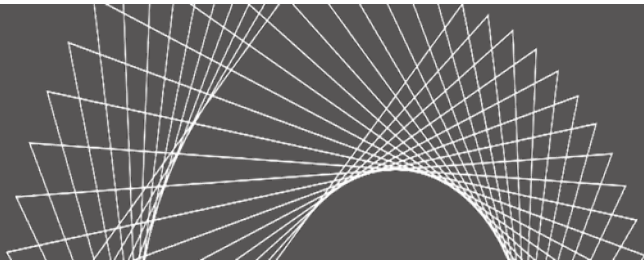


Purchasing & Selling Government Contracts



Akin Gump
STRAUSS HAUER & FELD LLP

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Scott M. Heimberg, Partner, *Akin Gump*

Maureen C. McDonald, Associate, *Akin Gump*

James W. Thomas, Partner, *PricewaterhouseCoopers*

James D. Villa, General Counsel & Corporate Secretary, *HENSOLDT Inc.*

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Structuring the Transaction

Background: The Anti-Assignment Act

- The Anti-Assignment Act (“AAA”) generally prohibits the transfer of a government contract to another party
 - See 41 U.S.C. § 6305 (“The party to whom the Federal Government gives a contract or order may not transfer the contract or order, or any interest in the contract or order, to another party.”)
- Violation of the AAA invalidates the relevant contract or order
 - See *id.* (“A purported transfer in violation of this subsection annuls the contract or order so far as the Federal Government is concerned, except that all rights of action for breach of contract are reserved to the Federal Government.”)

Background: The Anti-Assignment Act, cont'd

BUT, all hope is not lost.

The Federal Acquisition Regulation (“FAR”) establishes an exception to the AAA that allows for transfer of government contracts under certain circumstances.

Note, though, that the FAR also establishes that a novation agreement may be required in the event of a transfer.

Background: The Anti-Assignment Act, cont'd

FAR 42.1204(a) establishes that:

“The Government may, when in its interest, recognize a third party as the successor in interest to a Government contract when the third party’s interest in the contract arises out of the transfer of –

- (1)** All of the contractor’s assets; or
- (2)** The entire portion of the assets involved in performing the contract.
Examples of such transactions include, but are not limited to –
 - i.** Sale of these assets with a provision for assuming liabilities;
 - ii.** Transfer of these assets incident to a merger or corporate consolidation; and
 - iii.** Incorporation of a proprietorship or partnership, or formation of a partnership.”

Transaction Types & When Novation Agreements are Required

- **Asset Purchases (Novation Required)**
- **Stock Purchases (Novation Not Required)**
- **Mergers (Novation Likely Not Required)**

Asset Purchases

- In an **asset purchase**, a buyer purchases all or some portion of a seller's assets.
- Buyer may not assume all liabilities of the seller.
- **Asset purchases** trigger FAR 42.1204(a), meaning *novation agreements* are required.

Stock Purchases

- In a **stock purchase**, a buyer purchases the seller's stock.
 - Buyer usually assumes all liabilities of seller.
 - Corporation continues to exist, but it has different stockholders.
- *Novation agreement* generally not required.
 - “A novation agreement is unnecessary when there is a change in the ownership of a contractor as a result of a stock purchase, with no legal change in the contracting party, and when that contracting party remains in control of the assets and is the party performing the contract.” FAR 42.1204(b).

Mergers

- In a **merger**, entities combine and one entity survives. The surviving entity holds the assets and liabilities of the two combined entities. The non-surviving entity dissolves.
- A *novation agreement* typically is not required.
 - Case law establishes that when a transfer of a government contract occurs “by operation of law,” such as in the event of a standard merger, novation is not required. See, e.g., *Raytheon Co. v. United States*, 105 Fed. Cl. 236, 255 n.35 (2012); *Johnson Controls World Servs., Inc. v. United States*, 44 Fed. Cl. 334, 343 (1999); *Thompson v. Comm’r*, 205 F.2d 73, 76 (3d Cir. 1953).



Example of Importance of Transaction Structure

- Akin represented a buyer
- Buyer only wanted to purchase the seller's GSA schedule contract and a NASA SEWP contract – nothing else
 - The seller was not using the vehicles, but they had potential future value to the buyer
- The contemplated transaction did not fall directly in line with the situations and exceptions anticipated by the FAR
- Worried that the government may take issue with the transaction
- **Result:**
 - **The transaction had to be re-structured**
 - Buyer purchased other assets, too, even though didn't want or need them (like office equipment)
 - Payment held in escrow and not to go through until government approval of novation obtained

Even with those changes, GSA and NASA contracting officers and attorneys were hesitant to approve the transaction, and explaining to them why they should took many months

Takeaway

Failing to structure a deal in a way that does not run afoul of the AAA and that fits an exception in the FAR can result in termination of a transaction or extreme delay.

Determine early in the process what type of deal is most appropriate for your situation and least likely to receive pushback from relevant government authorities.

Due Diligence

Government Contracts Due Diligence



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Government Contracts Due Diligence, cont'd

- **Goal:** buyer will undertake due diligence to assess the seller's business and attempt to identify any areas of risk
- Negative discoveries can impact purchase price, or if serious enough, may lead to termination of the deal
- Due diligence usually conducted via review of documents (provided by seller pursuant to buyer's request) and responses to questions
- Also includes interviews with key personnel, including management

Some General Key Areas for Due Diligence

The following *noncomprehensive* list provides an overview of items that are usually addressed in due diligence:

- Responsibility
 - Suspension & debarment
- Performance
 - Termination for default
 - CPARS
- Litigation & Investigations

Some General Key Areas for Due Diligence, cont'd

- **Socio-Economic Requirements**
 - Affirmative action programs
 - Wage obligations
 - Anti-human trafficking
- **Cybersecurity**
 - Compliance with:
 - FAR 52.204-21 (Basic Safeguarding of Covered Contractor Information Systems) and
 - Agency-specific regulations, including DFARS 252.204-7012 (Safeguarding Covered Defense Information & Cyber Incident Reporting)
 - NIST 800-171 compliance or System Security Plan and Plans of Action & Milestones
- **Classified Information**
 - Compliance with National Industrial Security Program Operating Manual (DoD 5220.22-M)
 - U.S. Defense Security Service assessments
 - Necessary personnel security clearances

Accounting & Financial Due Diligence

Accounting & Financial Considerations

- Contract commitments such as key personnel, training requirements and minimum productive hours
- Potential requests for equitable adjustment
- Potential claims from the customer or suppliers
- Qualifications/labor categories on T&M contracts
- Subcontractor agreements
- Outstanding or potential audit issues (business systems, CAS Non-Compliances, etc.)
- Expected changes in cost allocations
- Other obligations that may be challenging to fulfill without the sellers' employees, facilities or business relationships

The purchase agreement should include appropriate requirements for cooperation, transition of support services, indemnities and financial responsibility for audit issues

Bottom Line for Buyers

- Consider using a *clean team* (an impartial third party, often a consulting firm) to diligence business information, particularly if there are antitrust concerns and the relevant rules prohibit you from reviewing competitively sensitive information belonging to the target
 - Depending on the buyer, a clean team may be impractical
- Do comprehensive research in advance about the company and industry so you know the price you are offering is competitive
- Distinguish between what is a show-stopper and what can be addressed post-close (your background research will help you make this determination, too)
- Consider whether a problem you identify is a cause of other issues or an effect of something else that you should investigate
- While gap analyses typically are not performed, you may want to conduct them if you are particularly concerned about compliance in certain critical areas
- Be comfortable with uncomfortable discussions
 - Remember that you will need cooperation from the seller after closing



Bottom Line for Sellers

- Plan ahead and anticipate likely areas of diligence
 - Collect documents that will be critical to the transaction
 - Think about which employees need to be read in to the transaction and know what you will tell them about it
 - If you are aware of a problem that you think could be a show-stopper, familiarize yourself with the facts surrounding that issue so you can explain it clearly to potential buyers
- Distinguish between **financial and strategic buyers** because doing so will help you assess reasonableness of offer
 - A *financial buyer* is typically an investor interested in the return it can realize through the purchase of a business
 - A *strategic buyer* is interested in how the target fits into its own business plans (i.e., the contemplated acquisition may expand into new product lines or parts of the world, fill a gap in the buyer's current portfolio, or eliminate competition)
 - Why does it matter?
 - Generally, a *strategic buyer* will probably realize the benefit of the acquisition more quickly because the purchase is likely to enhance operations the buyer already has in place, meaning the buyer may be willing to pay a premium
- Be honest
- Do not take questions or challenges personally
- Keep duties to shareholders in mind
- Attempt to avoid the 11th hour bombshell disclosure and minimize surprises

Accounting & Financial Considerations

Novation Agreements & Key Financial Issues

Novation Agreement – Key Financial Issues (FAR 42.1204 (i)):

- (a) (4) – *“The Transferee has assumed all obligations and liabilities of the Transferor under the contracts by virtue of the above transfer”*
- (b) (7) – *“The Transferor and the Transferee agree that the Government is not obligated to pay or reimburse either of them for, or otherwise give effect to, any costs, taxes, or other expenses, or any related increases, directly or indirectly arising out of or resulting from the transfer or this Agreement, other than those that the Government in the absence of this transfer or Agreement would have been obligated to pay or reimburse under the terms of the contracts”*

The buyer should understand the outstanding obligations and liabilities and be aware of the limit on recovery of increased costs

Cost Accounting Standards

Cost Accounting Standards – Consistency and Disclosure

- Contractors must consistently follow cost accounting practices (FAR 52.230-2)

Transfer of Contract Work (DDP Memo on CAP Changes 1/17/2002)

- *“Is not a change in cost accounting practice or a CAS 401 noncompliance, provided cost accounting practices at the segments remain unchanged”*
- *“The contract may incur the cost of the transferred work under a different indirect cost pool or a different cost element. However this is a business decision concerning how the work will be performed during contract performance, rather than a change in cost accounting practices of the segments remain the same, this is not a change in cost accounting practice or a CAS 401 noncompliance.”*

The buyer should be prepared to explain to auditors why any differences in cost accounting practices between the seller and buyer are permissible

Cost or Pricing Data

Cost or Pricing Data (10 U.S.C. § 2306a(h)(1))

- The addition or deletion of a major contract may require disclosure as part of future cost estimates
- Cost or pricing data include (FAR 2.101):
 - *information on changes in production methods and in production or purchasing volume*
 - *data supporting projections of business prospects and objectives and related operations costs*

Forward Pricing Rate Agreements require the contractor to submit (FAR 42.1701)

- “... *to the ACO and to the cognizant contract auditor any significant change in cost or pricing data used to support the FPRA*”

The buyer and seller should make appropriate disclosures with respect to any of the significant changes that affect Cost or Pricing Data

Contract Records

Contract Records

- Contract records must be maintained and are subject to audit (FAR 4.7 and 52.215-2)
- The records needed to support an audit will generally stay with the seller
- Types of Records
 - Financial and Cost Accounting Records (e.g., material purchase orders, check payments, labor cost distribution cards, etc.)
 - Pay Administration Records (e.g., payroll sheets, time attendance cards, paid checks to employees, etc.)
 - Acquisition and Supply Records (e.g., Store requisitions for materials, work orders for maintenance and other services, etc.)

The buyer should make arrangements, e.g., as part of the purchase agreement, to have access to records and people as necessary to support audits

Other Issues for Consideration During Purchase & Sale

Intellectual Property Rights



- Includes technical data, computer software, and patents
- A government contractor's IP is governed by a complex regulatory scheme and contract terms
 - See, e.g., FAR 52.227-14 Rights in Data – General (granting the government unlimited rights in data “first produced in the performance of this contract” and setting forth marking requirements)
- Those regulations and terms grant the government substantial rights in IP developed with government funding
- A buyer should determine whether a target's IP was developed using solely private funds and, if it was not, what rights the government currently holds in the government contractor's IP
- Keep an eye out for:
 - Research and development (R&D) contracts
 - Whether the target follows strict procedures with respect to pre-marking IP used in performance of its government contracts
 - With respect to commercial items or commercial computer software, whether the contractor implements standard commercial license rights terms and the reasonableness of those terms

GSA Schedules

- General Services Administration (“GSA”) Schedule Contracts impose specific requirements on the companies that hold them, and many of those requirements differ from standard terms typically found in other government contracts
- In particular, a GSA Schedule Contract contains a “price reductions” clause (“PRC”), which (at a high level) requires the holder of the GSA Schedule Contract to report to GSA any price reductions to the items or services that are the subject of the contract
 - See GSAR 552.238-75 Price Reductions
- Keep an eye out for:
 - Whether the contractor maintains written policies and procedures to ensure that any triggers of the PRC are discoverable and properly addressed
 - The company’s handling of an event, if any, that triggered the price reduction clause
 - Sale to a buyer that sells the same products or services that appear on the GSA Schedule may result in a price reduction upon closing
 - Whether the company’s name appears on the GSA eLibrary’s list of Schedules (<https://www.gsaelibrary.gsa.gov/ElibMain/home.do>)
 - A company may indicate that it does not have a GSA Schedule Contract, when instead, there just has not been an order placed against that contract for some time
 - The company still has obligations to comply with the PRC while the contract is active, even if there have not been any recent orders

Small Business Size Status



- The federal government establishes preferences for certain types of small businesses and issues certain solicitations as small business “set asides”
- Size standards, administered by the Small Business Administration (“SBA”), determine whether a business qualifies as small
- In determining the size of a business, SBA will look to the company’s “affiliates” and considers them part of the analysis. *See* 13 C.F.R. § 121.103 (“Concerns and entities are affiliates of each other when one controls or has the power to control the other, or a third party or parties controls or has the power to control both.”)
- Depending on the buyer, a small business could lose its status following closing, which could lead to:
 - Inability to win future work under contracts awarded as small business set asides
 - Possible termination of certain contracts, such as when a disadvantaged owner relinquishes control of company
- Keep an eye out for:
 - Contracts awarded to the target on the basis of the target’s status as a small business (typically indicated by a checkbox on the standard form (“SF”) that accompanies an awarded contract)
 - If those contracts represent a large portion of contractor’s revenue, and contractor will become a “large” business upon closing, consider making government approval of transfer a closing condition
 - Consider impact if contractor will become ineligible to perform any work associated with those contracts
 - Pending proposal submissions made on the basis of the contractor’s small business status and value of the same
 - Whether company is listed as small in its Reps and Certs on [SAM.gov](https://sam.gov)

Pending or Contemplated Proposals

- Seller will frequently have pending or planned proposals for follow-on or new work
- Key issue relating to acquisitions of government contractors with pending proposals is whether the company that would receive a resulting award is the same company that submitted the proposal
- The success of a pending or contemplated proposal could impact an *earn-out* (a clause entitling the seller to compensation if the business achieves certain financial objectives) if such a provision appears in the purchase agreement
 - Sellers inherently face some risk from earn-outs and should attempt to secure as much of the purchase price up front as possible
 - On the other hand, a buyer may want to include such a clause in its offer because it helps shield the buyer from losses associated with, among other things, unsuccessful proposals submitted by the target company
- If the target company's proposal relied upon resources of its previous parent or affiliates in its proposal, and the government issues an award based (at least in part) on that information, that award can be protested; company may also lose its standing to protest award to a different company
 - See, e.g., *Universal Prot. Serv. LP v. United States*, 126 Fed. Cl. 173 (2016); *Lockheed Martin Integrated Sys. Inc.*, B-410189.5; B-410189.6 (Sept. 27, 2016); *Wyle Laboratories Inc.*, B-408112.2 (Dec. 27, 2013).
- Keep an eye out for:
 - Contracts with period of performance end dates in the near future
 - Likely a signal that a proposal has been submitted
 - References in submitted proposals to previous owner and/or affiliates and capabilities that are not going to the new owner
 - Notice of intent or discussion letters, as well as authorizations to proceed



Organizational Conflicts of Interest

- Per FAR Part 2, “organizational conflict of interest” (“OCI”) means “that because of other activities or relationships with other persons, a person is unable or potentially unable to render impartial assistance or advice to the Government, or the person’s objectivity in performing the contract work is or might be otherwise impaired, or a person has an unfair competitive advantage.”
 - The government looks upon even the appearance of an OCI unfavorably
- OCIs can result in, among other things, the buyer or seller being precluded from contract competition, or the termination of an existing contract
- Keep an eye out for:
 - Similarities in the work performed by seller and buyer
 - Whether seller and buyer are competitors for the same or similar work
 - If an OCI is possible, consider
 - Value of the impacted work
 - Cost of implementing mitigation procedures
 - Impact on future business if seller or buyer can no longer perform relevant work

Questions?