

GAO

Testimony

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**LEGAL OPINION CONCERNING THE EXERCISE OF OPTIONS IN
SECTION 8(a) CONTRACTS AND COMMENTS ON A PERTINENT
PROVISION IN H.R. 1807 AMENDING THE SMALL BUSINESS
ACT**

Statement of
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Before the
Subcommittee on Procurement,
Innovation, and Minority Business Development
Committee on Small Business
House of Representatives



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Mr. Chairman and Members of the Subcommittee:

I am here today in response to your letter of April 16, requesting our legal opinion on certain questions relating to one of the provisions in H.R. 1807 concerning section 8(a) contracts.^{1/} You also ask for our views on how to strengthen that provision.

The provision would add a paragraph 22 to section 8(a) of the Small Business Act which would prohibit the Small Business Administration (SBA) from awarding any 8(a) contract or exercising an option under an existing 8(a) contract to any concern without first receiving prior adequate assurances that the disadvantaged owners of that concern will maintain ownership and control throughout the term of performance of any such contract or option.

The 8(a) program is intended to benefit small firms owned by economically and socially disadvantaged individuals. When firms with contracts awarded under the 8(a) program are purchased by or come under the control of nondisadvantaged individuals or large firms, continuation of the contracts or the exercise of options thereunder no longer directly benefits the firms and individuals for which the benefits were intended. Consequently, we support efforts that would help assure that section 8(a) assistance is provided only to those for whom it is intended. We

^{1/} Ms. Rosslyn Kleeman, Senior Associate Director, of General Government Division, is here to respond to the remainder of your questions.

therefore favor the approach taken by this provision in the bill. Later, I will suggest some changes to the bill that we think will strengthen it and make it more likely to accomplish the purpose intended. At this point, however, I want to respond to the specific questions you raise.

The first question is: "Under existing law and legal interpretations, is it the opinion of GAO that SBA has the authority, under section 8(a) of the Small Business Act, to execute an option, initially provided for under an 8(a) contract, if the 8(a) firm has subsequently exited the 8(a) program and -

"(a) the exited firm is still a small business and owned and controlled by socially and economically disadvantaged owners; or

"(b) the exited firm is no longer 'small' or ownership or control has passed to non-disadvantaged individuals?"

Our office has found that an 8(a) contract may not be extended or continued as an 8(a) contract after the contractor's eligibility has expired. This is the case whether or not the exited firm remains small and/or owned or controlled by disadvantaged individuals.

However, we have found permissible the exercise of contract options contained in section 8(a) contracts, even where the firm is no longer eligible to participate in the 8(a) program, so long as the options are exercised in

compliance with procurement regulations applicable to the exercise of options. See Gallegos Research Corp.-- Reconsideration, B-209992.2, B-209992.3, Nov. 21, 1983, 83-2 CPD ¶ 597. Such options, although contained in contracts originally awarded under the 8(a) program, are not exercised under that program, but in furtherance of the government's rights under the contracts. Options provide a valuable and vested unilateral right in the government to obtain additional services or products on specified terms, conditions and prices. Under current law, we believe this right exists regardless of the status of the contractor. Therefore, even where the contractor is no longer eligible to participate in the 8(a) program, an option contained in an 8(a) contract may be exercised by the contracting agency, if such exercise is consistent with Section 17.207 of the Federal Acquisition Regulation (FAR). That section requires the agency to determine if the exercise of the option is the most advantageous method of fulfilling the government's needs considering price and other factors. It is important to note that a contracting officer can make such a determination only after formal solicitation or a market survey.

The second question posed is: "If you believe SBA does not have the legal authority in either or both of the situations described in (1)(a) and (b) above, are options so executed void or voidable?"

If 8(a) contracts are improperly extended as 8(a) contracts after the contractor has exited the 8(a) program, or if the options are not exercised in compliance with the FAR, the contract extensions are in all likelihood voidable rather than void. According to the Court of Appeals for the Federal Circuit, a contract is void only if it is made contrary to statutory requirements and the making of the contract is caused by the contractor or the contractor is on direct notice that the procedures are in violation of statutory requirements. United States v. Amdahl Corp., 786 F.2d 387 (Fed. Cir. 1986). Where options are not exercised in accordance with applicable statutes and regulations, the illegality is generally caused by the government, and the contractor is usually not on direct notice of the illegality.

The third question you ask is: "In your opinion, can SBA legally delegate back to the buying agency the ability to execute an option provided for in the 8(a) contract? What functions are central to the concept of privity that SBA must retain and, consequently, cannot delegate back to the buying agency?"

Buying agencies can execute options contained in 8(a) contracts either as SBA's agent if they continue to be 8(a) contracts or pursuant to their own authority if the contracts are no longer to be 8(a) contracts. With respect to what SBA must retain, we have recognized that while SBA

is nominally the "prime contractor," SBA in practical terms is essentially a conduit between the buying agency and the small disadvantaged business; the only sense in which SBA is expected to perform the contract is by subcontracting the work to eligible firms. B-225175, Feb. 4, 1987. Therefore, the exercise of an option is the prerogative of the buying agency.

The Subcommittee's last question is: "In your opinion, what further provisions should be added to H.R. 1807 to insure that disadvantaged individuals are the sole beneficiaries of 8(a) contract support?"

I believe the objective of insuring that disadvantaged individuals are the sole beneficiaries of 8(a) contract support can be better achieved with the addition of implementing provisions to the proposed paragraph 22(A). Paragraph 22(A) would prohibit awards of 8(a) contracts or the exercise of options under 8(a) contracts unless "adequate assurance" is received that the disadvantaged individuals owning the 8(a) firm will maintain ownership and control for the entire contract or option term. SBA's Administrator is authorized to waive this requirement for exceptional circumstances on a nondelegable basis. We have some concern that the proposed language may not fully implement a congressional intent to assure that only firms owned by disadvantaged individuals are the beneficiaries of 8(a) support.

What constitutes "adequate assurance" that the contractor does not intend to relinquish ownership or control to nondisadvantaged individuals during the contract term is not defined, and there is no guidance as to how this prohibition is to be implemented. We suggest the addition of language to paragraph 22(A) that would require the contractor to certify, as a condition of award of an 8(a) contract and/or prior to the exercise of an option under such contract, that the individuals owning the contractor do not intend to relinquish ownership or control during the term of the contract. Secondly, paragraph 22(A) should also require that a provision be added to all 8(a) contracts stating that it may be grounds for contract default if the individuals owning the 8(a) contractor relinquish ownership or control during the contract or option term unless it can be demonstrated that the certification was made in good faith. Finally, paragraph 22(A) should require that the 8(a) contractor give prompt notification when ownership or control is to be relinquished during the contract or option term. We believe that these additional provisions will provide the government with a contractually enforceable right to terminate an 8(a) contract where, at the time of award or option exercise, the persons owning the contractor planned to sell or transfer control to other than disadvantaged individuals during the contract or option term.

I would point out that neither the language in the bill nor our suggested revisions would preclude the exercise of an option in those situations I discussed in response to the first question, that is, where the contractor is no longer eligible for 8(a) assistance but the buying agency finds, after complying with Section 17.207 of FAR, that exercise of the option would be in the best interest of the government. If the Subcommittee desires to preclude the exercise of options in such situations, I suggest the addition of language to the bill that would specifically preclude the government's exercise of an option in an 8(a) contract whenever the contractor no longer is owned or controlled by disadvantaged individuals or otherwise is not eligible for 8(a) program participation.

In summary, we favor adding paragraph 22 to section 8(a) of the Small Business Act, and hope that the suggested additional language will be of assistance to the Subcommittee. I have no comments to offer about the remainder of H.R. 1807.