Insights: Alerts

Supreme Court Finds The Department of Veterans Affairs Violated Procurement Law – Are There Broader Implications for Government Contractors?

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On June 16, 2016 the Supreme Court of the United States ("SCOTUS") issued its much anticipated decision in the *Kingdomware Technologies, Inc. v. United States* case ("*Kingdomware*"). One of two important cases, both decided on the same day, *Kingdomware* and *Universal Health Services, Inc. v. Escobar,*[1] constitute those rare SCOTUS decisions that have direct and important implications for the government contracts world.

In *Kingdomware*, the SCOTUS has found that the United States Department of Veterans Affairs ("VA") has violated established law in its making awards of contracts to veteran-owned small businesses ("VOSBs") and service-disabled veteran owned small businesses ("SDVOSBs") versus non-veteran owned businesses. This decision finally brings closure to the rare situation and long-running dispute between the VA and the U.S. Government Accountability Office ("GAO") that relates to their comparative interpretation and applicability of the Veterans Benefits, Health Care, and Information Technology Act of 2006 ("Act") and the VA's award of certain contracts to non-veteran owned businesses.

Introduction

Traditionally, the issuance and award of government contracts has been based on the fundamental of "full and open competition", competed for "on a level playing field." Over the past several decades, Congress saw fit to develop a number of programs that provide competitive advantages to certain classes of small businesses based on the type of owner and size of the business. These programs include the 8(a) (socially and economically disadvantaged); WOSB (woman-owned small business); HUBZone (historically underutilized business area); and veteran-owned and service-disabled veteran owned small business concerns (businesses owned by service-disabled veterans). It is these last two categories, veteran-owned and service-disabled veteran owned businesses, that apply to this decision.

Across most of these small business programs, agencies are generally required to set aside a contract for award to small business if there is a reasonable likelihood that two or more qualifying small businesses will bid on the subject solicitation (*e.g.,* competition) and there is an expectation that the awarded price will be fair and reasonable. This is known in government contracts parlance as the "Rule of Two". Under the Rule of Two which is part of the Act, the VA must set aside the contract so long as these requirements are met.

Background & Relevant Facts

Over the years, Congress has required that agencies establish small business participation goals for their procurements. In order to support and meet those goals, Congress had begun requiring the set aside of contracts for small businesses if the Rule of Two was met. This mandate, with certain exceptions, was imposed upon the VA by Congress through the Act.

GSA's FSS – A Brief Primer

In promulgating its regulations to effectuate the Act, the VA stated that (a) contracts that fall under the U.S. General Services Administration's ("GSA") Federal Supply Schedule ("FSS") task or delivery orders; and (b) certain exceptions relating to the type and dollar amount of the subject contract, were exempted from applicability of the Rule of Two.

The FSS is a mechanism under which the Government pre-negotiates contracts for certain fungible goods and supplies. Through this mechanism, a group of "schedules" are established by GSA under which the GSA directly negotiates between itself and vendors on behalf of GSA and other federal agencies. Items ranging from paper clips and pencils to hourly services are under these various schedules at unit prices or hourly rates. An online catalog (*see,* www.gsaadvantage.gov) is overseen by GSA. Under the FSS, the negotiated prices established in the schedules represent the cap or top price a vendor or contractor can charge the purchasing agency, but any purchasing agency can negotiate better or different pricing on an as desired basis.

Case Background

Kingdomware Technologies, Inc. is a SDVOSB that failed to obtain a VA-awarded emergency-notification system. Instead of competing the work among VOSBs or SDVOSBs, or even considering application of the Rule of Two, the VA instead solicited a non-veteran-owned business under the FSS. When that non-VOSB issued a reasonable price, the VA accepted the offer and issued a contract for one base year and an option to extend for an additional two years. That contract completed in May 2013. After learning of the award, Kingdomware filed a bid protest with the GAO. In its protest, Kingdomware alleged that the VA had procured multiple contracts using the FSS without restricting competition to VOSBs or SDVOSBs or even considering and conforming with the Act's Rule of Two. In other words, the VA failed to first consider whether two or more VOSBs or SDVOSBs would compete for the subject contracts.

The GAO ultimately agreed with Kingdomware, finding that under the Act, the Rule of Two applied and the VA's award to a non-VOSB violated the law. The VA refused to follow GAO's recommendation and kept the existing award in place.

Critical to note is that there had actually been a line of several prior protest decisions to this one in which GAO reached the same conclusion and the VA repeatedly refused to follow the recommendation and findings of GAO.

Upon learning that the VA would not comply with the GAO decision, Kingdomware filed suit in the U.S. Court of Federal Claims ("COFC") seeking injunctive relief. The COFC granted summary judgment for the VA, which was affirmed on appeal by the U.S. Court of Appeals for the Federal Circuit by a split decision. In its ruling, the Federal Circuit majority held that there was not a requirement for the VA to use the Rule of Two in all of its contracting. Instead, that court concluded that the Rule of Two was only limited to "contracts necessary to fulfill its statutory purpose", namely the VA's satisfying its annual set aside contracting goals. So long as the goals were

met, said the Federal Circuit, the VA could avoid using the Rule of Two. The dissent disagreed saying that the subject clause requiring application of the Rule of Two was mandatory, and that the VA could not avoid the Rule of Two analysis and consideration. The SCOTUS took this appeal.

Did the Court Have Jurisdiction?

Interestingly, before reaching the merits of the case, Justice Thomas in this unanimous decision, first considered whether the Court had jurisdiction. As the contract in question was over, there was no relief that could really be granted, potentially mooting the case. After all, how does a Court issue a remedy if there is nothing left to remedy or impact? The Court addressed this issue by concluding that where there is a "controversy that is 'capable of repetition, yet evading review,'" that it can consider the case anyway. This exception applies only in limited and "exceptional circumstances", where the action being questioned was too short for full litigation prior to its conclusion; and "'[t]here is a reasonable exception that the same complaining party [will] be subject to the same action again.'"

Given the short term nature of FSS contracts, the Court concluded that this exception applied and it retained jurisdiction. This was all the more the case given that that the VA's position since September 2015 has been that the definition of "contract" in the Act excludes orders from multiple-award vehicles, meaning the VA would continue ignoring the Rule of Two in the future. This potential impact to future contracting permitted the Court to conclude that it properly could consider the case's merits.

The Merits – The Rule of Two Applies

In summary, the SCOTUS found that the Rule of Two was mandatory and applied "…to all [VA] contracting determinations" including the award of contracts to VOSBs. Despite the VA's argument to the contrary, the Court found that the VA did not have discretion as to how to apply the rule and that the VA could not avoid that congressional mandate. The Court also found that there was no exception to this rule for FSS contracts. "Congress' use of the word 'shall' demonstrates that §8127(d) mandates the use of the Rule of Two in all contracting before using competitive procedures.'"

Discussion

The Rule of Two comes out of the Act's section 8127(a) which states in sum that the VA "'shall award' contracts by restricting competition for the contract to service-disabled or other veteran-owned small businesses." This language was conditioned on the Rule of Two and the finding that an award could be made at a fair and reasonable price. This section reads:

"Except as provided in subsections (b) and (c), for purposes of meeting the goals under subsection (a), and in accordance with this section, a contracting officer of the Department ***shall*** *award contracts on the basis of competition restricted to small business concerns owned and controlled by veterans if the contracting officer has a reasonable expectation that two or more small business concerns owned and controlled by veterans will submit offers and that the award can be made at a fair and reasonable price* that offers best value to the United States." 38 U.S.C. §8127(d). (Emphasis added).

Relying upon the long held requirement that statutory analysis such as this begin with the plain language of the statute, the Court found that Congress's use of the word "shall" formed a mandatory obligation (as distinguished from examples such as "may", which is discretionary). By including the word "shall" in this enacting provision, the Court concluded that Congress mandated that the Rule of Two, and analysis of its application, was required to be performed by the VA on all non-exempted contracts. Towards this end, the Court concluded that the VA "shall award contracts" based upon set aside restricted competitions for VOSBs whenever the Rule of Two applies unless one of the two exceptions relating to small business threshold applies.

In conclusion, the Court found that "[u]nlike the word 'may,' which implies discretion, the word 'shall' usually connotes a requirement….Accordingly, the Department *shall* (or *must*) prefer veteran-owned small businesses when the Rule of Two is satisfied." (Italics in original).

In reversing the COFC and Federal Circuit, the Supreme Court found that both courts' interpretations in relying on the Act's prefatory and purposes clauses was improper and would produce an anomaly. The Federal Circuit found that those clauses limited the VA's need to apply the Rule of Two to those cases in which the VA had not yet met its small business contracting goals. Once those goals were met, said the Federal Circuit majority opinion, then the Rule of Two could be suspended by the VA. The SCOTUS disagreed. If this were true, said the Court, then the mandatory "shall" language is not given effect and at the same time the permissive mandates in those clauses would not apply. This would render the two exceptions of no force and effect, which the Court concluded further supported its finding of the mandate for the Rule of Two.

The Court also took on the VA's alternative argument, which the first Court found had been waived by the VA's not raising it in the lower courts. That argument claimed that by the VA using the FSS system, the mandatory Rule of Two did not apply to those orders because they were "pre-existing FSS contracts." In plain language, because the FSS consists of already-existing contracts, the VA argued that they fall outside the Rule of Two mandate.

Despite finding this argument was waived, the SCOTUS found that the VA would have lost it anyway. In using the FSS system, "that [separate purchase] order creates contractual obligations for each party and is a 'contract' within the ordinary meaning of that term." While the VA argued that the FSS contracts were preexisting, the SCOTUS found that the FSS contracts were agreements to agree in which the Government had an option to buy but which did not require the government to expend monies. Because the VA could negotiate different or better terms on an order-by-order basis, each order was its own contract vehicle and effectively a standalone agreement.

The VA also argued that the FSS contracts were limited to simplified acquisitions (under $150,000 in value) and the use of the Rule of Two would hamper the streamlined effect of purchases under the FSS. The Court disagreed. Instead, the Court found that the FSS vehicles were used in an expanded manner by the VA, going way beyond the simple purchase of basic goods and services. Using the contract that was the subject of this case as an example, the Court found that "the contract at issue here concerned complex information technology services over a multiyear period." In addition, the Court identified that because these services could still to be purchased by the VA through the FSS or directly from a VOSB, so long as the contract was below the $150,000 simplified acquisition threshold, created a situation where the VA still should otherwise be held strictly to the Rule of Two.

Finally, the Court denied the VA's request that the Court defer to the VA's interpretation of the statute and regulations to support the VA's finding that FSS "orders" are not contracts *per se.* Citing its conclusion that the Act was clear, the Court refused to grant such deference.

Conclusion

The Court concluded by finding that the Rule of Two in the VA-specific Act applied to all contracts and not just those necessary to meet the small business goals. The Court also found that the Rule of Two applied to FSS contracts and purchases.

The Rule of Two in the context of this case is limited to VA-awarded contracts, including those under the FSS, and arises from the Act. That being said, the Rule of Two applies through regulations in the context of other, broader small business set aside preferences, including the 8(a), HUBZone and WOSB programs. While, perhaps not statutory in nature, unlike the present situation with the VA, *Kingdomware's* application of the Rule of Two will likely have an influence on these other programs, providing small businesses, not limited to just VOSBs, the ability to now point to a supreme court decision that says "yes" agency, you must apply the Rule of Two absent an express exception.

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[1] *Escobar* is a case involving the applicability of implied certifications to False Claims Act cases and has much broader implications. *See* our separate client alert on *Escobar*.

Related People



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