

Alert | Government Contracts



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Department of Defense Announces Heightened Scrutiny of Its 8(a) and Other Small Business Contracts

Go-To Guide:

- The U.S. Department of Defense (DoD) intends to conduct a comprehensive review of all small business sole-source and set-aside contracts over \$20 million.
- Recent efforts by the Small Business Administration (SBA) and other federal agencies signal a broader endeavor to identify fraud, waste, and abuse in 8(a) Program contracting. DoD expanded its review outside of the 8(a) Program.
- Small businesses may wish to prepare for heightened scrutiny of their eligibility and compliance with limitations on subcontracting.

On Jan. 16, 2026, Secretary Pete Hegseth announced that DoD will be assessing certain contracts awarded under the SBA's 8(a) Program, calling for a line-by-line review of every sole-source 8(a) contract exceeding \$20 million.

On Jan. 21, 2026, Secretary Hegseth also issued a memorandum (dated the same day as the Jan. 16 announcement) substantially expanding this review to include all set-aside awards to a small business over \$20 million "(identifying the type of set-aside)." While the focus appears to remain on the 8(a) Program, it has gone beyond that to cover any type of small business set-aside.

The scope of the assessment includes whether the contract contributes to DoD's warfighting priorities, and whether the small business contractor performed the contract consistent with the limitations on subcontracting or merely acted as a pass-through entity for large subcontractors.

Overview of the 8(a) Program

The SBA's 8(a) Program was established to provide training, technical assistance, and contracting opportunities to "socially and economically disadvantaged" small businesses. Participating firms are afforded contracting preferences like set-asides and sole-source awards, and agencies may award contracts under the program in order to reach their annual goals for contracting with small, disadvantaged businesses. Historically, the 8(a) Program has played an important role in broadening the Defense Industrial Base by allowing disadvantaged small businesses to contribute to defense manufacturing, services, and technology.

Contract Review of Small Business Sole Source and Set-Aside Contracts

According to Secretary Hegseth's memorandum, DoD spends 10 times more on contracts under the 8(a) Program than other federal agencies and that, as a result, DoD is going "above and beyond" other agencies in its efforts to combat waste, fraud, and abuse by performing a "a line-by-line review of all small business sole source and set aside awards above \$20 million in contract value." The rationale for this effort remains focused on the 8(a) Program, but the review now extends to all small business set-asides over \$20 million.

The memorandum requires DoD to conduct a two-part review:

- First, contracts must have the effect of making DoD more "lethal" and aid the United States in winning wars. The memorandum states that DoD "has no room in its budget for DEI and other wasteful contracts that do not advance our core mission of creating a lethal fighting force." The memorandum also states that "[a]ny contract that is not critical to the Department's warfighting capabilities, including research and development, industrial base investments, and enabling products and services, should be terminated for convenience to the maximum extent consistent with law to ensure adequate funding" of the Department's "unfunded priorities." This part of the review was required to be completed by Jan. 31, 2026.
- Second, DoD will perform a review to ensure contracting dollars are spent on legitimate small businesses and not "illegal pass-through schemes." The memorandum specifies that, by Feb. 28, 2026, DoD must confirm that contractors are complying with the limitations on subcontracting, and "[a]ny evidence of improper subcontracting, such as evidence of excessive pass-through charges," should be sent to the DoD and SBA Offices of Inspector General (OIG), and, if deemed necessary by the OIGs, referred to the Department of Justice (DOJ). It further indicates that the reviews should use readily available data sources, such as contractor invoice and payment records, contracting officer's representative logs/reports, personnel confirmation, contract deliverables and technical reports, and any other relevant sources.

The memorandum directs that DoD reviewers "should also confirm that the contracts identified are being performed at or below market rates," with a plan to terminate contracts above market rate within 90 days (if they cannot be terminated immediately) while still maintaining necessary services.

Scrutiny of Contracts Awarded Under the 8(a) Program

DoD's review represents just one aspect of the intensified scrutiny now facing the 8(a) Program across the federal government. As [previously reported](#), SBA and U.S. Department of the Treasury announced their

own audits of the 8(a) Program (and for the Treasury, all preference-based contracting programs) last year.

Additionally, on Feb. 11, 2026, SBA sent notices to 154 8(a) contractors located in Washington, D.C. to initiate program termination proceedings. SBA issued a public statement indicating that the wave of terminations came after a program integrity review by SBA's Office of Government Contracting and Business Development revealed that the firms failed to meet the economic disadvantage requirements for eligibility of the program:

The firms – which will be suspended for at least 30 days before final termination from the 8(a) Program – exceeded statutory net worth limits, adjusted gross income caps, or total asset limits. Collectively, these firms received nearly \$1.3 billion in 8(a) set-aside and sole-source contracts during the Biden Administration, from Fiscal Year 2021 to 2024.

Last month, the SBA suspended 1,091 firms (approximately 25% of the total number of 8(a) firms) from the 8(a) Program for failing to meet SBA's Dec. 5, 2025, directive to produce financial records for the last three fiscal years by Jan. 19, 2026.

False Claims Act and Suspension and Debarment Implications

The memorandum's statement that firms may be referred to DOJ signals an intent to pursue contractors found noncompliant during this review for False Claims Act violations.

With small business set-asides, potential False Claims Act risk should be considered in the context of the “**presumption of loss rule**” established by section 1341 of the Small Business Jobs Act of 2010, Pub. L. No. 111-240, codified at 15 USCA § 632(w)(1). This provision provides for a “presumption of loss” to the government equal to the entire value of a contract when a contractor that is “other than small” “willfully sought and received” a small business set-aside. See also 13 C.F.R. § 121.108.

DOJ often tries to apply the presumption of loss rule where it concludes a business is “other than small” due to affiliation. In the context of DoD's review of compliance with the limitations on subcontracting, this might be an issue for small businesses found affiliated under SBA's “ostensible subcontractor” rule, which provides that an offeror is ineligible as a small business if an other than small subcontractor “performs primary and vital requirements” of a contract or “or is a subcontractor upon which the prime contractor is unusually reliant.” 13 CFR § 121.103(h)(3).

Combined with the False Claims Act's treble damages provision, the presumption of loss rule could create significant exposure for businesses that obtain set-aside awards that they are ultimately found ineligible for.

Firms referred to the OIG and/or DOJ may also be at risk of suspension or debarment from federal contracting under FAR subpart 9.4. Under FAR 9.406-2, contractors may be debarred for, among other reasons: (i) criminal convictions or civil judgments for fraud or criminal offenses related to obtaining or performing public contracts, or for “any other offense indicating a lack of business integrity or business honesty that seriously and directly affects” the contractor's “present responsibility”; (ii) violation of contract terms so serious as to justify debarment (e.g., willful failure to perform or a history of failing to perform or unsatisfactory performance); (iii) failing to meet mandatory disclosure obligations—such as not reporting credible evidence of a False Claims Act violation; and (iv) for any other cause so serious or compelling that it undermines the contractor's present responsibility. FAR 9.406-2; see also FAR 9.407-2

(causes for suspension). The impact of debarment is not limited to participation in federal programs—it might also impact access to credit from commercial lenders and cause reputational damage.

Key Takeaways for Small Business Contractors

For small business contractors, and particularly 8(a) contractors, this new environment of oversight means compliance is more important than ever. To maintain eligibility and be prepared for federal audits, small businesses may wish to review their contract obligations and compile the supporting documentation referenced in the memorandum. In particular, contractors should consider:

- Verifying compliance with limitations on subcontracting.
- Determining how to demonstrate contracts are “critical to the Department’s warfighting capabilities.”
- Reviewing and updating their Codes of Business Ethics and Conduct and compliance policies and procedures.
- Adhering to program recordkeeping requirements and gathering information from subcontractors.
- Engaging counsel for compliance reviews, assistance with agency inquiries and government audits or investigations, terminations, and guidance on maintaining program compliance.

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