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BEFORE THE

SUBCOMMITTEE ON INVESTIGATIONS, OVERSIGHT AND REGULATIONS
COMMITTEE ON SMALL BUSINESS
U.S. HOUSE OF REPRESENTATIVES

MISREPRESENTATION AND FRAUD: BAD ACTORS IN THE SMALL BUSINESS PROCUREMENT PROGRAMS

OCTOBER 27, 2011

Chairman Coffman and distinguished members, I want to thank you for the opportunity to testify about companies fraudulently obtaining preferential contract awards under small business contracting programs.

At the outset, I acknowledge that my office does not purport to know all the intricacies that extend to contracts between the federal government and small businesses. We do play a role, however, in investigating companies that have made false statements to obtain preferential small business contract awards under programs administered by the General Services Administration (GSA). I will focus my testimony on some examples of cases in that area and impediments to prosecution.

I would like to highlight what I see as the two major types of schemes to fraudulently obtain preferential small business contract awards: (1) falsely claiming to meet small business eligibility criteria and (2) fraudulently using an eligible small business as a "pass-through" so that an ineligible company will actually perform the work and receive most of the taxpayer dollars. We have seen both of these schemes in our investigations. We also have experienced, first-hand, some of the problems in prosecuting these cases, with the primary one being determining the loss to the United States.

My office is presently investigating a case jointly with Offices of Inspector General (OIGs) for the Small Business Administration (SBA) and the Department of Veterans Affairs (VA) involving alleged false statements to meet service-disabled veteran-owned small business eligibility requirements. The indictment alleges that the defendants, who obtained more than $6 million in federal contracts, falsely self-certified that the company was eligible for contracts designated for service-disabled veteran-owned small businesses. After October 1, 2010, when the VA began verifying self-certifications regarding service-disabled veteran status, the defendants allegedly created and submitted false documentation to the VA that supported their status claim. The documents showed the claimed disabled veteran had completed three tours in Vietnam and had received numerous medals and citations. According to federal records, however, this individual was never classified as a service-disabled veteran by the VA or the Department of Defense (DOD). Rather, he was honorably discharged in 1968 as a Senior Engineer Equipment Mechanic with the rank of Specialist E-5, after serving five years in the National Guard, during which he never even left the state on active duty.

My office is also investigating cases that involve improper pass-throughs. A joint investigation with Internal Revenue Service Criminal Investigation; the Army Criminal Investigation Command; and the Department of Interior, SBA and DOD OIGs resulted in multiple convictions for bid rigging, bribery, and other fraud. One part of that investigation showed that federal employees steered business to companies legitimately designated as 8(a), small disadvantaged, or HUBZone, and those businesses would then subcontract the bulk of the work to companies owned by the same federal employees. In exchange, the legitimate small businesses received a small percentage of the contract work. Among others, the defendants negotiated an

agreement with a tribally-owned business that had preferential 8(a) status. As part of the conspiracy, millions of dollars in government contracts were funneled to the tribal business, which kept small percentages of the contract value as "pass-through fees," then subcontracted the majority of the contract's value to the defendants' company.

These cases illustrate how wide-ranging the fraud can be, and how significantly it can derail the goals of federal small business contracting programs. Unfortunately, however, it is not always possible to find a civil or criminal remedy. Prosecutors normally look first for loss to the United States. Often, however, they cannot establish a monetary loss to the United States, as the government has received the value of the products and services for which it paid. Some of the matters we have investigated have been declined for prosecution on this basis. Of course, the real loss and damage is to the integrity of the small business programs and the lost opportunities underlying those programs, starting with the fact that a legitimate small business did not receive the contract.

I have first-hand experience with the problem of measuring the loss to the United States. As an Assistant United States Attorney for the Eastern District of Virginia, I worked a case in which a small business qualified for the Small Business Innovative Research (SBIR) program and entered into contracts for research with five different federal agencies. These federal agencies did not know that the small business had contracts with other federal agencies, because the small business certified that it had no other federal contracts to perform this work. In other words, it sold the same research to the federal government five times and was paid for it five times. As it turns out, the small business did not even do the research itself, but rather it had a professor and graduate students at a major university research laboratory do the research. Interestingly, the final product was probably a better product than what the small business could have produced. If the United States received a better product than what it contracted for, then what was the loss to the United States? Fortunately, for that case, I had a good answer: We paid for it five times. Because five different agencies paid for the one research product, I could show that the United States paid five times more than it was worth. Had the United States paid only once for the research, this would have been a more difficult case, even though the small business clearly committed fraud and defeated the objectives of the SBIR program.

We believe that a strong penalty is required to provide the necessary deterrence because fraudulent small business self-certifications are difficult to detect, and unscrupulous companies may expect to get away with false self-certifications. As the Encyclopedia of Crime and Justice notes, "the greater the temptation to commit a particular crime and the smaller the chance of detection, the more severe the penalty should be."[1] A strong penalty will help take the profit out of crime, which is an idea underlying our forfeiture and fraud laws.

[1] This notion is based upon a theory by Jeremy Bentham, who wrote in 1781: "To enable the value of the punishment to outweigh that of the profit of the offense, it must be increased, in point of magnitude, in proportion as it falls short in point of certainty."

In many cases, including orders under GSA Multiple Award Schedule contracts, federal agencies rely on self-certifications made by the vendors to determine eligibility to receive contracts designated for small businesses. In the case of fraudulent certifications of eligibility, economic loss should be defined as the full value of the contract to encourage prosecution and provide a more effective deterrent. The absence of a financial loss in small business eligibility fraud stifles effective prosecution, resulting in a significant societal cost that includes preventing legitimate contractors from obtaining program benefits. A proposal to amend the Sentencing Guidelines along these lines was included in a 2008 white paper by the National Procurement Fraud Task Force's Legislation Committee, which I co-chaired.

As the SBA Inspector General pointed out in her March 3, 2011, testimony before the U.S. Senate Small Business and Entrepreneurship Committee, a HUBZone conviction that resulted from an investigation conducted by her office led to a light $1,000 fine and two years of probation, because under the Sentencing Guidelines, credit had to be given for any benefit (goods and services) the United States received as a result of the defendant's wrongdoing. The reality in that case, however, was that a company in an economically disadvantaged area, which the United States is seeking to aid through the HUBZone program, was deprived of business because the defendant fraudulently claimed to qualify for the program. Amending the Sentencing Guidelines as proposed in the white paper would address this harm in future cases.

The white paper did not address the similar impediment to obtaining remedies for small business eligibility fraud in civil cases, both under the civil False Claims Act and the Program Fraud Civil Remedies Act. We believe that for these purposes as well, loss to the government should be defined as the full value of the fraudulently obtained contract when a company falsely represents that it is a small business.

The Small Business Jobs Act of 2010 did create a "rebuttable presumption" that the loss to the United States was the value of the contract. However, a contractor could overcome the presumption by showing the United States received what it paid for, which would put us right back where we started – with no monetary loss to the United States. As you are doubtless aware, the SBA has recently issued proposed regulations that would make the presumption irrefutable. In other words, as a matter of substantive law, the loss to the government would equal the value of the contract.

The Small Business Jobs Act also required the SBA to issue regulations that protect individuals and business concerns from liability in cases of unintentional errors, technical malfunctions, and similar situations. The proposed regulations implementing this provision would consider the company's internal management procedures governing size representation or certification, the clarity or ambiguity of the specific requirements, and the efforts made to correct an incorrect or invalid representation in a timely manner.

I certainly agree, given the complexities of many of the rules governing eligibility for preferential contracting programs, that companies should not be punished for innocent mistakes. However, our experience has shown that we need a significant penalty to act as a deterrent for those companies that willfully misrepresent their status in order to obtain government contracts intended for true small businesses. It would be beneficial to have this deterrent in both civil and criminal cases.

I would be pleased to answer any questions.