

## Taking One For The Teaming Arrangement

Law360, New York (November 15, 2010) -- Small businesses frequently team with large businesses through prime/subcontractor and mentor-protégé joint venture arrangements to bid on federal small business set-aside work, including general small business set-asides, 8(a) set-asides, Women Owned C&L (WOSB) set-asides, HUBZone set-asides and Service Disabled Veteran Owned C&L (SDVOSB) set-asides. These teaming arrangements allow small businesses to gain important support from large businesses with more experience and resources, while allowing large businesses to perform a portion of the work on contracts that would otherwise be inaccessible to them.

While the Federal Acquisition Regulation (FAR) and the Small Business Administration (SBA) regulations provide for these teaming arrangements, such arrangements present severe business and legal risks to both parties if they are not properly structured, documented and managed. Recent judicial, legislative and administrative actions have highlighted some of these risks.

### **Court Refuses to Enforce Subcontract Agreement and Strikes Down Prime Contract**

First, in a recent court decision, *Morris-Griffin Corp. v. C&L Service Corp.*, 2010 WL 3221975 (E.D. Va., Aug. 16, 2010), a federal judge refused to enforce a subcontract between a small business prime contractor and large business subcontractor and found the prime contract between the small business and the government to be “void ab initio” because of alleged violations of SBA regulations that require the small business prime contractor on a set-aside contract to perform at least half of the work. See 13 C.F.R. § 121.103.

#### *Background of the Case*

*Morris-Griffin* involved a dispute between a prime contractor and a subcontractor who were performing a Department of Housing and Urban Development loan servicing contract.

Although the HUD contract was set aside for 8(a) businesses, the court focused on rules and concepts applicable to other types of small business set-asides as well. *Morris-Griffin Corp.*, the large business involved was the incumbent prime contractor but, at the time of the re-bid, *Morris-Griffin* had a problem — it was no longer “small” under the applicable size standard. *Morris-Griffin* therefore asked *C&L Service Corp.*, an 8(a) firm, to serve as the prime contractor for the bid.

*Morris-Griffin* knew *C&L* lacked the experience to perform the work. Indeed, *C&L* lacked any experience in loan servicing work and was primarily a provider of janitorial and maintenance services. Nevertheless, *Morris-Griffin* and *C&L* decided to submit a bid under arrangements that suggested *Morris-Griffin* would be providing the “leadership and expertise necessary to fulfill the contract requirements.”

The bid was successful. Although the SBA initially questioned the relationship between *Morris-Griffin* and *C&L*, it eventually backed down under pressure from HUD. The subcontract ultimately formed between *C&L* and *Morris-Griffin* afforded *Morris-Griffin* key managerial privileges and required *Morris-Griffin* to make substantial investments to facilitate

performance. For instance, the subcontract granted Morris-Griffin a number of managerial consent rights and Morris-Griffin was the sole signatory on a lease agreement for a loan servicing center.

In addition, the subcontract's year-end reconciliation mechanism also afforded Morris-Griffin the right to be reimbursed for indirect costs and expenses that exceeded the budget. Finally, Morris-Griffin's total reimbursement claims for were approximately 60 percent of the relevant expenses incurred under the HUD contract.

### *The Relationship Turns Bad*

The relationship between Morris-Griffin and C&L broke down when C&L refused to pay the year-end expenses and, according to the decision, attempted to cut Morris-Griffin out of the contract and hire another subcontractor.

Morris-Griffin set a dispute resolution process in motion that ultimately led it to ask a federal court to grant Morris-Griffin certain rights to the bank account used by the parties, and to force C&L to pay Morris-Griffin under the subcontract. C&L resisted, apparently at least in part in an effort to comply with limitations that SBA regulations placed on the percentage of set-aside work that can be subcontracted.

### *Subcontract (and Prime Contract) Held Unenforceable*

After warning the parties to settle the case and learning that they had failed to do so, the court found both the subcontract and the prime HUD contract unenforceable — a potentially disastrous result for the parties (and for HUD).

Upon finding that the parties were “affiliated” because C&L was unduly reliant on Morris-Griffin, the court found that C&L falsely certified itself as a small business and therefore the set-aside HUD contract was unenforceable and void ab initio, whether or not HUD wanted to void the contract. The court relied upon the 1988 case of *J.E.T.S. Inc. v. United States*, 838 F.2d 1196 (Fed. Cir. 1988). We note that the *J.E.T.S.* case has been roundly criticized by the one federal circuit court that has addressed the case. See *United States ex rel Siewick v. Jamieson Science and Engineering Inc.*, 214 F.3d 1372 (D.C.Cir. 2000).

The court also seemed to hold that the set-aside HUD contract was unenforceable because of wrongdoing by the parties in the performance of the contract, finding that Morris-Griffin personnel charges amounted to more than 50 percent of personnel expenditures and that Morris-Griffin controlled performance of the contract in violation of SBA rules.

The court also found the subcontract between Morris-Griffin and C&L unenforceable on three separate grounds. The court held that the subcontract: 1) violated public policy by hindering the managerial and control rights of C&L as the small business prime contractor in violation of 15 U.S.C. § 631(f)(2); 2) promoted an unlawful purpose; and 3) violated SBA rules requiring that C&L, as the small business prime contractor, incur at least 50 percent of the personnel cost and manage the contract.

### *Legacy of the Decision*

Although this case illustrates how failing to follow SBA rules in a set-aside situation can lead to disastrous consequences, it is important to note that some observers question the precedential value of the decision.

Nevertheless, there is a potential that other courts, adjudicative bodies, contracting officers and SBA officials will interpret the decision as a new mandate to carefully consider the circumstances before permitting small businesses to significantly rely upon large businesses in bids on, and performance of, set-aside contracts.

### **Congress Introduces Presumption of Loss for Misrepresentation of Size Status**

Second, in the C&L Jobs and Credit Act of 2010, signed into law on Sept. 27, 2010, Congress inserted a new provision into the Small Business Act. Public Law No. 111-240 § 1341. Where a business willfully misrepresents that it is small in order to

receive an award of a contract, subcontract, grant, cooperative agreement or cooperative research and development agreement (also known as a CRADA), the act creates a presumption that the loss to the U.S. is the total amount expended on the award.

In addition, the act indicates that a party will be “deemed” to be making an affirmative, willful and intentional certification of its size status when the party 1) submits a bid or proposal for a small business set-aside contract, grant, subcontract, cooperative agreement or CRADA; 2) submits a bid that encourages the government to classify an award on the bid as an award to a small business concern; or 3) registers in any federal electronic database for the purpose of being considered for the award of a federal contract, grant, subcontract, cooperative agreement or CRADA “as a small business.”

In light of the act, if a small business prime contractor and its subcontractors are found to be “affiliated” under SBA rules, the risk is that this could not only endanger the relationship and the contract (as under Morris-Griffin), but that it could also give rise to a presumption that the arrangements have resulted in a loss to the U.S. in the amount of all payments made by the government.

In the context of the False Claims Act, there is a further risk that these presumed damages could be tripled. Also, in light of the act, the SBA and other government agencies are likely to argue that anyone who makes a “size” representation is deemed to act with knowledge of the SBA’s dense mass of “affiliation” rules.

Small businesses and large businesses that enter into formal or informal teaming agreements, or subcontracts in connection with federal set-aside work, would do well to consider the act and ensure that their arrangements do not render the small business “large” in the eyes of the SBA, courts or other reviewing bodies.

### **Major Contractor Suspended in Small Business-Large Business Collaboration Review**

On Oct. 1, 2010, the federal contracting community was reminded yet again of the severe risk associated with large business-small business collaboration on set-aside contracts. GTSI Corp., a top federal contractor, confirmed that the SBA had suspended GTSI from participation in certain federal contract activities.

According to a Washington Post article, GTSI had developed relationships with a number of small businesses, including two Alaska native corporations (ANCs), and internal GTSI documents suggested GTSI was open to the concept of doing “ALL the work” on a contract with a small business “partner” and was to receive 99.5 percent of the revenue on another contract even though GTSI was a subcontractor to a small business. Robert O’Harrow Jr., SBA Suspends Major Contractor GTSI from Government Work, Washington Post, Oct. 1, 2010.

Although the SBA lifted the suspension of GTSI, the price to GTSI was significant. In an “Administrative Agreement” with the SBA dated Oct. 19, 2010, GTSI agreed 1) that its CEO (also a member of the board of directors) and its vice president and general counsel, would resign within seven days; 2) that it would cooperate with an ongoing investigation by the SBA and provide specific documents to the SBA; 3) that it would abstain from participating in new federal contract or subcontract work intended to benefit small businesses, including work involving or arising out of or relating to any mentor/protégé relationship, and including task orders and options on existing contracts; 4) that it would put in place compliance measures, audit procedures and retain an independent person with unfettered access to all company documents, information and personnel to monitor GTSI’s compliance with the agreement; and 5) that it would report any suspected breach of the agreement or other misconduct to the government within 15 days of discovery pursuant to FAR clause 52.203-13 and FAR 3.1003(2).

The GTSI suspension, and apparently ongoing investigation, further highlights the need for caution in large business-small business cooperation on set-aside work.

### **Conclusions**

The above judicial, legislative and administrative actions provide an important reminder that there is a grave risk associated with winning and performing small business set-aside contracts in a manner that violates SBA regulations and other applicable law.

The risks of suspension, triple damages and inability to enforce agreements against teaming partners and the government are very real, not to mention the potential for injury to a company's reputation and the expense of properly dealing with a government investigation and compliance agreement.

Small businesses and large businesses that team up on set-aside work need to structure, manage and document their relationships in a manner that demonstrates compliance with applicable regulations and decisional law to minimize the risk that competitors will challenge the relationship through size protests or other tactics.

In some instances, small and large businesses may desire to utilize the SBA's or the U.S. Department of Defense's mentor-protégé programs to help comply with the rules and limit risk while collaborating on set-aside work. Even parties with such arrangements in place, however, need to be mindful that these arrangements do not automatically erase all of the SBA's affiliation rules or eliminate the SBA's limitations on subcontracting in the set-aside context.

The best strategy in a specific situation may depend, in part, on whether the set-aside is a general small business set-aside, an 8(a) set-aside, a HUBZone set-aside, a WOSB set-aside or an SDVOSB set-aside because some of the applicable rules differ depending on which SBA program is at issue.

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