

**United States Small Business Administration
Office of Hearings and Appeals**

CVE Appeal of:

First State Manufacturing, Inc.,

Appellant,

Notice of Verified Status Cancellation

SBA No. CVE-184-A

Decided: April 8, 2021

APPEARANCES

Judith B. Kassel, Esq., Allison L. Burdette, Esq., Saul, Ewing, Arnstein & Lehr LLP,
Washington, D.C., For First State Manufacturing, Inc.

DECISION

I. Introduction and Jurisdiction

On February 2, 2021, First State Manufacturing, Inc. (Appellant) appealed a decision of the U.S. Department of Veterans Affairs (VA) Center for Verification and Evaluation (CVE) cancelling Appellant's verification in VA's Vendor Information Pages (VIP) database of eligible Service-Disabled Veteran-Owned Small Businesses (SDVOSBs). Appellant maintains that the cancellation was clearly erroneous and requests that the U.S. Small Business Administration (SBA) Office of Hearings and Appeals (OHA) reverse. For the reasons discussed *infra*, the appeal is denied.

OHA adjudicates CVE appeals pursuant to 38 U.S.C. § 8127(f)(8)(A) and 13 C.F.R. part 134 subpart K. Appellant timely filed the appeal within ten business days after receiving the cancellation notice on January 19, 2021. 13 C.F.R. § 134.1104(a). Accordingly, this matter is properly before OHA for decision.

II. Background

A. Verification

Appellant is a textile manufacturer headquartered in Milford, Delaware. On May 29, 2018, CVE verified Appellant as an SDVOSB and included Appellant in the VIP database. (Case File (CF), Exh. 1.) The verification was valid for a period of three years. (*Id.*)

B. Consent Judgment

In November 2020, the United States Attorney's Office (USAO) for the Eastern District of Pennsylvania filed a complaint against Appellant for violations of the False Claims Act, 31 U.S.C. § 3729 *et. seq.* (CF, Exh. 3.) The suit alleged that, between June 2014 and November 2017, Appellant, through its executive management, bribed an official of the National Railroad Passenger Corporation (Amtrak) to obtain lucrative contracts; conspired with that official to supply substandard products at inflated prices; and attempted to conceal the scheme by falsifying records and creating a fictitious company. (*Id.*) The USAO previously had criminally prosecuted the Amtrak official and two of Appellant's senior executives — Donald Scott Crothers, Appellant's Vice President for Marketing and Contract Administration, and John Gonzales, Appellant's Chief Executive Vice President and Chief Financial Officer — for their individual roles. (*Id.*) Messrs. Crothers and Gonzales pleaded guilty and were sentenced to terms in prison. (CF, Exhs. 3 and 14.)

To resolve the False Claims Act suit without further litigation, the USAO and Appellant entered into a Consent Judgment, subject to Court approval, whereby Appellant agreed to pay \$393,250.06 to the United States. (CF, Exh. 3.) On November 17, 2020, U.S. District Judge Chad F. Kenney approved the Consent Judgment. (CF, Exh. 4.)

C. Notice of Proposed Cancellation

On December 15, 2020, CVE issued a Notice of Proposed Cancellation (NOPC) to Appellant, proposing to cancel Appellant's verified status and registration in the VIP database. (CF, Exh. 9.) CVE observed that, under 38 C.F.R. § 74.21, CVE may cancel a participant's verification for “good cause,” which may include any “cause of so serious or compelling a nature that it affects the present responsibility of the participant.” (*Id.* at 2.) Further, pursuant to 38 C.F.R. § 74.2(e):

Protest Decisions or other negative findings . . . Any firm verified in the VIP database that is found to be ineligible due to a [SBA] protest decision or other negative finding may be immediately removed from the VIP database, notwithstanding the provisions of § 74.22. Until such time as CVE receives official notification that the firm has proven that it has successfully overcome the grounds for the determination, that the decision is overturned on appeal, or the firm applies for and receives verified status from CVE, the firm will not be eligible to participate in the 38 U.S.C. 8127 program.

(*Id.* at 1-2.)

In the instant case:

According to the Department of Justice, [the USAO] filed suit against [Appellant] for violating the False Claims Act by bribing a procurement official in order to receive contracts. Donald Scott Crothers, [Appellant's] Vice President for Marketing and Contract Administration, received a sentence of eighteen months

in prison. John Gonzales, [Appellant's] Chief Executive Vice President and Chief Financial Officer, is awaiting sentencing. The United States and [Appellant] entered a Consent Judgment to resolve the matter without litigation. On November 17, 2020, the District Court for the Eastern District of Pennsylvania entered judgment in favor of the United States and against [Appellant] in the amount of \$393,250.06. Therefore, CVE cannot reasonably determine whether the foregoing constitutes a cause of so serious or compelling a nature that it affects the present responsibility of [Appellant] pursuant to 38 CFR § 74.21(e).

(*Id.* at 2.) The NOPC explained that Appellant would have 30 days from the date of the NOPC to demonstrate why cancellation was not warranted. (*Id.* at 2-3, citing 38 C.F.R. § 74.22.)

D. Response to NOPC

Appellant responded to the NOPC with a two-page letter dated December 22, 2020. (CF, Exh. 12.) Appellant asserted that “the incident” referenced in the NOPC “took place over three years ago” and “served as an opportunity to tighten [Appellant's] stringent ethical standards.” (*Id.* at 1.) Following an extensive investigation, the Federal Railroad Administration, which provides federal funding to Amtrak, concluded that Appellant is presently responsible. (*Id.*) Appellant made no mention of the False Claims Act litigation or of the Consent Judgment. (*Id.* at 1-2.)

Appellant stated that, at the time the misconduct described in the NOPC occurred, Appellant had won multiple small business awards and held “one of the highest quality standards available.” (*Id.* at 1.) Nevertheless, Appellant has now implemented “additional safeguards.” (*Id.*) Appellant engaged outside experts to conduct a “complete internal forensic analysis” to prevent similar problems from recurring. (*Id.*) The three individuals who perpetrated the wrongdoing were fired by Appellant and Amtrak, respectively, and Appellant understands that “all three have confessed to their crimes and have plead[ed] guilty.” (*Id.*) Apart from those three individuals, “neither Amtrak nor [Appellant] have ever alleged” that other persons were involved in wrongdoing. (*Id.* at 2.) Further, even after the wrongdoing was discovered in November 2017, Amtrak “continued to place orders with [Appellant] before making a decision not to exercise its option years.” (*Id.*)

Appellant stated that it has revised its financial standards and ethics portions of its handbook. (*Id.* at 1.) Appellant also updated its ethics training. (*Id.*) Appellant offered an example of its newsletter discussing the firm's “Quality, Ethics and Excellence,” and a “report card” from Lockheed Martin attesting to the high quality of Appellant's products. (*Id.*)

Appellant urged CVE to conclude that Appellant has ensured that the “Federal government is protected against future harm.” (*Id.* at 2.) The activities referenced in the NOPC “provided an opportunity for [Appellant] to increase its high standards and commitment to quality programs **tenfold**.” (*Id.* at 1, emphasis Appellant's.)

Accompanying its response to the NOPC, Appellant provided CVE a letter from the Federal Railroad Administration, as well as: Appellant's Code of Business Conduct; Appellant's

Employee Handbook as revised March 2019; quality control certifications issued to Appellant; a newsletter dated August 2018; documents entitled “Cash Receipts — Control Narrative” and “Cash Disbursements — Control Narrative”; a presentation on “Ethically & Compliantly Working with Governments”; and the Lockheed Martin report card pertaining to Appellant. (CF, Exhs. 14-23.)

E. Federal Railroad Administration Letter

With its response to the NOPC, Appellant provided CVE a copy of a letter from the Federal Railroad Administration to Appellant, dated May 14, 2019. (CF, Exh. 14.) The letter noted that two of Appellant's senior executives, Messrs. Crothers and Gonzales, “were both charged and pleaded guilty to Federal program bribery (18 U.S.C. § 666(a)(2)) and aiding and abetting (18 U.S.C. § 2).” (*Id.* at 1.) Nevertheless, based on information Appellant had provided to the Suspension and Debarment Official (SDO), the SDO had “determined the likelihood of future harm to the Federal government did not warrant the suspension or debarment of [Appellant].” (*Id.* at 1-2.) The letter cautioned that, “[a]t the time of [the SDO's] decision, the [USAO] had not made an official determination on potential criminal charges against [Appellant].” (*Id.* at 1.)

F. Notice of Verified Status Cancellation

On January 19, 2021, CVE issued a Notice of Verified Status Cancellation (NOVSC) formally cancelling Appellant's status as a verified SDVOSB. (CF, Exh. 25.) CVE explained that, although Appellant is owned by one or more service-disabled veterans, CVE was unable to conclude that Appellant meets other eligibility requirements as set forth in 38 C.F.R. part 74. (*Id.* at 1.) Further, Appellant did not timely inform CVE of changes that would impact its verification eligibility, as required by 38 C.F.R. § 74.15(b). (*Id.* at 2.)

CVE noted that, in response to the NOPC, Appellant asserted that the wrongdoing which led to the False Claims Act suit and the Consent Judgment had occurred more than three years earlier, and had served as an impetus for Appellant to heighten its ethical standards. (*Id.*) More specifically, Appellant stated that it had “terminated the employees involved; hired additional skilled key individuals; completed an internal forensic analysis; revised financial standards; and updated [its] ethics training and standards.” (*Id.*) Appellant also provided a letter from the Federal Railroad Administration declining to pursue suspension or debarment against Appellant. (*Id.*) Nevertheless, in CVE's view:

[T]he judgment against [Appellant] establishes good cause for cancelling [Appellant's] verified status in accordance with 38 CFR § 74.21(e) and constitutes a negative finding that warrants removal from the VIP database pursuant to 38 CFR § 74.2(e).

(*Id.*) CVE added that Appellant also did not timely apprise CVE of changes that would affect Appellant's eligibility “within 30 days as required by 38 CFR § 74.15(b).” (*Id.*)

G. Appeal

On February 2, 2021, Appellant timely appealed the NOVSC to OHA. Appellant contends that CVE erred in cancelling Appellant's verified status, because CVE based its decision on “unproven allegations of conduct occurring three to five years ago,” specifically the allegations set forth in the False Claims Act suit. (Appeal at 1.) The resulting Consent Judgment stemmed from a Settlement Agreement between the USAO and Appellant. (*Id.*) As such, Appellant maintains, there has been no determination that Appellant itself or its owners are liable for the wrongful conduct. (*Id.* at 5.)

Appellant argues, first, that “CVE's conclusion that the Consent Judgment alone establishes good cause for removal of [Appellant] is unreasonable and unsupported by law.” (*Id.*) Rather, the regulation cited in the NOVSC, 38 C.F.R. § 74.21(e), provides that:

Other grounds for cancelling a participant's verified status include any other cause of so serious or compelling a nature that it affects the **present responsibility** of the participant.

(*Id.*, emphasis Appellant's.) By focusing on the Consent Judgment, CVE overlooked evidence in the record demonstrating that Appellant is “presently responsible.” (*Id.* at 6.) Appellant highlights that, after learning of the wrongdoing, Appellant “implemented a Code of Ethics, provided training on the Code, and implemented financial controls to facilitate timely discovery and disclosure of improper conduct.” (*Id.*) Further, Appellant is audited by a third-party accounting firm, and has hired an experienced Chief Financial Officer. (*Id.*) Given these changes, CVE should have had “no doubt that [Appellant] is presently responsible.” (*Id.*)

Appellant complains that CVE “fail[ed] to consider the terms of the Settlement Agreement, which forms the basis for the Consent Judgment.”¹ (*Id.*) The Settlement Agreement defines “Covered Conduct” as relating to the activities of Appellant's former executives, whose employment was terminated by Appellant years ago. (*Id.*, citing Attach. 5.) Moreover, Appellant admitted to no liability in the Settlement Agreement, and has not itself been convicted of any violation. (*Id.*) CVE's reliance on the Consent Judgment to find “good cause” for Appellant's cancellation is inconsistent with Federal Acquisition Regulation (FAR) 9.406-2, which indicates that a contractor may be debarred upon “a conviction of or civil judgment for” serious misconduct, such as fraud, bribery, or false statements. (*Id.*)

Appellant argues that CVE should have attached greater weight to the decision of the Federal Railroad Administration “that the likelihood of future harm to the Federal government did not warrant the suspension or debarment of [Appellant].” (*Id.* at 3.) The decision, in effect, amounts to a finding that Appellant is “presently responsible.” (*Id.*) In addition, because the Federal Railroad Administration is the agency most familiar with, and impacted by, the misconduct, its views should have been given deference by CVE. (*Id.* at 6, n.2.)

¹ The Settlement Agreement is not in the Case File, and it does not appear that Appellant ever provided the document to CVE.

Appellant next argues that CVE incorrectly found that Appellant did not inform CVE of changes that would affect Appellant's verification eligibility. (*Id.* at 6.) Although CVE did not explain this portion of its decision, CVE may have been concerned about the “good character” requirement in 38 C.F.R. § 74.2(b), which states:

Good character and exclusions in System for Award Management (SAM). Individuals having an ownership or control interest in verified businesses must have good character. Debarred or suspended concerns or concerns owned or controlled by debarred or suspended persons are ineligible for VIP Verification. Concerns owned or controlled by a person(s) who is currently incarcerated, or on parole or probation (pursuant to a pre-trial diversion or following conviction for a felony or any crime involving business integrity) are ineligible for VIP Verification. Concerns owned or controlled by a person(s) who is formally convicted of a crime set forth in 48 CFR 9.406-2(b)(3) are ineligible for VIP Verification during the pendency of any subsequent legal proceedings. If, after verifying a participant's eligibility, the person(s) controlling the participant is found to lack good character, CVE will immediately remove the participant from the VIP database, notwithstanding the provisions of § 74.22.

(*Id.* at 7.) Appellant emphasizes that, in the instant case, Appellant and its owners have not been debarred, suspended, convicted of a crime, incarcerated, or placed on parole or probation. (*Id.*) The Consent Judgment, based on the Settlement Agreement, also does not establish liability. Rather, the Settlement Agreement stipulates that it is “neither an admission of liability by [Appellant], nor a concession by the United States that its claims are not well-founded.” (*Id.*, quoting Attach. 5 ¶ 5.)

Even if CVE regulations could be understood as requiring Appellant to have notified CVE of the Consent Judgment, the Consent Judgment was not approved by the Court until November 17, 2020. As a result, Appellant would have had 30 days, or until December 17, 2020, to inform CVE of the Consent Judgment, and Appellant thus would not have been tardy in doing so as of the date the NOPC was issued. (*Id.* at 7-8.)

III. Discussion

A. Standard of Review

Appellant has the burden of proving, by a preponderance of the evidence, that the cancellation was based upon clear error of fact or law. 13 C.F.R. § 134.1111.

B. Analysis

Appellant has not shown that CVE clearly erred in cancelling Appellant's verified status. Therefore, this appeal must be denied.

Pursuant to 38 C.F.R. § 74.21, CVE may cancel a participant's verification for “good cause,” which may include “any . . . cause of so serious or compelling a nature that it affects the

present responsibility of the participant.” To be considered “responsible,” a concern must, among other requirements, “[h]ave a satisfactory record of integrity and business ethics.” FAR 9.104-1(d).

In the instant case, CVE learned, based on information provided by the USAO, that over the course of several years, two of Appellant's senior executives bribed an Amtrak official to obtain lucrative contracts; conspired with that official to supply substandard products at inflated prices; and attempted to conceal the scheme by falsifying records and creating a fictitious company. Sections II.B and II.C, *supra*. The two executives, Messrs. Crothers and Gonzales, pleaded guilty to federal bribery charges and were sentenced to terms in prison. *Id.* Initially no allegations were brought against Appellant itself, but in November 2020, the USAO filed suit against Appellant for violation of the False Claims Act. *Id.* Appellant agreed to settle the matter, without conceding liability, by entering into the Consent Judgment. *Id.* In light of these circumstances, CVE had ample cause to be concerned about Appellant's present responsibility.

Under 38 C.F.R. § 74.22(a), once CVE issues a Notice of Proposed Cancellation (NOPC), the participant then must come forward with “a written response to CVE explaining why the proposed ground(s) should not justify cancellation.” Here, Appellant's response to the NOPC was brief, vague, and lacking in supporting detail. Section II.D, *supra*. Although Appellant appeared to characterize the wrongdoing as a one-time “incident” attributable entirely to Messrs. Crothers and Gonzales, Appellant did not explain how their misconduct had remained undetected by Appellant for several years. *Id.* Appellant did not describe the nature of the new financial and ethical controls implemented by Appellant, and did not attempt to show how those controls would prevent future recurrence of similar wrongdoing. *Id.* Appellant alluded to a “forensic analysis” conducted by outside experts, but offered no details or corroborating evidence. *Id.* Further, Appellant remained silent as to the False Claims Act suit brought against Appellant itself, even though CVE specifically raised that issue in the NOPC. Sections II.C and II.D, *supra*. Given this record, CVE could reasonably conclude that Appellant did not provide adequate information to resolve CVE's concerns about Appellant's present responsibility.

On appeal, Appellant argues that CVE should have attached greater significance to the decision of the Federal Railroad Administration not to pursue suspension or debarment against Appellant. Section II.G, *supra*. The Federal Railroad Administration, though, made its decision in May 2019, well before the USAO filed the False Claims Act suit against Appellant in November 2020. Sections II.B and II.E, *supra*. Indeed, the Federal Railroad Administration cautioned that, at that time of its decision, the USAO had not yet made any determination about whether to bring actions against Appellant. Section II.E, *supra*. As a result, CVE could properly find the Federal Railroad Administration letter not dispositive on the question of whether Appellant is presently responsible.

Appellant also complains that CVE did not elucidate its reasons for determining that Appellant failed to timely apprise CVE of changes that would affect Appellant's eligibility. Section II.G, *supra*. Although I agree with Appellant that the NOVSC is unclear on this point, the issue is immaterial because, as discussed above, CVE had a proper basis to cancel Appellant's verification in any event pursuant to 38 C.F.R. § 74.21(e). It is worth noting, however, that, by Appellant's own admission, the misconduct of Messrs. Crothers and Gonzales

was discovered in November 2017, and Appellant, thus, apparently would have been aware of such misconduct at the time it was seeking verification from CVE in early 2018. Sections II.A and II.D, *supra*. The record does not indicate to what extent Appellant disclosed the misconduct to CVE during the verification process.

IV. Conclusion

Appellant has not established that CVE committed error of fact or law in cancelling Appellant's verified status. The appeal therefore is DENIED. 13 C.F.R. § 134.1112(f). This is the final agency action of the U.S. Small Business Administration. 38 U.S.C. § 8127(f)(8)(A); 13 C.F.R. § 134.1112(d); 38 C.F.R. § 74.22(e).

KENNETH M. HYDE
Administrative Judge