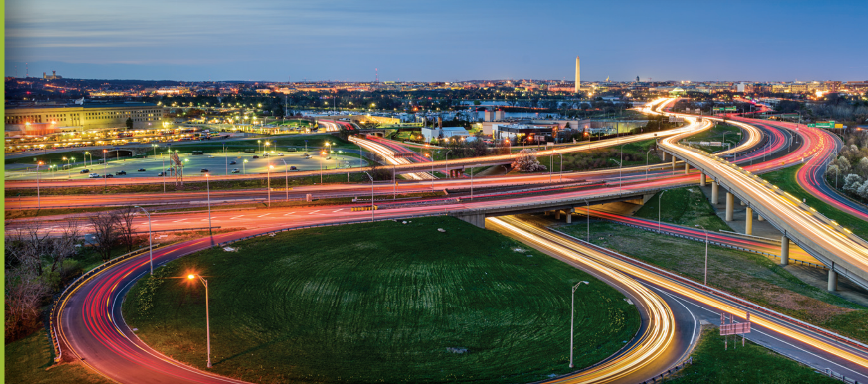
LEGAL ADVISOR



A PilieroMazza Update for Federal Contractors and Commercial Businesses

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GOVERNMENT CONTRACTING

Category Management: What Contractors Need to Know

By Michelle Litteken

In December 2014, the Office of Management and Budget (OMB) announced a new initiative called Category Management. This policy could dramatically change the way the federal government purchases goods and services. For this reason, contractors should be aware of Category Management and the recent developments associated with it.

Category Management is a successor to the Federal Strategic Sourcing Initiative (FSSI) which was implemented in 2010. Category Management has three primary goals: increase savings, reduce the number of new contracts, and increase the amount of spending that is subject to government-wide management. Under Category Management, purchases are divided into groups, and the acquisition process is streamlined by using fewer and more efficient contract vehicles. The Category Management Leadership Council, which is composed of procurement specialists from across the government, established the following ten categories: Information Technology (IT), Professional Services, Security and Protection, Facilities and Construction, Industrial Products and Services, Office Management, Transportation and Logistics Services, Travel and Lodging, Human Capital, and Medical. In 2014, the government spent $428 billion across these categories. Each category team is expected to gather and compile procurement data, analyze and assess the data, and identify opportunities to use Category Management strategies.

Most of the developments in Category Management have occurred in the area of IT, where Category Management has coincided with the implementation of the Federal Information Technology Acquisition Reform Act (FITARA). FITARA required the government to develop a streamlined approach to acquiring IT goods and services – a requirement that directly aligns with Category Management. OMB has issued three policy memoranda that aim to achieve this requirement; the most recent concerning software licensing.

OMB issued Category Management Policy 16-1: Improving the Acquisition and Management of Common Information Technology: Software Licensing on June 2, 2016. OMB explained that agencies buying and managing licenses in a decentralized manner have difficulty maintaining accurate inventories, often purchase unneeded capabilities, and do not share information pertaining to pricing, terms, or conditions.

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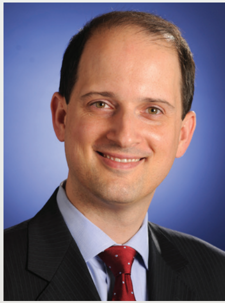
Editor's Note

By Jon Williams



This quarter we are excited to show off our new format for the *Legal Advisor.* With our updated look, we will continue to bring our readers the same quality, in-depth articles addressing the current issues that are of concern to federal government contractors and commercial businesses nationwide. In this edition, we focus on key recent developments such as the Supreme Court's Kingdomware decision and OMB's Category Management initiatives, and we feature an excellent guest article on estate planning for small businesses from our friends at Cochran Allan LLC.

Going forward, we plan to offer all future editions via email only. If you currently receive the *Legal Advisor* in the mail and would like to continue to do so, please email Holly Hayden at hhayden@pilieromazza.com or call her at 202-857-1000 to continue receiving the *Legal Advisor* in the mail.

CATEGORY

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The memorandum announced new policies and procedures intended to address these issues and fragmentation.

As explained in the memorandum, the Enterprise Software Category Team (ESCT) will guide the development of government-wide software license agreements for mandatory agency use. At least two new enterprise software agreements will be implemented by the end of 2016 and 2017, and the ESCT will establish biannual targets for future years. As part of this process, the ESCT will be identifying and promoting best-in-class agreements and posting standard pricing, terms, and conditions on the Acquisition Gateway. The memorandum directed agencies to develop plans to transition from existing agreements to the mandated government-wide agreements. And, agencies will be required to justify and obtain ESCT approval to pursue a new agreement that overlaps or conflicts with the ESCT mandated agreements.

The movement toward government-wide software license agreements has already begun. The ESCT recently negotiated a government-wide agreement with Environmental Systems Research Institute, a geospatial software provider. The government spends $294 million on geospatial software licenses each year, and $74 million goes to Environmental Systems Research Institute. The new agreement implemented a single set of terms and conditions for all of the government, provided tiered discounts, and required pricing transparency. This new agreement resulted in a 14 percent savings over prior orders, and is expected to save $1.5 million in 2016; $3 million in future years. Future government-wide agreements are expected to obtain comparable levels of savings.

The memorandum also announced several actions that agency Chief Information Officers (CIO) must take. First, within 45 days of the memorandum, each CIO must appoint a software manager who will be responsible for managing all agency-wide commercial and commercial-off-the-shelf (COTS) software agreements and licenses. Then, by September 30, 2016, each agency must compile a baseline inventory of commercial and COTS software licenses purchased, deployed, and in use. This inventory will be analyzed to consolidate redundant applications, identify opportunities for savings, and ensure compliance with software license agreements. As of November 30, 2016, agencies will be required to report all costs savings and cost avoidance attributable to software license management to OMB.

Although efficiency and savings are laudable goals, the software memorandum, and Category Management in general, raise several concerns. Category Management emphasizes government-wide contract vehicles. The procurements for government-wide agreements are extremely competitive and tend to occur infrequently. Businesses that are not selected for these vehicles may be shut out of a large segment of federal procurement. There are also concerns specific to software. The policy did not address small businesses that resell software licenses through existing government contracts. Additionally, the policy conflicts with aspects of the FAR. Namely, FAR 12.212(a) states that commercial software

The *Legal Advisor* is a periodic newsletter designed to inform clients and other interested persons about recent developments and issues relevant to federal contractors and commercial businesses. Nothing in the *Legal Advisor* constitutes legal advice, which can only be obtained as a result of personal consultation with an attorney. The information published here is believed to be accurate at the time of publication but is subject to change and does not purport to be a complete statement of all relevant issues.

"shall be acquired under licenses customarily provided to the public to the extent such licenses are consistent with Federal law and otherwise satisfy the Government's needs." The requirement to develop mandatory government-wide software license agreements seems to contradict that provision. And, because the government is often not the driver for commercial software development, requirements unique to the government may impose additional costs and slow development. This can be particularly problematic for small businesses. In comments submitted on the draft policy, several industry groups advocated for agency-wide agreements instead of government-wide agreements. Agency-wide agreements would provide more flexibility and allow agencies to develop license agreements that fit their specific missions.

In less than two years, Category Management has begun to reshape aspects of federal procurement, but its final impact is still unclear. Although most of the changes to date have been in the IT sector, there has been some activity in other areas. On July 1, 2016, OMB issued a memorandum directing all agencies to use a government-wide blanket purchase agreement when procuring identity protection services. If this recently-announced policy and the IT policies issued so far are successful, they may spur similar efforts in other categories. For this reason, it is critical that these early policies include and address the small business community. Incorporating small businesses now will provide a framework to use going forward.

A recently-announced proposed rule provides an opportunity for small businesses to express concerns about Category Management and the need to consider small businesses. On June 20, 2016, the government proposed to amend FAR 8.0004 by adding a provision that would require contracting officers to conduct an analysis when a service or supply is offered under the FSSI, but the FSSI is not used. The analysis must address the comparative value, including price and non-price factors, between the supplies and services offered under the FSSI and those offered under the source(s) to be used. The notice for the proposed rule stated that the rule could lead to more sales for small businesses that are under the FSSI, but it failed to recognize that small businesses that are not on the FSSI may be adversely affected. Comments to the proposed rule are due on August 19, 2016.

Small businesses are encouraged to submit comments. Please contact us if you would like help preparing your comments.

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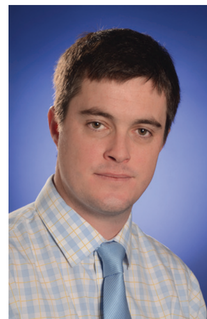
Aftermath of the Kingdomware Decision: Where Does the VA Go From Here?

By Peter Ford



Last month, the U.S. Supreme Court issued its highly-anticipated decision in Kingdomware Technologies, Inc. v. United States. In an 8-0 unanimous opinion, the Supreme Court held that the VA is required to follow the "Rule of Two" on all VA contracts, including orders under the Federal Supply Schedule (FSS), even when VA has met its annual veteran contracting goals. For veteran-owned small businesses and service-disabled veteran-owned small businesses (VOSBs), Kingdomware is a huge win.

Now that the Supreme Court has spoken, the focus shifts to how VA will respond and implement the ruling. Testifying before the Senate Committee on Small Business and Entrepreneurship (Committee) at a hearing on the ramifications of Kingdomware, Thomas Leney, Executive Director for VA's Office of Small and Disadvantaged Business Utilization (OSDBU), told the Committee that VA would immediately comply with Kingdomware. In this regard, Mr. Leney explained how VA had already engaged its acquisition workforce with new guidance on the application of Kingdomware to VA requirements. However, the Committee was concerned that Mr. Leney's testimony signaled VA would not move quickly enough to implement the Supreme Court's mandate. The Committee implored VA to move quickly and to report back in July regarding the policies and guidance issued to VA procurement officials regarding the decision.

On the same day as the hearing before the Committee, VA released its first internal guidance regarding Kingdomware, referred to as Acquisition Policy Flash! 16-16 ("Policy Flash"). The Policy Flash confirms VA's intent to

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implement Kingdomware in every context where the law applies and emphasizes the importance of conducting market research to ensure compliance with the "Rule of Two." In addition, the Policy Flash underscores a contracting officer's (CO) obligation to verify VOSBs are listed in the Vendor Information Pages (VIP) database before evaluating offers or making awards on VOSB set-asides. Most importantly, the Policy Flash sets forth specific guidance on how COs are to apply Kingdomware to VA requirements across each procurement phase and to all new competitive requirements.

For existing requirements in the pre-solicitation phase or the solicitation or evaluation phase, VA's intent is clear: the Kingdomware decision applies. In this respect, for procurements that VA previously determined not to set-aside for VOSBs, the CO shall review the original market research to confirm whether the "Rule of Two" was appropriately considered and if offers are likely to be received from two or more capable and verified VOSBs at a fair and reasonable price. If the review shows two or more VOSBs and the requirement is in the pre-solicitation phase, the procurement shall be set-aside for VOSBs in accordance with VA's contracting order of priority.

"For VOSBs and SDVOSBs, Kingdomware is a huge win."

Similarly, if the CO finds two or more VOSBs and the requirement has been solicited (or offers are being evaluated), the solicitation shall be cancelled and the requirement resolicited as a VOSB set-aside in accordance with the contracting order of priority. However, if there are urgent and compelling circumstances, and an appropriate written justification for not cancelling the solicitation is prepared and approved, VA can proceed with the requirement as originally solicited. Likewise, if the requirement is an existing set-aside for VOSBs, the CO can continue the original acquisition strategy.

VA's intent is also clear with respect to contracts that have been awarded to other than verified VOSBs but a notice to proceed has not been issued. For these requirements, VA is not applying the Kingdomware decision. Rather, the Policy Flash states that the CO should coordinate with the Head of the Contracting Activity, Office of General Counsel and OSDBU and be prepared to move forward with issuing the notice to proceed.

With respect to all new competitive requirements, the Policy Flash directs COs to review the VIP database to determine if two or more verified VOSBs can meet the procurement requirements and to perform market research to confirm the likelihood of receiving offers from two or more verified VOSBs as per the "Rule of Two." Thus, VA intends to apply the Kingdomware decision to all of its new competitive acquisitions, as the Supreme Court held it should. Though, interestingly, the Policy Flash goes on to say that if two or more verified VOSBs are on a Blanket Purchase Agreement (BPA), FSS, or existing multiple award indefinite delivery/indefinite quantity contract, the CO *may* consider setting the procurement aside using that vehicle. Here, VA's intent is unclear. VA's regulations require the use of certain contracts, BPAs and mandatory schedules before open market purchases. Yet, the Policy Flash suggests that use of these required sources of supply is now discretionary, even when the "Rule of Two" is satisfied, thus appearing to create a conflict between VA's Policy Flash and its regulations.

The Policy Flash is just the first step in VA's post-Kingdomware guidance and VOSBs should expect to see additional guidance soon. Such additional guidance, if issued timely and to fully implement the decision, would send a strong signal to the veteran community that VA is working expeditiously to address the Supreme Court's ruling. Having said that, Mr. Leney explained in his testimony that, for long-term planning, changes in response to Kingdomware must be accomplished through formal rulemaking. While this process takes time, revising VA's regulations to implement Kingdomware makes sense, particularly if VA intends to make required sources of supply discretionary. Furthermore, the rulemaking process allows for public comments on proposed regulatory changes and input from the veteran community would help ensure VA's compliance with the Supreme Court's ruling in all respects.

In the interim, VOSBs should monitor VA's VetBiz and OSDBU websites for additional post-Kingdomware

guidance and policies. Moreover, VOSBs must ensure that they always remain verified and visible in the VIP database, as the database is the starting point for "Rule of Two" market research. Similarly, VOSBs bidding on VA set-asides need to routinely check the VIP database (both pre and post-bid submission) to confirm verified status. This is a small task with huge benefits – it can shield an otherwise competitive offer from a non-responsive finding and help secure contract award.

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GUEST COLUMN

The Guest Column features articles written by professionals in the services community. If you would like to contribute an original article for the column, please contact our editor, Jon Williams, at jwilliams@pilieromazza.com.

Estate and Succession Planning Essentials for Small Business Owners

By Natanya Holland Allan and Gosia J. Bochenek, Partners at Cochran Allan LLC

Small business owners are some of the most creative, hard-working and motivated entrepreneurs. Consumed with day-to-day business affairs, however, they often neglect their personal financial and legal matters. In this article, we are pleased to survey key tax, estate and family planning matters that are essential to personal planning, as well as business succession planning, for small business owners.

One of the most common questions our entrepreneur clients ask is: How much can I give away and how can I transfer interests in my business to family members without paying gift or estate taxes? The answer is a lot! However, those who plan early strategically succeed in transferring more wealth, tax-free, than those who plan late or, worse, fail to plan at all.

Presently, the federal gift and estate tax exemption is $5,450,000. This means that a client can give up to $5,450,000 in value to his or her heirs, during his or her lifetime or upon death. Gifts to spouses qualify for an unlimited marital deduction and gifts to charity qualify for an unlimited charitable deduction, so tax concerns only arise in the context of gifts to other parties, such as children or employees. Once the $5,450,000 threshold is met, the estate tax is imposed at a 40 percent rate. For example, if an unmarried client passes away with a net worth of $10,000,000, leaving his entire estate to his children, the first $5,450,000 will pass tax-free and the balance, $4,560,000, will be subject to a 40 percent tax of $1,820,000. To make matters worse, some states, like Washington, DC and Maryland, impose an estate tax in addition to the federal tax; Virginia does not.

Clients also may make smaller annual gifts, which will not deplete their $5,450,000 exemptions, and through these smaller gifts they can significantly reduce their overall estate tax exposure. Presently, the annual gift tax exclusion is $14,000, meaning a client can give up to $14,000 to as many beneficiaries as the client chooses, without triggering any tax or affecting the $5,450,000 exemption. If a client's gifts in a given year all qualify for the annual exclusion or are charitable, then the client does not need to file a gift tax return to report the gifts.

When business succession planning is considered early, a business owner generally will have several exit options, including selling the business to a third party, selling or gifting business interests to family members, arranging for the entity to redeem the owner's interests or liquidating. While an outright sale is often the most straightforward exit strategy, it is not always the best method to maximize value for the owner and the owner's family.

There are tax and non-tax reasons why a business owner may wish to gift business interests to family members. In terms of estate tax planning, the goal generally is to gift when enterprise value is low or at least discounted, so future appreciation escapes estate tax when the original owner passes away. For those driven by management succession concerns rather than tax planning, gifting can be an optimal way to transfer control to chosen family members in an orderly way.

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Intra-family gifts can be made at different stages of business growth. Gifting in a start-up phase is straightforward and generates minimal gift tax concerns. Gifting in connection with financing rounds also is very common and often is preceded by a reorganization of the business structure and recapitalization of the stock or membership interests into two classes – one voting and managing and one non-voting and non-managing. A client seeking to retain value, but transfer control to a family member, perhaps a second generation leader, will want to transfer voting/managing interests, while one seeking to transfer value, but retain control, will want to transfer non-voting/non-managing interests. Pre-sale planning still offers tax benefits, but valuation discounts and gifting leverage may be minimized when gifting happens in close proximity to a sale. Every gift must be made at fair market value, so valuation reports are needed to substantiate gift values.

Intra-family gifts of business interests certainly can be made directly to the recipients. However, the benefits of trusts should not be overlooked. Trusts are widely used for business succession planning because they allow the business owner to maintain some control over the business, protect the business assets, and, in some cases, receive an income stream for a period of time after the transfer of ownership. When gifting business interests to a child, for example, the client could establish a trust for the child, with the child and/or a third party as the trustee. If properly structured, business assets in the trust should be protected from claims of the child's creditors and protected in the event of the child's divorce.

Trusts can have one or multiple beneficiaries. One very popular type of trust, commonly referred to as the spousal lifetime access trust (SLAT), can be created for a client's spouse and descendants, as beneficiaries. Additionally, the spouse can designate how the trust assets will pass among the descendants. Given the possibility for abuse by the spouse who is a beneficiary and possible trustee, SLATs must be administered with care to ensure the trust assets are not includible in the creator's estate.

A trust can also be designed to be dynastic, so it will continue for multiple generations without ever being exposed to estate tax upon the death of a beneficiary or ever being available to the beneficiary's creditors or spouses.

A trust can also be structured as a so-called grantor trust, where the client will be treated as the owner of the trust assets for federal income tax purposes and continue to pay the trust's income taxes, even though the trust will be excluded from the client's estate. As a result, the trust assets grow tax-free, a bit like an IRA, and the client's payment of the trust's income taxes essentially is a tax-free gift to the trust beneficiaries. This is a simple, but powerful way to leverage the gift tax exemption.

Lastly, following the client's death, if a trust beneficiary lives in a high income tax state, like New York or California, it may be possible to move the trust to a low income tax state, like Delaware or South Dakota, so the appreciation within the trust will not be minimized or eroded by state income taxes.

"Gifting in a start-up phase is straightforward and generates minimal gift tax concerns."

While these tax, financial and estate planning techniques provide business owners with an opportunity to capitalize on their business investments, they need to be considered in tandem with strategic business operations and the transition of management responsibilities. Family business succession can be challenging but is a highly rewarding process that should maximize value for the business owner, minimize, defer or possibly eliminate estate and income taxes, and provide the owner with peace of mind and an ability to focus more clearly on growing the business.

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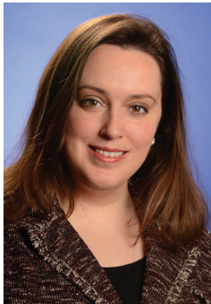
BUSINESS & CORPORATE

Size Recertification Now Required for Pending Proposals After Merger or Acquisition

By Kathryn Flood



This article appeared in the July 22, 2016 issue of the Set-Aside Alert.

Effective June 30, 2016, the SBA has implemented a final rule regarding the subcontracting limitation requirements mandated by the National Defense Authorization Act of 2013. This new rule addresses numerous topics, amongst which includes a new requirement for offerors to recertify size on pending proposals for small business set-asides if the offeror has undergone a merger or acquisition.

Under the prior version of the SBA rules, a business only recertified its size status with respect to its existing set-aside contracts upon a triggering event, such as a merger, acquisition, or novation. The new rule adds a requirement that, subsequent to a merger or acquisition, a business must recertify it size status for any pending proposals for set-aside contracts as well. In other words, if a business submitted a proposal to a federal agency under a small business set-aside, and while that proposal is pending with the agency the business undergoes a merger or acquisition, the recertification rules now require the business to recertify its size status to the agency with respect to that pending proposal.

The pre-existing recertification requirements make clear that the business' size status recertification will not affect the terms of existing contracts. So, regardless of the new size status of the business upon a recertification, it would not change the terms of those affected existing contracts. If the business recertifies as other than small, the awarding agency will not be able to count the contract for small business purposes going forward. Without the incentive of the agency being able to claim small business credit for the awarded contract, the agency could end the contract or could prevent the contractor from competing for future task orders under the contract. However, the agency does not have to terminate the contract, and in most cases will let the contractor remain on the contract after a recertification from small to large.

The new rule has a much greater potential to negatively impact contracts for small businesses. Under the new rule, if a small business has a pending proposal with an agency for a small business contract and the business undergoes a merger or acquisition, it must inform the agency. At the sensitive stage when proposals are under evaluation, it seems highly unlikely that agencies would award a small business contract to a contractor that has recertified its size status from small to large. Thus, and perhaps not surprisingly, we expect the new rule to significantly diminish a contractor's chances of winning a set-aside contract when it has to recertify as large while its proposal is pending.

If an agency did proceed to award a small business contract to a firm that recertified as large on its pending proposal, it remains to be seen whether other offerors could successfully challenge that award. On the one hand, it seems a size protest would not be successful because of the long-standing principle that size is determined as of the date of proposal submission, not the date of award. However, SBA could look at the circumstances differently in light of this new recertification rule and depending on when the merger or acquisition became an agreement in principle. Additionally, there may be grounds to protest such an award to GAO or the Court of Federal Claims. We will have to watch how these issues are fleshed out as agencies and contractors live with the new rule.

Another practical implication of the new recertification rule is that it has the potential to further depress the merger and acquisition market for small businesses. The pre-existing recertification rules already made it unfairly onerous for small businesses by devaluing their existing set-aside contracts in the eyes of potential large business purchasers. The added recertification rule for pending proposals will only make this worse by devaluing proposals (already a very speculative factor in acquisitions) even further.

In light of the new recertification rule, small businesses that are considering a merger or acquisition need to be mindful of the potential impact of recertification on their pending proposals for set-aside contracts. In many cases, it might be prudent to delay the transaction until after the pending proposals have been awarded, so the small business will have the contract in hand and, therefore, potentially greater value in the acquisition.

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The Legal Advisor newsletter is published by PilieroMazza PLLC, a full-service law firm located in Washington, DC. We are most well known as a government contracting firm and for more than 25 years we have helped our clients navigate the complexities of doing business with the federal government. We also provide a full range of legal services including advice on business, corporate, labor and employment, SBA procurement programs, and litigation matters. If you have any comments or suggestions for future articles, please contact our editor, Jon Williams, at jwilliams@pilieromazza.com.

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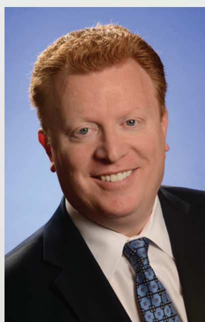
ATTORNEY IN THE SPOTLIGHT

Michael A. de Gennaro



Michael A. de Gennaro joined PilieroMazza in May as partner, leading our Business & Corporate Law practice.

Prior to joining our firm, Michael was an attorney at several well-known international law firms and was general counsel for the U.S. subsidiary of SNCF, the French national railroad. Before law school, Michael worked as a real estate developer and manager in the New York area, primarily in the affordable housing space. A summa cum laude graduate of the City College of New York with a B.A. in History, Michael earned his J.D. from Vanderbilt University Law School in 2004, where he served as a member of the Executive Board of the Vanderbilt Journal of Transnational Law.

Michael sees the practice of law as both an art and a science. He compares the drafting of a merger agreement for a client to be very much like one of his favorite hobbies: Classical music composition. In his earliest professional days, Michael briefly served as a staff music writer for a national publishing company.

Michael has donated pro bono time to education nonprofits in the past, especially those serving diverse populations of at-risk youth, children, and mothers. He considers the culture at PilieroMazza to be close-knit and fun-loving, which is in line with his belief that it is very important to create and nurture a positive work environment where people not only respect one another, but enjoy each other's company.

Michael enjoys traveling and taking long walks in DC, New York, Montreal and Paris. He currently lives in Washington, DC, is engaged to Fulbright scholar and DC Latino Affairs Commissioner Catalina Talero, and is the proud father of three sons and one daughter.