

8(A) PROGRAM: YOUR TOOLBOX AND BEST PRACTICES FOR YOUR SURETY PROGRAM

What are the basics of the 8(a) program and who is eligible? What about the Mentor-Protégé Program and joint ventures? If your company is approached, are you comfortable getting involved and properly managing the risks? Be aware of recent revisions, the surety's concerns and, most importantly, know the rules and proceed with due diligence and best practices.

As you may already know, effective March 14, 2011, the Small Business Administration revised its rules and regulations to strengthen its 8(a) business development program. These efforts aim to reduce fraud and abuse and ensure that benefits flow to intended recipients. While the updated 8(a) rules and regulations are beyond the purview of this article, key revisions are addressed, and we stress the importance of continued familiarity and compliance with all of the rules. In light of legislative concern and revised regulations, we expect greater scrutiny of applicants and participants, and increased enforcement procedures. Willis is here to help you navigate the roads ahead.

THE 8(A) PROGRAM - GIVE ME THE BASICS....

At the very least, most construction firms have *heard of* "8(a)." Whether you are an 8(a) contractor, a non-8(a) contractor, joint-venture participant or the surety, it is important you know the basics, and certainly much more prior to involvement in a federal 8(a) set-aside contract. "8(a)" refers to section 8(a) of the Small Business Act (SBA), which creates a business development program



for small disadvantaged businesses. The 8(a) program offers participating contractors a broad scope of support, including federal contract procurement, financial assistance, mentoring, teaming and training, management assistance, technical training *and* surety bonding. The objective of the program is to provide access and opportunity to obtain a foothold in federal government contracting.

To qualify for the program, a contractor must be owned and controlled by a socially and economically disadvantaged individual. The SBA defines socially disadvantaged individuals as "those who have been subjected to racial or ethnic prejudice or cultural bias within American society because of their identities as members of groups." Additionally, contractors must meet appropriate size standards and provide financial documentation showing economic

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disadvantage. The updated rules provide added clarity regarding the factors determining economic disadvantage (e.g., total assets, income, spousal support). Once approved, an 8(a) contractor may participate in the program for up to nine years. New rules also provide a basis for early program graduation resulting from excessive withdrawals or program earnings.

Once admitted, participating contractors are not guaranteed a contract under the 8(a) program. 8(a) participants may receive sole-source contracts *and* bid for competitively awarded 8(a) contracts. Participants undergo periodic eligibility reviews and are subject to many SBA 8(a) program regulations, including restrictions relative to the contract type, size and number of contracts awarded. While your company may not qualify as an 8(a) contractor, involvement opportunities arise out of the Mentor-Protégé Program, joint ventures and the need for surety bonds.

SO...WHAT ABOUT THE MENTOR-PROTÉGÉ PROGRAM AND JOINT VENTURES?

8(a) contractors are encouraged to work with other 8(a) and non-8(a) contractors. The SBA Mentor-Protégé Program's purpose is to enhance the capability of 8(a) participants by partnering them with more experienced, well-established and often larger contractors. Protégé contractors benefit from the mentor contractor's financial assistance, management and technical assistance, as well as increased access to government contracts via joint-venture agreements. This assistance ultimately provides access to strong surety relationships and increased capacity, which may otherwise be limited or unavailable to the protégé-8(a) contractor. Alternatively, mentor contractors and joint venture participants clearly benefit from increased access to federal contracts, joint ventures, business development and, of course, the fulfillment of mentoring and training small disadvantaged contractors.

8(A) JOINT VENTURE AGREEMENTS

The SBA must approve all joint venture agreements pertaining to the performance of an 8(a) contract. Carefully prepare and review your agreement, as the SBA requires adherence to a lengthy list of contract provisions prior to approval. An 8(a) joint venture is permissible *only when* the 8(a) contractor lacks the necessary capacity to perform the contract on its own, the agreement is fair and equitable, the venture is of substantial benefit to the 8(a) contractor; and the 8(a) contractor must contribute substantial resources and/or expertise to the joint venture.

There are two types of 8(a) joint ventures. One is between an SBA-approved mentor and protégé and the other between an SBA-approved 8(a) contractor and non-mentor contractor. SBA approved mentor-protégé joint ventures may contain an NAICS "large" contractor/mentor. Both types of 8(a) joint ventures adhere to different SBA regulations, including size and revenue standards, so be sure to identify and follow the proper mentor-protégé and joint venture rules.

New rules state the 8(a) firm must perform at least 40% of the work for each 8(a) joint venture contract, including mentor-protégé joint ventures. This 40% performance requirement also applies when 8(a) entities engage in other SBA set-aside contracts, such as HUBZones and SDVOSBs. Furthermore, an 8(a) joint venture awarded an 8(a) contract *may not* subcontract work to the non-8(a) joint venture partner (including a “large” business mentor) unless no other potential subcontractors are available. These changes will greatly impact prior industry practices relevant to who actually performs the work. Also, the 8(a) venturer must now receive profits “commensurate” with the 8(a) venturer’s work, rather than the former requirement of at least 51% of the profits.

The underlying project contract must be executed in the name of the joint venture entity and not the 8(a) contractor individually. Closer scrutiny of non-formal/silent joint ventures is anticipated, as 8(a) entities must meet performance of work and revenue requirements. Prime contractor/subcontractor arrangements or teaming agreements will be watched closely to find *de facto* affiliation equating to a *de facto* joint venture, which in turn, must comply with all 8(a) rules.

If your firm provides third-party indemnity to the surety in order to help an 8(a) contractor qualify for bonding, your firm does not gain privity to the prime set-aside contract, which includes its conditions and afforded defenses. In this situation, if issues arise, the surety may exercise any number of its options, while third-party indemnity remains non-cancellable. When surety credit is obtained by virtue of a larger contractor’s indemnity or other collateral, ultimately providing increased access to 8(a) set-aside work, this is viewed as a strong indicator of affiliation (possibly creating a *de facto* joint venture) for SBA 8(a) purposes. Whatever the nature of the business relationship, large contractors collaborating (either formally or informally) with 8(a) contractors should exercise caution.

In light of recent economic conditions, government contracts are sought after in a highly competitive manner. As a result, small contractors seek creative methods to win federal projects, and larger contractors seek out smaller contractors for possible joint ventures and/or increased access to set-aside work. As long as federal funding remains available, this program will continue helping contractors grow as businesses and enter into joint venture arrangements while competing for government contracts. Though, from both non-8(a) qualified contractors’ and sureties’ viewpoints, there are important business risks and contractual considerations when engaging either formally or informally with an 8(a) contractor.



PROCEED WITH CAUTION - KNOW THE RULES AND FOLLOW THEM

Clear guidelines govern participation in the 8(a) program; however, instances of fraud and abuse remain a concern. The SBA directed an audit of the 8(a) program performed last year by the U.S. Government Accountability Office (GAO). The GAO audit identified 14 ineligible construction companies that received \$325 million in 8(a) sole-source and set-aside contracts. In most cases, participation in the program and contract awards were based on false statements and misrepresentations on behalf of the 8(a) contractor. The report recommended the program strengthen fraud protection controls. Subsequently, legislative committees conducted hearings and responded with the recently updated regulations.

Sureties are also taking necessary precautions, as they are well aware of updated rules and risk-prone situations involving federal 8(a) contracts and contractors. For example, as part of the bonding process, sureties may require a letter be sent directly from their office to senior SBA-8(a) program officials detailing surety arrangements and disclaiming knowledge of, or investigation into, the 8(a) contractor's or joint venture's program compliance and eligibility. Sureties are concerned about providing credit for potentially fraudulent contractual situations, which may lead to suspension from bonding federal contracts and ultimately contribute to increased losses. 8(a) qualified and non-qualified 8(a) participating contractors risk varying degrees of punishment if found in violation of the SBA regulations, up to and including permanent suspension from contracting with the government.

Though let's not lose sight of the many benefits of the SBA's 8(a) program! With proper risk management strategies, including best surety practices, 8(a) program benefits are abundant. We recommend large contractors support surety disclosure practices and possibly obtain an added layer, or layers, of corporate and/or personal indemnity from the 8(a) entity or owner to increase leverage and protect against lack of privity. You should also consider separate written agreements to address project-specific concerns, such as creating a separate project bank account to manage funds and payments, and express a first right to cure potential performance difficulties.

WILLIS IS HERE TO HELP

If abided by properly, this program provides small *and* large contractors increased opportunity to compete for federal 8(a) contracts and enjoy the benefits of federal stimulus set-aside funding. It also promotes business development through joint ventures and mentoring relationships. Whatever your role may be, your Willis Surety broker will help you understand the recent rule changes and guide you down the proper avenues as you engage in SBA 8(a) contracts. As your firm explores 8(a) endeavors, we are here to equip you with the knowledge and expertise you need.

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