LEGAL ADVISOR

A PilieroMazza Update for Federal Contractors and Commercial Businesses

Business & Corporate Law

THE IMPORTANCE OF A GOOD PRENUPTIAL AGREEMENT FOR YOUR COMPANY

By Dean Nordlinger

In business ventures, as with personal relationships, business owners generally prefer to focus on all things positive. This is only natural. Business owners invest time, energy and money into business ventures with others propelled by confidence and belief in their ability to work well together and succeed. However, it should come as no surprise that many business ventures do not work out as expected. Therefore, an important (but often overlooked) component of good business planning is to prepare upfront for the possible pitfalls and perils of going into business with others. When it comes to dealing with disputes amongst business owners, an ounce of prevention truly is worth a pound of cure.

Business owners should utilize a company's shareholders agreement or operating agreement (owners' agreement) as a form of prenuptial agreement to plan for and overcome disruptive events in the company's business life cycle. Discussing and addressing how these events will be handled is key to promoting stability and continuity of ownership. Disruptive events can lead to disputes among the business owners. While the business can still be successful, certain differences in partners' beliefs and/or personalities may not be reconcilable. In that regard, perhaps one or more owners should stay in, and one or more others should exit, the company. A good owners' agreement is even more important in small to mid-sized private companies and/or closely held businesses because typically there are fewer owners, many if not all of whom are actively involved in the day-to-day operations of the company.

Many owners' agreements share a common but unfortunate element. They discuss and address certain standard disruptive events such as the death, disability or bankruptcy of an owner, but do not delve into other and even more disruptive events the company is likely to face, including an owner's unexpected decision to discontinue his involvement with the company to engage in unrelated pursuits, or even business owners at some point not seeing eye-to-eye on fundamental matters that affect the company's business and operations. The typical owners' agreement, for example, will address only basic management and membership provisions such as designating certain persons (which may or may not include one or more owners) as "managers" to run and control the company's day-to-day operations and providing the company a right of first refusal to buy the membership interest of each of its members if such member were to die, become disabled or otherwise desire to sell his membership interest in the company.

What a basic owner agreement typically does not do, however, is address more complex issues such as "disassociating" or expelling a member from the company. Events that may give rise to disassociation include a party's serious breach of its member obligations to the company or otherwise engaging in wrongful conduct that materially and adversely affects the company. Without a provision to address situations like these, the owners' agreement leaves the company and business owners at decisive disadvantage in trying to handle and resolve disruptive events that could dramatically and negatively impact the success and/or survival of the company.

The following scenarios illustrate the value and importance of a well-drafted and comprehensive owners' agreement.

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Scenario 1: A Business Relationship That Has Soured

In this scenario, several individuals join together to form a limited liability company (LLC) to perform government work. When they form the LLC, the individuals get along well and do not envision a time when they might not be on the same page. Therefore, the owners use a basic owners' agreement that does not provide for an orderly business divorce. For several years, everything goes well and the owners get along great and the business is successful. However, after that, the owners begin to differ on business development and corporate strategy matters. These cracks slowly expand, and the relationships continue to deteriorate, until the ownership strife is so pervasive that it is negatively impacting the company's profitability and employee morale. In short, the ownership problems are threatening the company's survival.

So what can the owners do? Because the owners used a basic owners' agreement that did not provide for disassociating and buying out a member, their options are limited. The majority owners can terminate a minority member from the company, stripping the minority owner of his day-to-day participation in the company. However, this is only a partial solution because without clear provisions in the owners' agreement for disassociation and buy-out rights that spell out when and how the LLC and the majority owners can remove a minority owner and buy out his ownership interest, it is difficult (if not impossible) to completely remove and sever ties with such minority owner.

When an owners' agreement does not provide express terms to address a situation like this, the default rules of the applicable state LLC act will control. As an example, in Virginia, owners can petition a court to judicially expel a member. If successful, this process will remove the owner's management and operational rights, but will not cause the owner to forfeit his economic rights in the company. This leaves the owners in the difficult position of a partial divorce, with continuing financial obligations to each other. The only way to completely sever the ties would be to reach a negotiated buy-out, which could be difficult depending on the level of acrimony between the owners. And the company and remaining owners might be forced to pay a premium (above fair market value) to convince the departing owner to sell his interest.

Scenario 2: Recruitment of New Partners Goes Awry

Another, similar scenario involves an individual who forms a company and devotes a substantial amount of her time and resources, along with several key employees, to grow the company into a successful government contractor with multi-million dollar annual revenue. Feeling the company has reached a plateau, the owner decides to bring in new partners to take the company to the next level. To do so, the owner gives away a small amount of her equity to a long-time key employee and an outsider who is brought in to handle business development. What the owner did not do, however, was update her basic owners' agreement that was in effect from the time when she was the sole owner of the company.

The problem arises when the owner realizes that her new partners are not a good cultural fit and do not have the expertise she thought they would bring to the table. As a result, the original owner continues to be responsible for the lion share of the company's business development and operations, with little generated by the newer partners. As in the first scenario, the original owner can terminate her partners from active participation in the company's operations, but this is only a partial remedy. Because the owners' agreement was basic and did not provide any right to dissociate or force a sale by an owner, the original owner does not have a clear path to buy back her partners' economic interests in the business.

Situations like these, and others like them, could largely be avoided with advance planning in the owners' agreement to spell out the procedures for handling a business divorce. Indeed, when care is taken to plan via the owners' agreement, this prenuptial agreement for a business can be an invaluable tool for the business owners and the company to proactively address fundamental ownership and operational matters and avoid unexpected or unfavorable results and distractions. Therefore, when entering into and forming a business venture, business owners should take the time upfront to discuss with their business lawyer the spectrum of scenarios, good and bad, the company is likely to face in order to implement an owners' agreement that is appropriately tailored to the needs of the business. ❐

About the Author: Dean S. Nordlinger is a partner with PilieroMazza and heads the Business and Corporate Law Group. He represents companies, private equity firms, entrepreneurs and other clients on a variety of corporate matters across varied industries. He can be reached at dnordlinger@pilieromazza.com.

GUEST COLUMN

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STRATEGIC SOURCING: RISKS AND OPPORTUNITIES FOR SMALL BUSINESSES

By Richard J. Hernandez, CPCM

This article discusses how the shift toward "strategic sourcing" will create new risks and opportunities for small businesses. This change is occurring in the corporate and Federal government markets. Understanding the process will help small businesses successfully adapt.

Small businesses cannot ignore the threat strategic sourcing may push them out of their contracts with major buying organizations or prevent them from even getting considered.

Reasons for Strategic Sourcing: The early 1990's was the era of business process re-engineering. Purchasing was also impacted by this trend. As major corporations examined how to re-engineer their business processes they realized about typically 30% to 40% of their budgets were moving through the Purchasing Department. They realized the purchasing processes needed to be streamlined to help them reduce costs and be more competitive in a global economy.

Definitions: Strategic sourcing is a major re-engineering of the purchasing process. Historically, purchasing has been a transaction-orientated process (i.e., three bids and a buy). However, in the early 1990s, purchasing started to move toward an Integrated Supply Chain Management (SCM) model. This model involved long-term procurement planning, strategic sourcing, and management of the entire supply chain. To implement this new SCM model, cross functional sourcing / buying teams were created. These teams select suppliers for key products & services. They also help determine the optimal supply chain structure that provides the lowest total cost of ownership.

A strategic supplier provides key supplies and/or services in a particular commodity area. Strategic suppliers add a high degree of value to the supply chain management process by reducing costs, aggregating demand, etc.

The key elements of strategic sourcing include:

- Total cost of ownership (TCO)
- Strategic suppliers
- Optimizing supply base
- Supplier development
- Aligning purchasing with business strategies
- Developing organizational strategies to meet future needs
- Developing commodity and supplier strategies
    - Supply performance and relationship management
    - Participating in long-range business planning

Federal Strategic Sourcing Initiative: The Government is phasing in the SCM model. In 2005 the Federal Strategic Sourcing Initiative (FSSI) was started. The initial focus of FSSI was on consolidating the office supplies products and printing services supply chains. This was done by reducing the number of suppliers from the Federal government's "preferred vendor" program also known as the GSA Schedule Contracts. In 2013, the number of FSSI sourcing initiatives increased from two to seven. This list will continue to expand over time. You can find a complete FSSI list at www.GSAAdvantage.gov.

Impact to Small Business: Strategic sourcing is impacting small businesses in several key ways:

- Contract Bundling
- Major Reductions in the (Non-Strategic) Supplier Base
- Increase Use of Preferred Vendor Programs
- Additional Pre-Qualification Costs

Survival Strategies: Small businesses cannot ignore the threat strategic sourcing may push them out of their contracts with major buying organizations or prevent them from even getting considered. Below are some recommended strategies to protect your business.

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- Plan Strategically. Plan long-term like your customer(s).
- Branding / Niche Strategy. Find the best place for your company in the supply chain – then protect it.
- Targeted Set-Aside Contract Strategy. Use small business programs (e.g., 8(a), MBE, WBE, HUBZone, etc) and other set-asides to get contracts.
- Create Strategic Alliances. Build new relationships and seek new markets.
- Create Capacity with a Mentor. Find ways to handle larger contracts.
- Sound Price / Cost Structure. Make sure your pricing is competitive.
- Develop Multiple Contract Vehicles. Have more than one way to buy from your company.
- Attempt to become a Pre-Qualified Supplier. This helps ensure you get the best contracts with a high strategic value to your customer(s).

Having a mentor(s) can also help a small business succeed in the strategic sourcing process. A mentor can help a small business with increasing their capacity to handle larger strategic contracts, show they how to innovate & create value, educate them on process management improvements (operations, quality, safety, security, etc). A mentor can also help their small business protégé build strategic relationships.

Summary: Strategic Sourcing will become the "New Normal" in procurement. Federal government agencies will also move to reduce their number of vendors as they phase-in strategic sourcing.

The hard truth is there are many more suppliers than buyers. It costs a lot of money to maintain a large supply base and strategic sourcing is more efficient.

Small businesses can survive strategic sourcing by developing a niche strategy where they can offer the most value in the supply chain, find ways to create value and innovate, and find mentors to help them increase their capacity and improve their core business processes. ❐

About the Author: Richard J. Hernandez, CPCM is a Chicago-based consultant who specializes in helping small businesses become strategic suppliers in their respective market niche. Mr. Hernandez is a former US Air Force Contracting Officer (PCO) and corporate buyer. He has written several books, including the "8(a) Survival Guide,"and over 60 articles. He is a graduate of the US Air Force Academy. His website is www.E-MBE.net. He can be reached at 312-404-2224 or RHernandez@E-MBE.net.

Small Business

SBA PROVIDES NEW SET-ASIDE AUTHORITIES FOR MULTIPLE AWARD CONTRACTS

By Patrick Rothwell

On October 2, 2013, SBA issued a final rule which made numerous changes to its rules governing small business contracting procedures for multiple award contracts (MACs). We recently summarized the regulatory changes in a Client Alert. This article focuses on a portion of the final rule that is perhaps of greatest interest to small businesses – the so-called "Section 1331 Authorities."

The Section 1331 Authorities get their name from the Jobs Act of 2010. Because agencies are increasingly using MACs, the goal was to expand contracting authority for set asides and other methods of ensuring small businesses participation on the MACs. The final rule confirms that agencies must set aside a MAC when there is a reasonable expectation that two or more small businesses (including 8(a), SDVOSB, HUBZone, etc.) can provide the required services or supplies at a fair market price. However, if the "rule of two" is not satisfied at the MAC level, agencies will now have the discretion to use the new "Section 1331 Authorities" as means to increase small business participation in a MAC.

The first Section 1331 Authority is to segregate a MAC into a partial set aside. Partial set asides can be used when: (i) the acquisition can be broken into smaller discrete portions, such as CLINs, SINs, etc.; and (ii) the "rule of two" can be met for some of these smaller, discrete portions. An agency may partially set aside MACs for any category of small business. Competition for orders will be restricted according to whether the order falls under a CLIN that was set aside.

Furthermore, the new rule permits small businesses to submit an offer on the set-aside portion of a partial set aside, the non-set-aside portion, or both. Currently, however, the FAR requires small businesses to submit offers on the non set-aside portion as well as the set-aside portion. Thus, SBA anticipates that the FAR will need to be amended.

The next Section 1331 Authority allows agencies to "reserve" awards for the various categories of small businesses under the following three circumstances:

First, agencies may create reserves when the acquisition cannot be broken into smaller, discrete portions until the individual task orders are drafted, and two or more awards can be made to small businesses that can perform part of the requirement, but not all of it. If the "rule of two" is met on an order, the order is competed solely among the small businesses.

Second, a reserve may be created when at least one small business can perform the entire requirement, but the "rule of two" cannot be met. In this case, orders can be issued directly to the one small business awardee.

Third, if the "rule of two" cannot be met for a bundled acquisition, and no small business can perform because it is bundled, an agency can issue the solicitation as a reserve for one or more small businesses with a "Small Business Teaming Arrangement." A "Small Business Teaming Arrangement" can be either a joint venture or prime/sub teaming arrangement as long as both firms are small businesses and use a written "Small Business Teaming Agreement" that sets the responsibilities, roles, and percentages of work between the parties.

The final Section 1331 authority concerns already-established MACs that were competed on a full and open basis. Under this authority, an agency has discretion to set aside orders for the various types of small businesses when the "rule of two" is met. In addition, this authority can be used to set aside orders on GSA Schedule contracts, but FAR 8.4 must also be followed.

The effective date of the final rule is December 31, 2013. However, the SBA noted in the preamble to the final rule that implementation of some of these changes may take as long as five years, in part because the complex changes in the final rule will require significant retraining of the government's acquisition workforce. Thus, as a practical matter, it may take some time for contracting officers to become aware of and use many of the newly-available set-aside options. It is also important to remember that agencies have the discretion to forego using the Section 1331 Authorities even if the "rule of two" could be met. However, if an agency declines to use these tools, it must document why. For this reason, and given the increased use of MACs and pressure to meet small business goals, the Section 1331 Authorities are posed to become important methods for agencies to increase small business participation and meet their goals through MACs. ❒

About the Author: Patrick Rothwell, an associate with PilieroMazza, practices primarily in government contracts and litigation. He can be reached at prothwell@pilieromazza.com.

Labor & Employment Law

SUPREME COURT TO DECIDE SEVERAL CASES WITH IMPORTANT RAMIFICATIONS FOR EMPLOYERS

By Nichole DeVries

Despite the government shutdown, the U.S. Supreme Court recently began its new term. The Court's docket may not grab the headlines like some past terms, but the Court will consider several cases with the potential to change the labor and employment landscape. This article provides a snapshot of several key cases and discusses the potential ramifications for employers.

NLRB v. Noel Canning, U.S. No.12-1281 — In one of the most anticipated cases of the term, the Court will determine whether the D.C. Circuit ruled correctly that the President can only make recess appointments for federal government posts for which Senate confirmation is required: (1) during the periods between congressional sessions, not during "intra-session" Senate recesses; and (2) where the vacancy arose during the "inter-session" period. The D.C. Circuit found that President Obama's intra-session appointments to the National Labor Relations Board (NLRB) were invalid. Consequently, the D.C. Circuit found the underlying NLRB decision to be invalid. The Court's decision will impact the validity of many NLRB determinations that involved the intra-session appointees, as well as the President's authority to fill future vacancies

Lawson v. FMR, LLC, U.S. No. 12-3 — On November 12th, the Court will hear oral arguments regarding whether the whistleblower provision in the Sarbanes-Oxley Act (Act) applies to employees of a publicly traded company's private contractors or subcontractors, or only to the employees of the public company. The Act protects those employees who report suspected violations of federal securities laws. This is the first time the Court has examined the Act since its passage following the Enron scandal in 2002. The First Circuit ruled that the Act only protected employees of the publicly traded company and not its contractors. The legislative history indicates the Act was intended to protect a company's accountants or other contractors that may be in the best position to report unlawful actions. The solicitor general urged the Court to defer to the Department of Labor (DOL), which was empowered by Congress to enforce the Act's whistleblower provisions. The DOL administrative review board has already determined that a company's contractor employees are covered by the Act. Thus, the Court's decision

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ATTORNEYS AT LAW
888 17th Street, NW, 11th Floor, Washington, DC 20006

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will interpret the breadth of the Act and the extent to which the DOL's administrative process will control in determining the interpretation of the whistleblower provisions.

Sandifer v. U.S. Steel Corp., U.S. No. 12-417 — The Court will hear argument on November 4th regarding whether donning and doffing of personal protective equipment at a steel plant qualifies as "changing clothes" under the Fair Labor Standards Act (FLSA) and therefore does not court toward an employee's working time. The Seventh Circuit dismissed the underlying law suit because the time donning and doffing personal protection items such as ear plugs, safety glasses, and hard hats is so minimal that it is not compensable. The Seventh Circuit also ruled that a "principal activity" that is non-compensable cannot start or prolong a workday and require compensation for things such as travel time between a locker room and work station. While Section 203(o) of the FLSA generally excludes changing clothes at the beginning and end of a work day from compensable time, the workers argued that this exclusion was not meant to cover protective equipment. The Court's ruling will impact businesses that encounter these types of compensable time issues.

Harris v. Quinn, U.S. No.11-681 — On October 1st, the Court announced that it will review whether home healthcare aides in Illinois can be forced to accept a union as their exclusive bargaining representative with the state and to pay a "fair share" fee for the costs of union representation. The Seventh Circuit upheld a 2009 state executive order and a collective bargaining agreement requiring such participation, which the home health care aides argue is compulsory participation. The outcome of this case bears watching for multi-jurisdictional employers and those with organized workforces.

These cases exemplify the many nuances and complex determinations under existing labor and employment laws, regulations, and administrative procedures. Staying on top of the latest developments in these areas will help you to adjust your internal policies and procedures accordingly to stay compliant and ahead of potential administrative claims and lawsuits. PilieroMazza will continue to keep you up to date on the most recent jurisprudence affecting your business. ❐

About the Author: Nichole DeVries, an associate with PilieroMazza, primarily practices in the areas of labor and employment law and general litigation. She may be reached at ndevries@pilieromazza.com.