Building or other similar activities where the concern cannot be responsible for the entire project (e.g., pouring concrete, site preparation, plumbing, painting, and electrical work);
- Electrical contractors supplying the current-carrying and non-current-carrying wiring devices that are required to install a circuit; and
- Plumbing, heating, and air-conditioning contractors who supply the parts required to complete a contract.

North American Industry Classification System (NAICS) Code 238990 describes this as follows:

If a procurement requires the use of multiple specialty trade contractors (i.e., plumbing, painting, plastering, carpentry, etc.), and no specialty trade accounts for 50 percent or more of the value of the procurement, all such specialty trade contractors activities are considered a single activity and classified as “Building and Property Specialty Trade Services.”¹⁵

In all, FAR 52.219-14 does not prohibit the concern from subcontracting out. However, depending on the work to be performed, the concern is required to perform no less than 50 percent for ser-

vices, 50 percent for products the concern makes, 15 percent for general construction, and 25 percent for construction by special trade contractors, as detailed above.

What Can Businesses Do to Avoid Government Sanctions?

One of the main principles of doing business successfully is integrity. If business ethics is not the core principle of an organization, the organization will not be in business for long. In order to achieve integrity, businesses must follow the following guidelines:

- Businesses should act at all times in an ethical manner, even when no one is watching over their shoulders.
- Businesses must comply with government laws, regulations, and policies (specifically, *FAR* or *Defense FAR Supplement* requirements) at all times.
- Businesses must not tolerate unethical employees within their organizations.
- Businesses must provide ethical training on a regular basis for their employees (at least on a quarterly basis).
- Businesses must make sure they know the status of their company (no company can be both “large” and “small” at the same time) to avoid any misrepresentation. If the number of a business’s employees is more than 500, it automatically becomes a large business because the SBA size standard for small businesses is 500 employees or less.¹⁶ Holding one or two contracts with a size of 1,000 employees (e.g., NAICS Code 334111) does not change the size status of the organization.
- Businesses must identify and stop any organizational or personal conflicts of interest and noncompliance with procurement integrity.
- Businesses must remember that “ignorance of the law is no excuse for breaking it.”
- Businesses must allow their contracts professionals to ensure compliance with contract terms and conditions and to not retaliate against them when they raise ethical issues regarding certain actions of the organization.
- Businesses must have a strong business ethics policy in place and make certain that their prime contractors and subcontractors possess the same.

What Can the Government Do to Fix the Loophole?

There are several ways the government can fix this loophole. They include the following.

- The government must follow *FAR* requirements when issuing solicitations and awarding contracts to businesses—and small businesses in particular. The *FAR* provides guidance on how to structure the requirements when developing acquisition plans, conducting market research, and awarding contracts to small businesses. Among them are *FAR* Parts 7, 10, and 19. For example, *FAR* 7.103(s) specifically states that the government's acquisition planners, to the maximum extent practicable, must ensure that they "[s]tructure contract requirements to facilitate competition by and among small business concerns; and...[a]void unnecessary and unjustified bundling that precludes small business participation as contractors."¹⁷ *FAR* 15.304(c)(4) states:

The extent of participation of small disadvantaged business concerns in performance of the contract shall be evaluated in unrestricted acquisitions expected to exceed \$550,000 (\$1,000,000 for construction) subject to certain limitations.¹⁸ For solicitations involving bundling that offer a significant opportunity for subcontracting, the contracting officer must include proposed small business subcontracting participation in the subcontracting plan as an evaluation factor.¹⁹

- Before setting aside an opportunity, make sure that the work can be performed by one or two small businesses. The small business(es) must be able to satisfy the solicitation requirements (specifically, technical requirements). The *FAR* states:

Proposal evaluation is an assessment of the proposal and the offeror's ability to perform the prospective contract successfully. An agency shall evaluate competitive proposals and then assess their relative qualities solely on the factors and subfactors specified in the solicitation. Evaluations may be conducted using any rating method or combination of methods, including color or adjectival ratings, numerical weights, and ordinal rankings. The relative strengths, deficiencies, significant weaknesses, and risks supporting proposal evaluation shall be documented in the contract file.²⁰

- Award contracts only to well-qualified and responsible businesses. *FAR* Part 12 states that "the government will award a contract resulting from this solicitation to the responsible offeror whose offer conforming to the solicitation will be most advantageous to the government, price and other factors considered."²¹ For example, small business responsibility is determined by SBA through issuance of a Certificate of Competency (COC),²² unless otherwise found in *FAR* 19.602-4, which states:

- a) If new information causes the contracting officer to determine that the concern referred to the SBA is actually responsible to perform the contract, and award has not already been made under paragraph (c) of this subsection, the contracting officer shall reverse the determination of



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non-responsibility, notify the SBA of this action, withdraw the referral, and proceed to award the contract.

- b) The contracting officer shall award the contract to the concern in question if the SBA issues a COC after receiving the referral. An SBA-certified concern shall not be required to meet any other requirements of responsibility. SBA COC's are conclusive with respect to all elements of responsibility of prospective small business contractors.
- c) The contracting officer shall proceed with the acquisition and award the contract to another appropriately selected and responsible offeror if the SBA has not issued a COC within 15 business days (or a longer period of time agreed to with the SBA) after receiving the referral.²³
- The government should require small businesses to identify all their teaming partners and percentage of work to be performed by the set-aside as well as the teaming partners by focusing on FAR 52.219-14, "Limitations on Subcontracting."
- The government should monitor the performance of the small business concerns to make sure that the concerns are performing in accordance with the contract terms and conditions.
- The government should require consent for all small businesses' "first-tier subcontractors."²⁴
- The government should encourage contractor teaming arrangements among small business concerns to complement their skills and capabilities.²⁵
- The government should uphold the rule of law against government contractors who break the rules. Failure of the government to enforce such rules and regulations will surely create a pattern for businesses to continue to break the law.

Conclusion

In the wake of all the suspensions and investigations by the U.S. government, has the business community learned its lesson, or will it continue to be "business as usual"? Can just paying a fine be sufficient to prevent the business community from continuing to abuse the system? Only time and enforcement of the federal procurement laws will tell.

One thing is sure, if the business community does not change its behavior, the U.S. government will be stepping in and forcing businesses to follow the rules with the potential consequence of shutting down the violators. And, as always, those businesses smaller in size will suffer the most since they do not have the necessary resources to survive a long-term suspension or investigation by the government. **CM**

ABOUT THE AUTHOR

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ENDNOTES

1. See IBM 2008 Annual Report, available at www.ibm.com/annualreport/2008/note_o.shtml.
2. Semiannual Report to the Congress, available at www.gsaig.gov/semireports/2009-04-01.pdf.
3. See www.justice.gov/opa/pr/2010/August/10-civ-979.html.
4. See www.bloomberg.com/news/2010-07-22/dell-agrees-to-pay-100-million-to-settle-sec-fraud-claims.html.
5. See http://enr.construction.com/business_management/ethics_corruption/2010/1110-WhistleBlower.asp.
6. FAR 3.10, "Contractor Code of Business Ethics and Conduct."
7. See www.usaid.gov/press/releases/2010/pr101208.html.
8. See www.aed.org/About/index.cfm.
9. See www.washingtonpost.com/wp-dyn/content/article/2010/10/01/AR2010100106319.html.
10. See <http://washingtontechnology.com/blogs/editors-notebook/2010/10/gtsi-sba-suspension.aspx>.
11. FAR 52.219-14(b).
12. As per FAR 19.001; see also 13 C.F.R. 121.406.
13. For the most current listing of classes for which SBA has granted a waiver, contact an SBA Office of Government Contracting. A listing is also available on SBA's website at www.sba.gov/gc.
14. As per FAR 19.102.
15. NAICS Code 238990, "Table of Small Business Size Standards."
16. See www.sba.gov/idc/groups/public/documents/sba_homepage/guide_to_size_standards.pdf.
17. See also FAR 7.107 and 15 U.S.C. 631(j).
18. See FAR 19.201-202.
19. As per FAR 15.304; see also 15 U.S.C. 637(d)(4)(G)(i).
20. FAR 15.305(a).
21. FAR Part 12.
22. See FAR 19.6.
23. FAR 19.6(a)-(c).
24. See FAR 52.244-2.
25. See FAR 9.6.

