

\$4.47 Million False Claims Act Settlement Targets Set-Aside Contractors, Affiliates, and Even Third-Party Bonding Company

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Over three years after the filing of the initial sealed complaint, a New York-based construction company and several affiliates—including its bonding company—have agreed to pay a combined \$4.47 million to settle a False Claims Act case alleging a decade-long scheme to fraudulently obtain federal contracts set aside for Service-Disabled Veteran-Owned Small Business Concerns (“SDVOSBCs”) and small businesses operating in Historically Underutilized Business Zones (“HUBZones”). *United States of America, ex rel. James Hagan v. Northland Associates, Inc., et al.*, No. 5:17-cv-00036-GTS-TWD (N.D.N.Y.).

The Small Business Administration (“SBA”) maintains several programs that provide small and disadvantaged businesses exclusive opportunities to procure certain set-aside contracts with the federal government, *i.e.*, contracts that non-eligible companies cannot compete for. These programs are governed by an extensive set of statutes, regulations, and rules. Under the Small Business Act, certain size standards apply when determining if a business qualifies as a “small business” for government contracting purposes. See 13 C.F.R. § 121.201. When assessing size, small businesses must consider whether any relationship rises to the level of “affiliation,” which exists when another business controls or has the power to control the small business. See 13 C.F.R. § 121.103. Control by an affiliate may arise in several ways, including through ownership, management, financial support, employee sharing, or other relationships or interactions between the parties. *Id.*

Small business must meet additional standards set forth by the SBA to obtain more specialized SBA certifications. For instance, the SDVOSBC program requires a small business to be 51% owned and controlled by a military veteran injured in the line of duty. 15 U.S.C. § 632(q); 38 U.S.C. § 101(2), (16); 13 C.F.R. § 125.10; 38 C.F.R. § 74.4. Under the SBA’s separate HUBZone program—designed to encourage investment and employment in historically underutilized communities—a small business may obtain a HUBZone certification if it is located in a designated underutilized business zone. 13 C.F.R. § 126.

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In *Northland Associates*, two former-employee relators filed a complaint alleging that Northland Associates, Inc. (“Northland”) created a sham company—Diverse Construction Group, Inc. (“Diverse”)—to bid for and fraudulently obtain over \$50 million in construction set-aside contracts for the SBA’s SDVOSBC and HUBZone programs. The complaint alleged that Northland and its owner, James Tyler, worked with a service-disabled veteran, the late Hunter Grimes, to establish and certify Diverse as a SDVOSBC. According to the complaint, the parties further certified Diverse as a HUBZone business by setting up an office for the company in Plessis, New York. The complaint, however, alleged Grimes lacked the experience or capabilities to run a construction company, and that he did not take part in the management of Diverse or any day-to-day decision-making. Instead, the complaint alleged Northland controlled Diverse at all relevant times—including the bid process and the performance of contracts awarded to Diverse—from Northland’s office in Liverpool, New York.

Going beyond certification-related misrepresentations, the relators’ complaint alleged that Northland, Tyler, and Diverse took several affirmative actions to prevent discovery of their scheme. For instance, the complaint alleged that after a competitor initiated a bid protest involving Diverse in September 2009, the SBA conducted a size determination and concluded that Diverse did not qualify as a small business due to its affiliation with Northland. According to the complaint, Diverse successfully appealed the determination based upon declarations in which Tyler and Grimes allegedly misrepresented that: (1) Northland did not control Diverse, (2) Northland did not assist Diverse in the bid process; (3) Northland did not share employees, equipment, or facilities with Diverse; and (4) Northland did not financially assist Diverse or help it obtain bonding. The companies also allegedly attempted to hide their financial affiliation by transferring money through a Northland subsidiary, Maple Ridge Plateau, Inc., and using different bonding companies.

The Department of Justice (“DOJ”) opted to intervene and simultaneously filed its settlement agreement with Northland, Defense, and Tyler. In the settlement agreement, Northland, Diverse, and Tyler admitted to their involvement in “a scheme devised and engaged in . . . to circumvent service-disabled veteran-owned small business and HUBZone contract requirements.” They further admitted to the undisclosed affiliation between Northland and Diverse—including employee-sharing, funneling of funds through a Northland subsidiary, Northland’s involvement in the bid process, and Northland’s performance under the Diverse contracts—and that the declarations submitted in response to the bid protest contained material misrepresentations.

In addition, the DOJ filed a separate settlement agreement with Rose & Kiernan, the bonding company used by Northland and Diverse. Notably, Rose & Kiernan had *not* been named as a defendant in the complaint. In the settlement agreement, Rose & Kiernan admitted that it “knew or should have known . . . that Diverse and Northland were affiliated in violation of SBA regulations and that [Northland and Diverse] took steps to hide their affiliation from the government to obtain and receive payment on government set-aside contracts.” Rose & Kiernan further admitted that “[w]ithout the surety bonds that [Rose & Kiernan] helped Diverse procure . . . Diverse’s fraud would not

have been possible.”

Combined, the defendants and bonding company agreed to pay \$4,470,000 to settle the allegations, although the bonding company’s share was only \$120,000. The relators—two former Northland employees—will receive \$1,000,000.

This resolution provides three important reminders for all those who contract with the United States government. First, companies applying for any small or disadvantaged business certification must carefully and accurately assess their eligibility. This includes, importantly, assessing whether they have any affiliates and whether those affiliates affect eligibility. Second, bonding companies should look closely at the DOJ’s settlement agreement with Rose & Kiernan. Although FCA liability is most frequently applied to contractors who submit claims to the government, this settlement evidences an expansive reading of the FCA in which a bonding company knowledgeable of underlying fraud can be held liable under the FCA. Finally, the government eagerly and aggressively investigates fraud in its contracting programs—particularly where funds earmarked for veterans and small businesses are involved. As the DOJ reiterated in its [press release](#), “those who contract with the United States government must do so fairly and honestly,” and “[p]roviding false information to gain access to SBA’s preferential contracting programs is fraught with peril and is especially egregious when it involves programs intended to benefit our nation’s service-disabled veterans.” Given the large number of set-aside contracts that have been awarded under tight deadlines in response to the current COVID-19 crisis, we are likely to see an increase in small business-related FCA investigations and prosecutions in the coming months and years.