Congress of the United States

H.S. House of Representatives Committee on Small Business 2361 Rayburn House Office Building

Washington, DC 20515-6515

MEMORANDUM

To: Members, Subcommittee on Investigations, Oversight and Regulations

From: Judy Chu, Chairwoman

Date: October 22, 2019

Re: Subcommittee Hearing: "Native 8(a) Contracting: Emerging Issues"

On Tuesday, October 22, 2019 at 10:00 a.m. in Room 2360 of the Rayburn House Office Building, the Committee on Small Business will hold a hearing entitled, "Native 8(a) Contracting: Emerging Issues." The purpose of the hearing is to provide a full overview of the 8(a) program as it applies to native 8(a) contractors, including some of the oversight weaknesses the Government Accountability Office (GAO) has identified in SBA's management of the program. The hearing will also discuss the program's intent, benefits, and overall performance. The hearing will enable Committee Members to gain valuable insight into the program and ultimately ensure that it is working as intended.

Witnesses for this hearing include:

Panel One

• Mr. Seto Bagdoyan, Director, Forensic Audits and Investigative Service, Government Accountability Office, Washington, DC

Panel Two

- Mr. Joe Valandra, Executive Director, Native American Contractors Association Washington, DC
- Ms. Annette Hamilton, Chief Operating Officer of Ho-Chunk Inc., Winnebago, NE
- Mr. Edwin A. (Skip) Vincent, Chairman and Founder of the Hawaii Pacific Foundation, Honolulu, HI; Testifying on behalf of the Native Hawaiian Organization Association (NHOA)
- Ms. Jana Turvey, President and CEO of Leisnoi, Anchorage, AK; Testifying on behalf of the Alaska Native Village Corporation Association (ANVCA)
- Ms. Christine V. Williams, Managing Partner Outlook Law LLC, Anchorage, AK

Background

In 2017, the government purchased over \$550 billion of goods and services. Thus, there is no question that federal procurement can be an invaluable tool to allocate economic resources to the poorest areas of the country and incentivize growth. Recognizing this, small businesses owned by

¹ U.S. Gov't Accountability Off., Watchblog, *Federal Government Contracting for Fiscal Year 2018 (infographic)* (May 28, 2019), *available at* https://blog.gao.gov/2019/05/28/federal-government-contracting-for-fiscal-year-2018-infographic/.

Indian tribes, Alaska Native Corporations (ANCs) and Native Hawaiian Organizations (NHOs) have been granted the opportunity to participate in the 8(a) program. Their participation in the program serves to address devastating levels of economic hardship. In fact, one-in-four American Indians and Alaska Natives were living in poverty in 2012. Moreover, the program injects resources in places that otherwise would have little to no economic opportunity, improving the conditions of communities as a whole. Finally, the existence of the program helps further policies of self-sufficiency and self-determination that strengthen the relationship between these communities and the Federal government. Today, there are approximately one thousand firms owned by Indian tribes, ANCs, and NHOs, participating in the 8(a) program.

8(a) Program Overview

The Small Business and Capital Ownership Development Program, known as the 8(a) program, is a federal contracting program, which was created in 1978⁶ to give explicit statutory authority to the Small Business Administration (SBA) to focus on minority-owned businesses. In the 1980s, the program was further expanded to include small businesses owned by disadvantaged groups, including Indian tribes, Alaska Native Corporations (ANCs) and Native-Hawaiian Organizations (NHOs). Generally, Indian tribes, ANCs and NHOs do not themselves participate in the program; instead, they are the parent entities of small businesses that participate. Parent entities – whether Indian tribes, ANCs, or NHOs – can own 8(a) and non-8(a) subsidiaries, often creating complex corporate structures.

Requirements to participate in the 8(a) program

The requirements to participate in the 8(a) program vary slightly depending on whether the participant is an individually-owned small business or a small business owned by an Indian tribe, ANC, or NHO.¹¹ The main differences in eligibility criteria are highlighted in Table 1 below:

² Pew Research Center, *One-in-four American Indians and Alaska Natives are living in poverty* (June, 13, 2014), available at: https://www.pewresearch.org/fact-tank/2014/06/13/1-in-4-native-americans-and-alaska-natives-are-living-in-poverty/.

³ Native American Contractors Association, *Basics of Native 8(a)*, available at http://nativecontractors.org/member-services/archive/advocacy-archive/basics-of-native-8a.

⁴ Id

⁵ Small Business Administration, Dynamic Small Business Search Data System, accessed on October 15, 2019 and available at: https://uscontractorregistration.com/dynamic-small-business-search-dsbs/

⁶ To amend the Small Business Act and the Small Business Investment Act of 1958, P.L. 95-507, 92 Stat. 1757, (Oct. 24, 1978).

⁷ The 8(a) Program, as originally enacted, was not limited to socially and economically disadvantaged businesses. *See* ROBERT JAY DILGER, CONG. RESEARCH SERV., R44844, SBA'S "8(A) PROGRAM": OVERVIEW, HISTORY AND CURRENT ISSUES (2019) [hereinafter Dilger R44844].

⁸ *Id*.

⁹ *Id*.

¹⁰ U.S. Gov't Accountability Off., GAO-12-84, Monitoring and Oversight of Tribal 8(a) Firms need Attention (2012).

¹¹ In this document, we sometimes collectively refer to small business owned by Indian tribes, ANCs or NHOs as "native 8(a) contractors."

Table 1: Requirement	Description (individually-owned 8(a) firms)	Description (firms owned by Indian tribes, ANCs, and NHOs)
Small	Pursuant to the Act, a small business is one that is independently owned and operated, is not dominant in its field of operation and meets the size standard set by the SBA Administrator. 12 All affiliations – whether domestic, foreign, for profit or nonprofit – are considered in size determinations. 13	Definition of "small business is equally applicable. Thus, small businesses must meet the size standard for their primary industry. Affiliates are not considered in size determinations. Exception: Unless SBA Administrator determines that the small business will or is likely to obtain a substantial unfair competitive advantage in its industry based on not excluding said affiliation. ¹⁴
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51% Unconditionally Owned and Controlled	51% unconditionally owned and controlled by the individual. 15 Unconditional ownership means "not subject to conditions precedent, conditions subsequent, executory agreements, voting trusts, restrictions on or assignments of voting rights, or other arrangements causing or potentially causing ownership benefits to go to another." 16 In contrast, control includes "strategic policy setting and day to day management and administration of business operations." 17	Small businesses must be 51% unconditionally owned and substantially controlled by the Indian tribe, ANC, or NHO. ¹⁸ In terms of control, concerns owned by Indian tribes and ANCs may be managed by others who are not ANC or tribal members if the firm can demonstrate that: • the Tribe or ANC can hire and fire those individuals • it will retain control of all management decisions common to boards of directors; and • a written management development plan exists which shows how Tribal or ANC members will develop managerial skills sufficient to manage the concern or similar ones in the future. ¹⁹

¹² 15 U.S.C. §632(a)(1)- (a)(2)(A).

¹³ 13 C.F.R. §121.103(a)(6).

¹⁴ 13 C.F.R. §124.109(c)(2)(iii) and 13 C.F.R. §124.110(b).

¹⁵ 13 C.F.R. §124.105.

¹⁶ 13 C.F.R. §124.3.

¹⁷ 13 C.F.R. §124.106.

¹⁸ 13 C.F.R. §124.109(c)(3)(i) and 13 C.F.R. §124.110(a). ¹⁹ 13 C.F.R. §124.109(c)(4)(i)(B).

		NHO-owned firms must demonstrate that the NHO controls its board of directors or managers. Individuals responsible for the day-to-day management of an NHO-owned firm do not need to establish social and economic disadvantage. ²⁰
Social Disadvantage	"Socially disadvantaged individuals are those who have been subjected to racial or ethnic prejudice or cultural bias within American society because of their identities as members of groups and without regard to their individual qualities." ²¹ Individuals that are presumed socially disadvantaged are: African-Americans, Hispanic Americans, Native Americans, Asian Pacific Americans, and Subcontinent Asian Americans. ²² If an individual is not a member of one of these groups, then they must show through preponderance of the evidence that they are socially disadvantaged. ²³	Indian tribes, ANCs and NHOs are presumed to be socially disadvantaged. ²⁴
Economic Disadvantage	Economically disadvantaged individuals are "socially disadvantaged individuals whose ability to compete in the free enterprise system has been impaired due to diminished capital and credit opportunities as compared to others in the same or similar line of	ANC's are deemed to be economically disadvantaged. ²⁶ Indian tribes and NHO's must demonstrate that they are economically disadvantaged by providing pertinent data. Once it is established that and Indian tribe or NHO is economically disadvantaged, it does not need to reestablish it for other small

²⁰ 13 C.F.R. §124.110(d).

²¹ 13 C.F.R. §124.103(a). ²² 13 CFR §124.103(b).

²³ 13 CFR §124.103(c).

²⁴ 13 C.F.R. §124.109(b)(1) and 15 U.S.C. §637(a)(4)(A)(i)(II).

²⁶ 43 U.S.C. §1626(e)(1).

Good Character	business who are not socially disadvantaged." ²⁵ To determine the good character of an applicant or participant, SBA considers any credible source regarding possible criminal conduct, violations of SBA's regulations, debarred or suspended concerns or persons, among other matters. ²⁸	businesses to participate in the program, unless SBA requires it. ²⁷ In the case of Native 8(a) contractors, this requirement applies only to: • Officers or directors of the firm • Shareholders owning more than a 20% interest ²⁹
Potential for success	Generally, by being in business in its primary business classification for, at least, two years before the date of application. ³⁰	Potential for success can be proved in multiple ways: • By being a business in primary business classification for two years; • By showing that "the individual(s) who will manage and control the daily business operations of the firm have substantial technical and management experience, the applicant has a record of successful performance on contracts from governmental or nongovernmental sources in its primary industry category, and the applicant has adequate capital to sustain its operations and carry out its business plan as a Participant;" or • By demonstrating that parent entity "has made a firm written commitment to support the operations of the applicant concern and it has the financial ability to do so." 31
One-time eligibility	"Once a concern or individual upon whom eligibility was based has	While a particular small business can only participate once, the same parent company

²⁵ 13 CFR §124.104 (a).
²⁷ 13 C.F.R. §124.109(b)(2) and 13 C.F.R. §124.110(c).
²⁸ 13 CFR §124.108(a).
²⁹ 13 C.F.R. §124.109(c)(7)(ii) While this regulation does not apply specifically to NHOs, they are subject to the same requirement in practice. *See* DILGER R44844, *supra* note 7.
³⁰ 13 CFR §124.107.
³¹ 13 C.F.R. §124.109(c)(6) and 13 C.F.R. §124.110(h).

participated in the 8(a) business development program, neither the concern nor that individual will be eligible again."32	can confer eligibility upon multiple businesses. ³³
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Benefits, responsibilities and concerns under the 8(a) native program

Under the 8(a) program, native 8(a) contractors receive certain privileges and benefits but also have to comply with certain responsibilities. For example, whereas particular individuals can confer program eligibility over only one business, parent companies can confer eligibility to an unlimited amount of companies.³⁴ Also, as will be further discussed below, parent companies may own multiple firms that participate in the program at the same time as long as they do not operate in the same primary industry. ³⁵

Small firms owned by tribes, ANCs, and NHOs qualify for set asides (in which competition is restricted to a certain pool of contractors) and sole-source contracts (contracts awarded without competition). However, unlike individually-owned firms who can receive sole-source awards up to a ceiling (less than \$4 million or \$7 million for manufacturing contracts), native 8(a) business may receive sole-source contracts of any amount, ³⁶ the only requirement being that sole-source contracts to native 8(a) businesses over \$22 million require a justification and approval. ³⁷ Furthermore, there are dollar limits on the overall amount of 8(a) contracts that individually owned firms can receive but these limits do not apply to native 8(a) small businesses. ³⁸ Finally, just as any other small business, each native 8(a) small business can participate in the program for up to nine years as long as they remain eligible for the program by meeting the eligibility criteria.

Due to these benefits and often prompted by the need to be fiscally responsible with taxpayers' dollars, the 8(a) native program has been subject to additional oversight. For example, there have been concerns of non-native individuals and large firms benefitting from the program, when they clearly should not be beneficiaries.³⁹ Also, because some parent companies have been successful at leveraging these benefits and their small firms are often able to capitalize on common resources, there is a concern that these firms are effectively large companies operating in a small business program, thereby having an unfair competitive advantage over other truly small firms.⁴⁰ However, native 8(a) contractors are granted these benefits because they have a social responsibility to fulfill. Unlike individually-owned companies, native 8(a) contractors use their profits to benefit whole

^{32 13} C.FR §124.108(b).

³³ 13 C.F.R. §124.109(a) & (b) and 13 C.F.R. §124.110(a).

³⁴ *Id*

³⁵ 13 C.F.R. §124.109(c)(3)(ii) and 13 C.F.R. §124.110(e).

³⁶ F.A.R. §19.805-1(b)(2) and DFARS §219.805-1.

³⁷ F.A.R. §6.303-1.

³⁸ 13 C.F.R. §124.519(a).

³⁹ See GAO-12-84, supra note 10. For example, this report highlights the concern of large companies serving as subcontractors to native 8(a) companies but effectively being the ones doing the majority of the work and therefore reaping the majority of the profits.

⁴⁰ *Id*.

communities, sometimes hundreds or thousands of disadvantaged individuals. These profits are used in many ways, ranging for providing services to their constituents to delivering dividends to each and every member of the community. In fact, native 8(a) contractors currently have an obligation to report the benefits provided to SBA. ⁴¹ Thus, in order to strike the right balance between the benefits they receive and concerns of abuse, it is imperative that the SBA provides proper oversight of the program.

SBA Regulations and GAO Reports

In 2011, SBA revised its regulations regarding the 8(a) program, including regulations applicable to native 8(a) contractors. Among the changes, the 2011 regulations prohibited the award of follow-on sole-source contracts to sister subsidiaries under the same parent company and made technical updates to the regulations that impede sister subsidiaries from using the same NAICS codes for their primary line of business. Following the issuance of these regulations, the Government Accountability Office (GAO) conducted two reports focused on native 8(a) contracting: one in 2012 focusing on oversight concerns of native 8(a) contractors in general and a subsequent report in 2016, which addressed SBA's limitations in monitoring ANCs' compliance with 8(a) program requirements. While the 2016 report is constricted to ANCs and therefore narrower in scope, it presents many of the same concerns regarding these two topics. The following sections highlight the two main concerns that those reports have in common:

Sole-source follow-on contracts

Per the 2011 regulations, agencies are now barred from giving a follow-on sole-source contract to a native 8(a) contractor if the contract was performed immediately before by another 8(a) firm or graduate 8(a) firm owned by the same parent company. ⁴⁴ According to SBA, the rationale for this change was the following:

"[...] when SBA certifies two or more firms owned by a Tribe or ANC for participation in the 8(a) BD program, SBA expects that each firm will operate and grow independently. The purpose of the 8(a) BD program is business development. Having one business take over work previously performed by another does not advance the business development of two distinct firms. [...] In such a case, the negative perception is that one business is operating in the 8(a) BD program in perpetuity by changing its structure or form in order to continue to perform the contracts that it has previously performed."⁴⁵

However, according to both reports, SBA lacks the necessary resources and data to enforce this prohibition. For example, in 2012, GAO reported that SBA's data system only provided district offices information about the firms they service.⁴⁶ Thus, because the information is not the same across district offices, they could not track compliance if sister subsidiaries were in different geographical locations. To address this data limitation and others, SBA officials stated that the

⁴¹ 13 C.F.R. §124.604.

⁴² 76 Fed. Reg. 8222 (Feb. 11, 2011).

 $^{^{43}}$ Id. See also U.S. Gov't Accountability Off., GAO-16-113, Oversight Weaknesses Continue to Limit SBA's Ability to Monitor Compliance with 8(a) Program Requirements (2016).

⁴⁴ *Id*.

⁴⁵ *Id*.

⁴⁶ GAO-12-84, *supra* note 10.

agency intended to develop a new data system to facilitate the data sharing across offices and GAO agreed with that solution.⁴⁷ As further discussed in the next section, that data system has not materialized.

Another way to potentially verify compliance with this prohibition is through offer letters. Regulations require that agencies interested in awarding a contract through the 8(a) program provide SBA with an offer letter detailing several items like the work to be performed, the acquisition history of the contract (if any), and information of the small business contractors that have performed the contract in the previous 24 months. Nonetheless, the GAO reports found multiple instances where this information was not provided or when provided, was unclear. Also, the SBA did not follow up with agencies to clarify it. Moreover, in 2016, GAO found that SBA did not maintain required documentation in its files, such as offer letters, acceptance letters, and contracts that would enable verifying compliance through an independent review of the records. Finally, GAO noted that SBA personnel and procurement agencies could benefit from training about this requirement and that while SBA had provided multiple trainings to personnel in other agencies, there was still an opportunity to be more specific about the information required for offer letters and for training SBA's personnel on how to enforce this prohibition. S1

Sister subsidiaries using the same NAICS codes for their primary line of business

In order for a business to be considered small and participate in 8(a) program, it needs to fall within the size standards for its primary industry. Sall industries are classified under the North American Industry Classification System (NAICS), given a numerical code (NAICS code) and SBA assigns them a size standard. Therefore, as part of entering the program, small businesses provide the primary NAICS code under which they wish to operate and demonstrate they are small for that industry. Once in the program, if the firm at any point surpasses the size standard for that NAICS code, SBA can terminate its participation in the program or the firm can voluntarily withdraw.

The 2011 SBA regulations restrict new native 8(a) contractors from having the same primary NAICS code as a sister firm that is already in the 8(a) program or that graduated within the last 2 years. ⁵³ The goal of this restriction is to assist native 8(a) contractors with diversifying and expanding their portfolios by enabling each firm to engage in separate and independent lines of work. ⁵⁴ However, nothing impedes native 8(a) contractors from engaging in secondary lines of work to promote business growth.

It is through the certification process and annual eligibility examinations that SBA mainly verifies that two sister companies do not use the same NAICS code as their primary line of work. However, since 2006, and as reiterated in the 2012 and 2016 report, SBA's inability to track revenues generated by 8(a) native firms for their first and secondary lines of businesses has been a long-

⁴⁷ *Id*.

⁴⁸ GAO-16-113, *supra* note 43.

⁴⁹ *Id*.

⁵⁰ *Id*.

⁵¹ Id.

⁵² See 13 C.F.R. §124.109(c)(2) and 13 C.F.R. §124.110(b).

⁵³ 76 Fed. Reg. 8222 (Feb. 11, 2011).

⁵⁴ GAO-16-113, *supra* note 43.

standing vulnerability.⁵⁵ Essentially, a native firm may be reporting a NAICS code and then effectively generate the majority of their revenue in the same primary industry reported by another sister subsidiary. As noted by SBA, although this practice is not necessarily prohibited (what is prohibited is reporting the same NAICS codes as first line of business for two businesses) it potentially conflicts with the regulation and tracking it would be a first step to determining the extent of the situation and what measures, if any, need to be implemented.⁵⁶

Consequently, in 2012, GAO recommended to develop a data system with multiple functionalities, including the ability to collect and track native 8(a) revenue. While SBA originally intended to create this data system, by March 2015 SBA had decided to terminate the initiative because its design was incompatible with other SBA systems.⁵⁷ Given the situation, SBA officials stated as part of the 2016 report that other measures, such as a random surveillance method would be used to mitigate the vulnerability. However, at the time, no milestones or timelines were given to put this process in place.⁵⁸ Moreover, SBA later delayed these plans, putting forward an interim plan to track award obligations through the Federal Procurement Data System (FPDS) on a spreadsheet.⁵⁹

Other vulnerabilities

In addition to the items highlighted above, each of the reports highlights its own set of oversight concerns in different substantive matters. For example, the 2010 report, highlighted the difficulties in monitoring subcontracting limitations that exist to ensure that other companies, such as large entities, are not the main benefactors of the incentives granted to native firms through the 8(a) program. ⁶⁰ Similarly, the 2016 report, highlighted difficulties in monitoring and verifying compliance with rules pertaining to excessive withdrawals. ⁶¹ To a greater or lesser extent, the root causes of these issues stem from the same vulnerabilities or weaknesses in SBA's data collection, supervisory review, staffing, and guidance. The 2016 report studies these weaknesses but within the context of ANCs:

• SBA's oversight documentation was incomplete and inconsistent: According to the report, the information provided in response to GAO's requests was sometimes incomplete and when provided, the level and type of information given varied according to district offices. Moreover, SBA encounters challenges in providing basic information such as the total number of ANC firms serviced by the agency. According to GAO, it took SBA three months to provide a list of ANC-owned firms in the 8(a) program, and on three separate occasions it provided three separate numbers for the total 8(a) participants – ranging from 226 to 636.

⁵⁵ *Id*.

⁵⁶ *Id*.

⁵⁷ *Id*.

⁵⁸ *Id*.

⁵⁹ Id

⁶⁰ GAO-12-84, *supra* note 10.

⁶¹ GAO-16-113, *supra* note 43.

⁶² *Id*.

⁶³ *Id*.

- Inconsistent supervisory review of ANC transactions: All 8(a) participants, including native 8(a) contractors must submit annual reviews to their district offices, which are used by SBA personnel to determine whether a firm has maintained its eligibility for the program. In reviewing 26 sets of annual updates (each covering 4 years), GAO found that 10 annual reviews lacked appropriate supervisory reviews. Moreover, they found 6 cases where the same person who started the review, also reviewed their own work, which is inconsistent with the need to segregate key responsibilities between personnel to reduce the risk of error and fraud.⁶⁴
- Staffing Challenges: Staff turnover and staff attrition caused by steps to increase the number of employees who are eligible for retirement has contributed to limited staff in the Alaska District Office. This situation combined with the atypical high workloads of SBA's personnel in this district office, limit the ability to conduct proper oversight.⁶⁵ From 2012 to 2014, for example, the number of personnel servicing ANCs decreased from 5 full-time employees servicing 60 firms each to 1 full-time and 1 part-time employee. As of April 2015, this office added 2 more business opportunity specialists, but it still fell 2 employees short of what it is considered appropriate staffing levels.⁶⁶
- Proper guidance: As of December 2015, and after reiterated postponements, SBA had not finished its internal guidance addressing the 2011 regulatory changes to the 8(a) program.⁶⁷ The proper internal guidance was finally issued on September 2016.⁶⁸

Allegations of Fraud Reported by the Los Angeles Times

On June 26, 2019, the Los Angeles Times published a report alleging that more than \$300 million in federal and state contracts reserved for Native Americans had been awarded since 2000 to companies whose owners made unsubstantiated claims of being Native American. ⁶⁹ These allegations concern individual business owners who participated in the 8(a) program as opposed to businesses owned by Native Tribes, ANCs, or NHOs. SBA has stated that it did not violate rules in certifying contractors for the 8(a) program and attributed their eligibility to the regulations in place prior to 2011, when contractors seeking minority status as Native Americans were required to have held himself or herself out as Native American and be recognized by others as a member of a Native American community. Those regulations changed in 2011, and SBA now requires an individual to be an enrolled member of a Federally or State recognized Indian Tribe in order to be considered an American Indian for purpose of being determined socially disadvantaged. SBA has referred at least one contractor involved in the LA Times investigation to the Office of Inspector General for further scrutiny.

⁶⁴ *Id*.

⁶⁵ *Id*.

⁶⁶ Id

⁶⁸ Small Bus. Admin., Standard Operating Procedure, No. 80 05 5 (Sep. 23, 2016).

⁶⁹ LA Times, Claiming to be Cherokee, Contractors with White Ancestry Got \$300 Million (June 26, 2019), available at: https://www.latimes.com/local/lanow/la-na-cherokee-minority-contracts-20190626-story.html.

Conclusion

This hearing will allow Members to take a closer look at the 8(a) program as it applies to native 8(a) contractors, understand its subtleties, and receive valuable insight from program participants. At the same time, it will facilitate a deeper understanding of the challenges that surround it, including oversight deficiencies that limit proper enforcement of regulations and hurt the legitimacy of the program. It is through the exploration of these challenges that Members will gain the tools to tackle them and ultimately strengthen the program.