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Small Businesses Beware: The False Claims Act Risk with Federal Government Contracts

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As highlighted in [U.S. ex rel. Cherwenka v. Fastenal Company](#), today small businesses must deal with the possibility of False Claims Act lawsuits, which were previously a concern to larger corporations with deep pockets. As detailed by government contract attorney, [Andrew Mohr](#), a Partner with [Morris, Manning, & Martin LLP](#), this case highlights the importance of document retention, and understanding the possible threats extending from qui tam plaintiffs seeking financial gains for government contract violations.

The Case in Question

This case involved, Fastenal Company, which is an international distributor of industrial supplies and parts with approximately 2,500 branches worldwide. Fastenal engaged in a 2006 Mentor Protégé Agreement with Wells Technology, Inc., a small business participant in the [US Small Business Administration's](#) 8(a) business development program. Under the agreement, which was entered into pursuant to the applicable SBA regulations and was approved by Well's local SBA office, Fastenal provided management, operational, logistical and sales support for the sale of industrial supplies and parts to US federal agencies. The contract allowed Wells, a smaller company, to compete for government contracts set aside for small businesses. It benefited Fastenal by developing a new channel to sell their products.

One area the parties did not consider at the time was the possibility of a False Claims Act lawsuit being filed against them. Under [False Claims Act, 31 U.S. Code § 3729-3733](#), private third parties have the right to file lawsuits, as qui tam relators on behalf of a government agency. This is what occurred eight years after the original contract was executed between the parties. Michael Cherwenka, a small business owner claimed the contract agreement was a scam. In his complaint, he alleged that the contract was basically allowing Fastenal, a major corporation, to benefit from contracts that were set aside for small businesses. Mr. Cherwenka further alleged Wells was a large company, rather than a small business because it was affiliated with Fastenal under the contract. Therefore, Wells shouldn't have been able to apply for small business contracts set aside for small businesses.

The Alleged Claim and Outcome

Mr. Cherwenka filed his claim under seal, allowing the SBA and DOJ, to further investigate the claim. The investigation continued from 2014 to 2017, including a series of informal unrecorded interviews with Fastenal's and Wells' witnesses. Following the investigation, the DOJ declined to intervene. Although this allowed Mr. Cherwenka to follow through as a qui tam plaintiff, it signaled to the court that the DOJ was not interested in the case.

Following the DOJ's declination to intervene, Fastenal, Wells, and other unnamed defendants filed motions to dismiss and motions for judgment on the pleadings, stating the plaintiff failed to meet the particularity requirements of Rule 9(b), of the False Claims Act. The defendants further claimed Mr. Cherwenka couldn't bring



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his claim under the “public disclosure bar,” and that he wasn’t an injured party of the alleged schemes he alleged took place. Ultimately, the claims were dismissed. The court found that the Mentor Protégé Agreement had been properly reviewed and was approved by the SBA offices, giving rise to them being considered legally valid contracts.

... Where does this leave small business owners?

As this case highlights, and as government contract attorney Andrew Mohr points out, small businesses are now in the line of fire as it relates to small business contract violation claims. More qui tam plaintiffs are [alleging violations against small businesses](#). In this case what was instrumental to their victory was that the parties were able to produce 10-year-old documents to prove they had engaged in a legally binding contract.

The [SBA has also taken strides](#) in attempting to cut back on fraudulent agreements. Implementing stricter regulations for women and Veteran-owned small businesses, along with requiring additional documentation for businesses to receive funding, are some measurements that are in effect to minimize the occurrences of businesses receiving funding when they would otherwise be ineligible.

Mohr warns small businesses, and large corporations alike, to maintain copies of agreements, contracts, and proof that the SBA (and other applicable government agencies) have reviewed and approved such contracts. Although these qui tam claims won’t be eliminated, record-keeping and document management are imperative to fighting the allegations levied against a business for a fraudulent contract agreement. Mr. Mohr also stresses the importance of ethics training and self-audits, to avoid False Claims Act violation lawsuits being filed.

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