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*PilieroMazza Breakfast Seminar*

# GETTING YOUR GOVERNMENT CONTRACTING HOUSE IN ORDER

**JUNE 9, 2011**

**Presented by**

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# Overview

- How to evaluate whether your company's eligibility and status are in compliance
- How corporate structure and planning can facilitate compliance
- How certain amendments to your company's contracts can facilitate compliance
- Trends in compliance issues & audits and investigations

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# What is the Relevance of Eligibility and Size in Government Contracting?

- **Eligibility and size are the essential ingredients of federal small business government contracting programs**
  1. An individual must be "eligible" to qualify and to participate in the 8(a), SDVOSB, HUBZone and WOSB programs
  2. A concern must be "small" for admission into the SBA's small business contracting programs: 8(a), SDVOSB, HUBZone and WOSB programs
  3. A concern also must be "eligible" and/or "small" to be awarded sole-source procurements and/or to compete for and win small business set-aside procurements

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# Eligibility and Status

- **Eligibility**
  1. 8(a) concern – socially and economically disadvantaged small business
  2. SDVOSB concern – service-disabled veteran-owned small business
  3. HUBZone concern – small business located in a historically underutilized business zone
  4. WOSB concern – woman-owned small business
- **Status**
  1. Small Business
  2. "Other than Small"

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# Core Elements of Eligibility

- **8(a), SDVOSB, WOSB**
  1. At least 51% *direct* and *unconditional* ownership by 8(a), SDVO or a woman
  2. 8(a), SDVO or woman *control* over day-to-day business and operations and long-term decision-making
  3. 8(a), SDVO or woman as highest ranking officer
  4. 8(a), SDVO or woman as mostly highly compensated
- **HUBZone**
  1. At least 51% *direct* and *unconditional* ownership by a US citizen or wholly owned by a Community Development Corporation, an agricultural cooperative or an Indian Tribe – with certain exceptions
  2. Principal office located in HUBZone
  3. 35% of employees live in HUBZone

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# Core Elements of Eligibility

(continued)

4. Qualifying as a HUBZone
   - Principal Place of Business Requirement
   - 35% Requirement
     - Getting the documentation right

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# Core Elements of Size

- **Small Business**
  1. "Independently owned and controlled" and "is not dominant in its field of operation" (Small Business Act definition)
  2. Industries are assigned codes under the North American Industry Classification System ("NAICS")
  3. Each NAICS code has a "size standard" that defines what it means to be a small business in the corresponding industry
  4. Size standards are expressed as total number of average employees in the past twelve (12) months or three-year average total revenues
  5. Generally speaking, the SBA has assigned employee-based size standards to the manufacturing industries, and revenue-based size standards to the construction and services industries

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# Core Elements of Size

(continued)

6. Current issues in the law: Getting your size right
   - Using the right tax returns
   - Making the right exclusions
   - Avoiding affiliation

- **"Other than Small" – essentially, a "large" business in the government contracting industry**

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# Corporate Structure and Planning to Facilitate Compliance

- **Governing documents**
  1. Corporation – articles/certificate of incorporation, bylaws and shareholders agreement
  2. LLC – articles/certificate of organization/formation, operating agreement
  3. Partnership – certificate of partnership (if an LP), partnership agreement (for GP or LP)
- **Governing documents should demonstrate direct and unconditional ownership and control**
  1. 8(a), SDVO, WO, HUBZone ownership (* - some exceptions with HUBZone)
     - Direct ownership
       - Cannot be diluted below 51%*
     - At least 51% share of profits*
     - Consider use of "phantom equity" for key management and/or employees, not actual ownership

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# Corporate Structure and Planning to Facilitate Compliance

(continued)

2. Limit conditions on disadvantaged owner's ownership interest
   - Disadvantaged owner should have the right to "transfer" ownership interest (e.g., sell, assign, transfer, pledge or otherwise dispose of ownership interest)
   - "Drag-along" and "tag-along" rights to balance disadvantaged and non-disadvantaged owners' interests
     - Right to force non-disadvantaged owner(s) to sell when disadvantaged owner is ready to sell to 3rd party, on same terms as and alongside of disadvantaged owner
   - "Tag-along" right
     - Right of non-disadvantaged owner(s) to sell its/their ownership interest to 3rd party on same terms as and alongside of disadvantaged owner

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# Corporate Structure and Planning to Facilitate Compliance

(continued)

3. 8(a), SDVO, WO, HUBZone governance
   - Simple majority versus super-majority or unanimous approval requirements
     - Simple majority control over BoD/management committee
     - Simple majority approval of matters or questions by BoD/management committee members or by owners
     - Limit number of matters or questions that require super-majority or unanimous approval by BoD/management committee members or by owners
     - Balance interests of disadvantaged and non-disadvantaged owners, BUT
     - Federal law not obligated to recognize state law requirements

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# Corporate Structure and Planning to Facilitate Compliance

(continued)

- Quorum – at BoD/management committee and owner level
  - Avoid non-disadvantaged owners' ability to prevent conduct of business

4. Company "Minute Book" to maintain corporate records
   - Governing documents
   - Minutes of BoD/management committee and owners' meetings
   - Ownership records – stock ledger, stock certificates

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# Corporate Structure and Planning to Avoid Negative Control and Affiliation

- **Make sure your governing documents do not contain "negative control" provisions which could cause affiliation**
- **Affiliation and negative control can affect eligibility and/or size**
- **What is "affiliation"? Two firms are deemed to be "affiliated" when one person has the power to control another person (but need not actually exercise control)**
- **Negative control could lead to finding of affiliation and therefore ineligibility – disadvantaged owner does not control company**
  1. Super-majority or unanimity voting requirements on material business decisions (which affects the disadvantaged owner's ability to manage and conduct the company's business)
  2. Quorum requirements by which non-disadvantaged owner(s) could prevent the disadvantaged owner from conducting company business

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# Corporate Structure and Planning to Avoid Negative Control and Affiliation

(continued)

- **Negative control could lead to affiliation and therefore finding of being other than small**
  1. Avoid undue reliance on or too many ties to one specific 3rd party
- **Examples of Affiliation**
  1. Common ownership and management
  2. Shared facilities and employees
  3. Newly organized concern
  4. Joint ventures (too many with one 3rd party)
  5. Significant percentage of revenue from contracts with one company
  6. "Totality of the circumstances"

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# THE RISE OF TRANSPARENCY AND OVERSIGHT

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# The Mandatory Disclosure Rule

- **Final rule published in the Federal Register on November 12, 2008; effective date was December 12, 2008 – not new, but not to be forgotten either**

- **Several parts to the Mandatory Disclosure Rule ("MDR"): (1) obligation to disclose certain violations of law; (2) obligation to establish a Contractor Code of Business Ethics; and (3) for some companies, obligation to implement a compliance program and a system of "internal controls"**

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# MDR Changes to the FAR

- **<u>FAR Part 3</u>: New FAR clause, 52.203-13, Contractor Code of Business Ethics and Conduct, and provision stating that failure to disclose may result in suspension or debarment**
- **<u>FAR Part 9</u>: Failure to disclose may result in suspension (9.407-2) or debarment (9.406-2)**
- **<u>FAR Part 52:</u> 52.203-13, Contractor Code of Business Ethics and Conduct**
  1. Applies to contracts over $5 million with a term of 120 days or more
  2. Addresses MDR, Contractor Code of Business Ethics and "Business Ethics Compliance Program"

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# Language of the MDR/FAR Contract Clause

- **The Contactor shall <u>timely disclose</u> … whenever, in connection with the award, performance or closeout of this contract <u>or any subcontract</u> thereunder, the Contractor has <u>credible evidence</u> that a principal, employee, agent or subcontractor of the Contractor has committed –**
  1. a violation of (some provisions of) criminal law;
  2. a violation of the civil False Claims Act

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# Scope of the MDR/FAR Contract Clause

- Applies to contracts in excess of $5 million/120 days
- Need nexus with the specific Government contract or subcontract under the specific Government contract
- 3 year "look back" provision
- Disclosure extends to conduct of Agents and Subcontractors
- FAR clause must be included in subcontracts over $5 million with a term greater than 120 days

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# Transparency

- **Federal Awardee Performance and Integrity Information System ("FAPIIS")**

  See 75 Fed. Reg. 14059 (Mar. 23, 2010)

  **– AKA The "Bad Boy List"**

- **Changes to Organizational Conflict of Interest Policies**

- **SBA Top Priority – Eliminate Fraud, Waste and Abuse**

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# Reporting Executive Compensation

- **Background on rule**
  1. Interim final rule adopted on July 8, 2010
  2. Outgrowth of the Federal Funding Accountability and Transparency Act
  3. Rule was effective immediately, but is likely to be revised via a final rule after considering comments from interested parties
  4. Comment period closed in September 2010; more than 200 pages of comments submitted
- **Reporting threshold – if <u>all</u> are met, contractor must report**
  1. In preceding fiscal year, contractor received 80% or more of its revenues from federal contracts, subcontracts or grants
  2. In preceding fiscal year, contractor received $25 million in revenue or more from these sources
  3. Public does not already have access to executive compensation through SEC or IRS

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# Reporting Executive Compensation

(continued)

- **If threshold is met, contractor must report the <u>total compensation</u> of its (and its first-tier subcontractors') five highest-paid executives**
  1. Reported to www.ccr.gov, and for subcontractors to www.fsrs.gov
  2. "Executive" is defined as "officers, managing partners, or any other employees in management positions"
  3. "Total compensation" includes salary, bonus, awards of stock, stock options, change in pension value, earnings for services under non-equity incentive plans, above market earnings on deferred compensation which is not tax-qualified, and "other compensation" if above $10,000
- **Exemptions**
  1. Disclosure not required if contractor received a classified contract; FAR defines "classified contract" as any in which the contractor or its employees have access to classified information during performance
  2. Contracts with individuals
  3. Gross corporate income less than $300,000

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# The Presumed Loss Rule

- **Provision of Small Business Jobs Act of 2010**
- **May increase False Claims Act penalties for incorrect SB certifications**
- **Government presumed to lose the total spent on the contract if certification false**

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# Small Business Jobs Act – Certification Provisions

- **"Deemed Certification" Provision**

  Submission of a bid or proposal for, or registration on any Federal electronic database for the purpose of being eligible for, any Federal contract or subcontract will be considered to be an "affirmative, willful, and intentional certification" as to the status and size of the offeror

- **"Presumed Loss" Rule**

  For each contract or subcontract, there "shall be a presumption of loss to the United States based on the total amount expended" on the contract or subcontract where it is established that a business concern other than a small business concern willfully sought and received a contract award by misrepresentation

- **Exceptions**

  SBA to publish regulations to provide "adequate protections" from liability in cases of "unintentional errors, technical malfunctions, and other similar situations."

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# QUESTIONS OR COMMENTS?

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