



Mergers & Acquisitions & Complications Involving Government Contracts

Richard J.R. Raleigh, Jr.
Wilmer & Lee, P.A.



Richard J.R. Raleigh, Jr.
rraleigh@wilmerlee.com

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Some Things I Do:

- Bid Protests
- Size and Affiliation Issues
- Joint Venture Agreements
- Mentor-Protégé Agreements
- Subcontract Disputes
- Intellectual Property / Trademarks
- Labor and Employment (Service Contract Act)
- Non-Compete Agreements
- Commercial Disputes





Mergers & Acquisitions Involving Government Contractors



Congratulations, Somebody Loves You!
(Or) Congratulations, You Are So
Successful You Are In “Acquisition Mode”





Some Considerations

- Novation agreements
 - Set asides – Still qualify post transaction?
 - Other contractual requirements
- Government discretion/rules & regulations
- Security issues/Foreign Ownership
- Buyer & seller exposure and liabilities
- Cost allowability issues



The Transaction

Timeline



Types of Transactions

Asset Purchase/Stock Purchase/Merger

Asset Purchase – Buyer purchases some or all of seller's assets. Buyer may or may not assume liabilities.

- Pro – avoid assumption of some liabilities
- Con – (i) subject to novation agreement approval process; (ii) cross-guaranty of past and future performance. Note: unclear if novation agreement “guaranty” includes extraordinary penalties.
- Avoids assuming liabilities combo of ordinary income and capital gains.

Stock Purchase – Buyer purchases seller's stock. Corporation continues to exist with assets and liabilities, but with new stockholders.

- Pro – (i) no government approval; (ii) no Seller guaranty of future.
- Con – retain all government contract liabilities, including penalties. Note: limitations period 6 or more years.
- Retains liabilities and taxed as capital gains.

Merger – Combination of firms where one survives to hold the assets and liabilities of the combined firms and the others are dissolved. Same as stock purchase except novation agreement may be required depending upon government agency.

Anti-Assignment Act & Novations – FAR § 42.1204(b) recognizes three forms of successors in interest:

- (1) An asset sell
- (2) Merger or corporate consolidation
- (3) Stock purchase

Although I'm concentrating on other issues, of course there are tax considerations and other considerations to all these decisions.



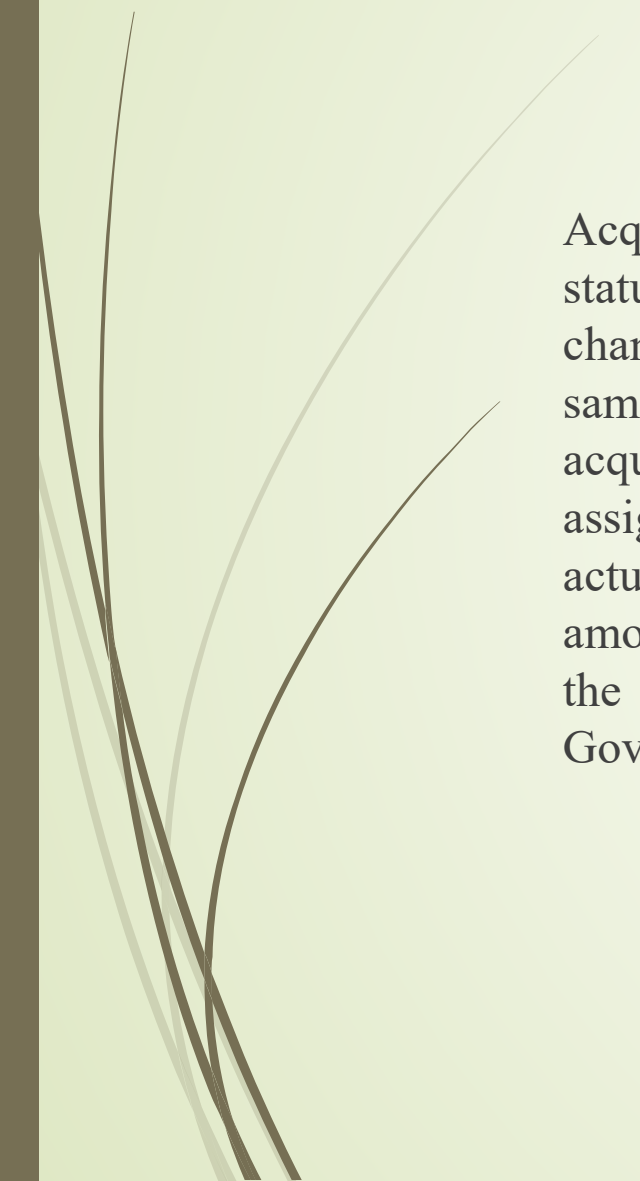
Transfer of Government Contracts and Assignment of Interests

41 USC 6305 & 31 USC 3727

- Prohibit, respectively, transfer of government contracts (or interests therein) and assignment of claims and interests in claims against the government.
- Plenty of reason – discourage speculation in government contracts and “flipping” government contracts for profit, and to ensure government knows who it is dealing with, for example.
- But we know there are M&A’s – so how?




Stock Purchases



Acquisitions made by way of a stock purchase should not implicate the anti-assignment statutes. The entity in privity of contract with the Government does not change; the only change is in the identity of the shareholder(s). Because the contracts will be performed by the same entity, utilizing the same facilities, assets, personnel, skills, and experience applied by the acquired entity before the stock purchase, none of the policy reasons that underlay the anti-assignment statutes are implicated by this type of transaction. Although there is no case that actually squarely so holds, the Federal Acquisition Regulation does not list stock purchases among the transactions that trigger the need for Government consent. *See* FAR 42.1204(a). To the contrary, FAR 42-1204(b) expressly excepts stock purchases from the requirement for Government consent.




Asset Purchases



FAR 42.1204(a) identifies a sale of assets as a transaction that requires Government consent. This makes sense if one examines the policy reasons for the anti-assignment statutes – the performing entity is no longer the entity to which the contract was awarded in the first instance and the prospect of conflicting claims and misdirected payments is obvious. The case law uniformly recognizes the Government's approval rights in connection with asset transactions. The types of asset sales that will be favorably considered for consent by the Government generally include the sale of all of the assets of the original contractor, or the sale of all of its assets involved in performing the contract, with a provision for the assumption by the acquiring entity of the liabilities associated with the acquired contracts. The Government will not want to chase an entity with which it no longer has privity of contract to enforce liabilities not assumed by the new contractor.



Mergers and Consolidations



Up to now, the answers have been fairly straightforward, with predictable outcomes. This is where the road gets curvy, hilly, and bumpy. There are a number of cases – including Supreme Court, Court of Claims, and Armed Services Board of Contract Appeals precedent – holding that a merger or consolidation effects a transfer of assets “by operation of law” that is not subject to the anti-assignment statutes and for which Government consent is not required. Unfortunately, the FAR provides that consent is required for a transfer of assets “incident to a merger or corporate consolidation.” FAR 42.1204(a)(2)(ii). While one might assume that the U.S. Supreme Court trumps the FAR, contracting officers do not necessarily subscribe to that view and, in the world of government contracting, they rule the roost. While one can occasionally encounter a contracting officer who will actually listen on this score, and the ASBCA has held that a reverse reflexive response that they must comply with the FAR as written. When this happens, despite the parties’ compelling legal arguments for the inapplicability of the statutes, there is no way effectively to resolve the issue in advance of closing and the course almost invariably charted by the parties is to (a) advise the contracting officer of the transaction, (b) seek agreement that a novation is not necessary, (c) failing that (as will usually be the case) precondition him/her so that consent can be readily obtained promptly after closing, and (d) bemoan in private the FAR’s reversal of Supreme Court precedent.

Other

“Reorganization” is a generic term. Basic restructuring – tends to be considered outside of the purview of the Anti Assignments Act – Mancon Liquidating, ASBCA No. 18304, 74-1 BCA-A10, 470.

- Restructures and Reincorporation or Reorganizations

- “[B]usiness restructurings, such as reincorporation, which involve no change in ownership of the business” are regarded as transfers by operation of law that are not subject to the consent requirements of the anti-assignment statutes. Once the reorganization involves changes in ownership, the need for Government consent becomes an issue.

- Assignments in Bankruptcy

- The question here is whether the assumption of an executory government contract by the debtor in possession is a prohibited transfer that is subject to the Government’s consent prerogatives. This involves the intersection of the anti-assignment statutes and 11 U.S.C. § 365(c)(1). This latter statute provides that the “trustee may not assume... any executory contract...if... applicable law... excuses a party... to such contract... from accepting performance from... an entity other than the debtor or debtor in possession...”

- Bankruptcy

- Unfortunately, there are cases that come down on both sides here, holding in contradictory fashion that (1) Section 365(c)(1) does not prohibit a debtor in possession from assuming an executory contract, with or without the other party’s consent, e.g., *In re James Cable Partners, L.P.*, 154 B.R. 813 (M.D. Ga., 1993); and (2) a debtor in possession cannot assume an executory contract if applicable law would prohibit an assignment to a hypothetical third party. *In re Catapult Entertainment, Inc.*, 165 F.3d 747 9th Cir. 1998). These cases proceed on the assumption that “a solvent contractor and an insolvent debtor in possession going through bankruptcy are materially distinct entities.” *In the Matter of West Electronics*, 852 F.2d 79, 83 (3rd Cir. 1988). Under these latter cases, thus, the Government can exercise its consent rights under the anti-assignment statutes to block the assumption of the contract by the debtor in possession.



Bids and Proposals

FAR 14.404-2 (j) permits COs to reject bids and proposals that have been “transferred”



Novation of Acquired Contracts

- Identify agreements during due diligence and novation process occurs post-closing.
- Required for carve-out transactions, including asset sales.
- If agreement will transfer by operation of law (e.g., target is acquired via merger or 100% stock purchase), then arguably no novation is required.
- However, the expectation should be that these agreements are novated following a change in control transaction.
- Novation is a question of time and money; no real risk of agreement not being novated.
- Sellers in carve-out transactions may remain liable under novated contract for buyer's failure to perform.
- FAR includes a standard form of novation agreement.
- Novation rules do not apply to pending bids that are outstanding at the closing.

Novation issues (Sections 1204(e) and (f) of Part 42 of FAR contain laundry list of documents that contractor must submit to CO with a novation request.

Government contracts and contract claims are transferable only with government consent (41 U.S.C. § 15; 31 U.S.C § 3727)



Novation Agreement

Novation Agreement is attached to a contract modification demonstrating the government's consent to the transfer.

- Attachment A – FAR Subpart 42.12, “Novation and Change-of-Name Agreements”
- Accompanied by FAR-specified document package

Practice Tip: Sales agreement should specify post-close obligation for seller to timely provide required documents

- Buyer guarantees Seller's past performance, Seller guarantees Buyer's future performance
- Required for asset purchase contract transfers, but generally not required for stock purchases

Practice Tip: GSA requires for corporate mergers, structure transaction documents accordingly

Novation Agreement (cont.)

“Lead Agency” contracting officer (CO) approves all transferred government contracts

- Lead agency CO is generally largest contract CO – consults with other agency COs
- Some opportunity to “forum shop”

Practice Tip: include GSA Schedule contract Blanket Purchase Agreements (BPAs) and outstanding task and delivery orders on list of transferred contracts

- No government “pre-approval” of Novation Agreement but sometimes advisable to speak with CO during due diligence phase (they will usually effectively preapprove)
- Time required for government review and approval varies, **can require 2-6 months**
- Seller remains the legal party to the contract until novation is approved

In short, novation follows closing, but you’d best involve the administration or responsible CO early. They have broad discretion and grant or deny in the “best interest of the Government”. See FAR 42.1203(c); 42.1204(c)(4) and (g). See FAR 42.1204(e).



Before Transaction Submit:

- Proposed Novation Agreement
- Document describing proposed transaction (for example Purchase Agreement)
- Evidence of buyer's capability to perform
- Anything else the CO requests



As they become available (usually after closing):

- An authenticated copy of the instrument affecting the transfer (e.g., bill of sale, certificate of merger, contract, deed, agreement, or court decree);
- Appropriate corporate approval of the transfer consisting of certified copies of board resolutions and/or stockholder minutes;
- An authenticated copy of the transferee's certificate and articles of incorporation (if a corporation was formed to receive assets involved in performing government contracts)
- Opinion of legal counsel for the transferor and the transferee stating that the transfer was properly effected under applicable law and the effective date of the transfer;
- Balance sheets of the transferor and the transferee as of the dates immediately before and after the transfer of assets, audited by independent accountants;
- Evidence that any security clearance requirements have been met; and
- The consent of sureties on all contracts transferred or a statement from the transferor that none are required.

FAR 42.1204(f)



Cooperation



- Government approval can be obtained only after closing and transfer.
- Ensure purchase agreement contains a provision requiring seller to continue to cooperate to obtain novation after closing.



Proposals

So, what happens to the as-yet-unaccepted offers?

The Government can reject the bid or proposal, even if it was acquired in connection with a transfer of all of the assets of the transferor, if the transferor's assets were not substantial. In such a case, the transaction will likely be viewed as a sale of the bid or proposal, and nothing more, and trafficking in Government contracts is, after all, one of the evils at which the anti-assignment acts are directed. *Mil-Tech Sys., Inc. v. United States*, 6 Ct. Cl. 26, 34 (1984); *see also Premier Security*, B-275908, July 14, 1997, 97-2 CPD 15 (sustaining a protest where the other assets of company were of negligible value).

Mil-Tech is a particularly interesting case because it involved a stock sale. Technically, the identity of the offeror had never changed; there was no transfer of the offer from one company to another, only a transfer of stock from one shareholder to another. But, the facts reveal the basis for the decision – the Small Business Administration had denied Mil-Tech a Certificate of Competency because its sole shareholder was on probation for a misdemeanor tax violation. The shareholder sold his stock to his brother for a nominal sum, which plainly suggested that the “meat” of the transfer was the pending Mil-Tech offer. Reviewing that same record, the GAO found that there had been no “transfer of the reconsideration, the GAO reversed its initial decision. When Mil-Tech took the matter to the Court of Federal Claims, the COFC sided with the agency. The facts and procedural history of Mil-Tech give life to the proposition that “decisions regarding matters of corporate status and restricting are highly fact-specific, and turn largely on the individual circumstances of the proposal transactions and timing.” *IBM U.S. Federal*, B-409806 *et al.*, Aug. 15, 2014, 2014 CPD 241.



Proposals Cont.

Bottom line – original offeror intact with intent to honor commitments or proposal?

If no access to resources or ability then award unlikely to withstand scrutiny.

Small Business Status





Possible Loss of SB Status

The small business is “a concern, including its affiliates, that is independently owned and operated ... and is qualified as a small business under the SBA’s size standards.”

FAR § 19.001

Within 30 days of an approved contract **novation**, a contractor must recertify its small business size status to the procuring agency, or inform the procuring agency that it is other than small. If the contractor is other than small, the agency can no longer count the options or orders issued pursuant to the contract, from that point forward, towards its small business goals.

13 C.F.R. § 121.404(g)(1)



Possible Loss of SB Status

8(a) Contracts

A contract awarded to an 8(a) concern shall be performed by the concern. If the owner relinquishes ownership, the contract shall be terminated for the convenience of the Government.

15 U.S.C. § 637(a)(21)(B)

The 8(a) contractor must notify the SBA “immediately upon entering an agreement (either oral or in writing) to transfer all or part of its stock or other ownership interest to any other party.”

15 U.S.C. § 637(a)(21)(D); 13 C.F.R. § 124.515(g)

To obtain a waiver, the SBA requires a certification from the head of the contracting agency or another authorized agency official that “termination of the contract would severely impair attainment of the agency’s program objectives or missions.”

15 U.S.C. § 637(a)(21)(B)(ii); 13 C.F.R. § 124.515(b)(4)



Possible Loss of SB Status


8(a) Contracts

- IDP, an 8(a) contractor was awarded an IDIQ contract in 1997 for desktop computers. Estimated quantity was \$100 million.
- In 1998, IDP was acquired by a non-8(a) firm.
- Government had paid IDP for over \$35 million worth of products.
- Government terminated for convenience.
- Government insisted successor be responsible for warranty obligations.

International Data Products Corp. v. United States, COFC (March 28, 2005)



Small Business



Agencies have goals for awarding contracts to small businesses. They take those goals seriously. Some government contracts are set aside for small businesses. In other cases, small businesses may receive preferential treatment in the evaluation and source selection process. The Government determines whether a contractor is a small business based on its revenue or number of employees plus the revenue or number of employees of all of its affiliates. The rules define affiliation very broadly. Acquiring a small business or even making a substantial investment in a small business can result in a loss of small business size status. Once a contractor loses its small business status as the result of an acquisition, it is no longer eligible for small business set-asides, agencies can no longer count awards toward their small business goals, and there is some risk that existing awards could be terminated for convenience. Thus, the buyer should identify the contracts that were awarded to the target as small business set-asides and determine whether the target will continue to qualify as a small business after the acquisition. If the target will not continue to qualify as a small business, the buyer should consider: (1) the risk that the Government will terminate existing contracts for convenience or decline to exercise options; (2) whether there are opportunities for large businesses for the type of work the target performs (e., whether contracts for such work are typically set aside for small businesses); and (3) the likelihood that the target will be able to compete with those large businesses for such work.





“Small Business” Set-Aside Contracts

- Federal government procurement preference programs for “Small Business”
- Small Business size standards are industry-specific, based upon – total employees (manufacturing) or average annual revenue (services)
- “Small Business” is “affiliated” with its owners
- “Affiliate” revenue and employees count when determining a company’s size status
- Small Business status can be a key ingredient in a company’s success
- Loss of Small Business status could result in
- Immediate termination of some contracts
- Re-competition among Small Businesses instead of exercising contract renewal options
- Loss of Small Business status bars participation in future competitions for Small Business set-aside contracts
- Possible competitive disadvantage relative to federal subcontracts



Update to Size Status

- Old Rule: SB contractor required to update size status representation only for asset purchase
- Buyer could structure acquisition as stock purchase if “small business” contracts were key to acquisition
- Current Rule: SB contractor must “re-represent” its size status within 30 days of stock purchase or merger. FAR 52.219-28

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- Practice Tips: (i) reach out to CO for key small business contracts before closing; (ii) closing condition of government approval of the contract transfer
 - Does the Seller hold set-aside contracts?

Red Flags: (i) Contract standard form (SF) with “set-aside” box checked; (ii) listed in government databases as “Small Business” (e.g., www.sam.gov)




Anti-Trust



Anti-Trust: Government's Harder Look

“Agencies are required ... to report to the Attorney General any bids or proposals that evidence a violation of antitrust laws.”

FAR § 3.303





Anti-Trust: Government's Harder Look

Examples

- Lockheed Martin & Northrop Grumman merger *blocked by DOJ in 1998*
- General Dynamics & Newport News merger *blocked by DOJ in 2001*



Anti-Trust: Government's Harder Look

U.S. v. Alliant Techsystems, Inc.

- Alliant and Aerojet-General competed against each other in the Combined Effects Munition (CEM) market
- In 1990, the Air Force “downsized” to one vendor—Alliant
- After the Gulf War, Air Force issued RFP seeking competition
- Alliant and Aerojet entered into a teaming agreement and submitted a single bid for the CEM contract with Alliant acting as the prime
- The price submitted by the Alliant/Aerojet team was higher than previous contracts
- DOJ brought an Anti-Trust action
- Alliant and Aerojet subsequently entered into a consent decree with DOJ. Alliant agreed to pay \$2,047,500.



Anti-Trust: Government's Harder Look

FTC & DOJ Guidelines

In 2000, the Federal Trade Commission and Department of Justice issued Antitrust Guidelines for Collaborations Among Competitors to clarify when anti-trust enforcement is likely.



Due Diligence



Due Diligence

- Government contracting is, of course, a regulated industry
- Thus, there are many business aspects that could create greater risks
- But for a purchaser, one should always engage in the diligence that is due under the circumstances, right?
- Some considerations include:
 - valuation of backlog – with IDIQ contracts and Blanket purchase agreements, how much does the government really promise to buy? How much is funded? Term? Scope? All considerations.
 - CPRS/Past Performance
 - IP – who owns it?
 - Audits/Investigations – anyone know TINA? Something to think about is potential defective pricing risks.
 - Changes/Claims/Disputes
 - SCA Issues (correct wage determination rates?)



So What is Due Diligence?

- Exercise of investigating the business being sold
- Both buyer and seller engage in due diligence – for different purposes
- Really begins with the “initial discussions”
- Need an NDA signed before really share info
- What we all really mean by “Due Diligence” is the process following NDA and sometimes Letter of Intent (LOI) – where validate assumptions, discover “hidden liabilities and risks”
- Usually need CPA and Attorney to help through due diligence



Checklist

- You need a checklist; no form is perfect but there are many out there
- OCIs – Organizational Conflicts of Interest (OCI)
 - OCI rules specified in FAR subpart 9.5
 - OCI rules are designed to prevent unfair “structural” competitive advantages
 - E.g., evaluating an affiliate for award
 - E.g., helping to draft specifications that you’ll later bid on
 - OCI could bar participation in procurements where the Seller is in the same or similar industry as the Buyer
 - Surrender of existing contracts to avoid or properly mitigate OCI
 - Does the transaction create a potential OCI?
 - Red flag: Buyer and Seller compete on government procurements for complex requirements in the same or substantially similar industries
 - If there is a potential OCI, examine: value of potentially affected programs
 - Whether existing mitigation plan is sufficient
 - Cost of additional mitigation steps
 - Restriction on future business development resulting from OCI



Checklist Cont.

- Bid Protests
- Ethics and Compliance – have ethics policy, code of conduct, mandatory disclosures? Is there someone at target who is responsible for receiving whistleblower complaints and compliance issues? If not, that can be telling.
- Facility Clearances
- Foreign Ownership
- International Procurement? ITAR/Export Control – if buyer then need conference call discussion with head of import/export at target business; credentials, clearances, permits.
- Labor and Employment Investigations – EEOC, Wage Hour, SCA/Wage Determination issues
Size Protests?
- What Teaming Agreements, JV, MPAs, Subcontract Agreements exist?
- Suspension/Debarments? Investigations? Letters/Show Cause Notices?
- Look at Code of Conduct, Employee Handbook, Policies and Procedures, EEO-1 Reports, Small Business Subcontracting Plans
- Do they have Standard Purchasing Terms and Conditions (T&Cs)?



Things for Buyer to Request and Consider

- Historical Statements – income, balance sheets, cash flow
- Interim Statements
- Assets – cash, AR, inventory, fixed assets, intangibles (trademarks, patents, good will)
- Liabilities – accounts payable, accrued expenses (bonuses, vacation, deferred comp, etc.), notes, taxes, stockholder equity
- Sales – products, lines, contracts, prices, margins, customers, competition
- Labor – rates, benefits
- Research and Development
- G&A expenses
- Management team
- Litigation, environment issues, OSHA concerns

Look at: corporate documents, minutes, financing, leases, employment contracts, patents, non-competes, stock and agreements, all plans (pensions, deferred comp, benefits), deeds, citations, investigation, insurance, and taxes.



Due Diligence in Defense Industry Mergers & Acquisitions

- FCPA
- Import/Export
- Ethics and Compliance Programs
- Top Secret Programs and Contracts
- False Claims Act/Government Audits/Similar



Foreign Investment

- Where foreign companies are investing on government contractors:
 - Review by the Committee on Foreign Investment in the United States (CFIUS)
 - Mitigation of any foreign ownership, control or influence (FOCI) to safeguard the U.S. government's national security interests pursuant to the requirements of the National Industrial Security Program (NISP)



ITAR and Export Licensing Requirements for Foreign Personnel

- The International Traffic in Arms Regulations (ITAR) are State Department controls and they continue to expand the reach of ITAR
- ITAR includes:
 - Registration requirements
 - Restrictions on transfer of technical data and regulated software
 - Restrictions on the performance of defense services for foreign parties
 - Requirement to obtain export licenses
 - Record keeping requirements
- Applies even if the company's only customer is the U.S. Government
- Penalties:
 - Criminal liability and monetary fines
 - Debarment or denial of export privileges
 - Seizure of goods transferred in violation of ITAR requirements



False Claims Act - FCA



Intellectual Property Due Diligence



IP Due Diligence



1. Valuation Considerations
2. Past Performance
3. Service Contract Act
4. GSA Schedules
5. Truth In Negotiations Act
6. IP Pitfalls
7. Compliance Programs
8. Disgruntled Employees



Due Diligence - IP

- IP ownership can justify a sole source award
- IP can impact valuation
 - If Government has unlimited rights – drop valuation
 - If Government has limited/restricted rights – increase
- Does IP have value for commercial markets?
- Has IP been properly protected?



Due Diligence – IP Pitfalls

Campbell Plastics Engineering & Mfg., Inc., 389 F.3d 1243 (Fed. Cir. 2004) (Appeal from ASBCA Decision)

- Campbell, an 8(a) contractor, had been awarded a contract by the Army for tooling to produce protective masks for aircrews.
- While performing the contract, Campbell devised a sonic welding process
- The contract contained standard FAR Patent Rights clause
- Under the clause, Campbell was obligated to disclose its invention to the Government within 60 days after the inventor informed the “Contractor personnel responsible for patent matters.”
- The clause further states that, if the Contractor does not disclose the invention within the sixty days, the Government may request the title to the invention
- On three occasions in early 1993, Campbell informed the COTR about the sonic welding process
- On the DD Form 882, Report of Inventions, Campbell no “subject inventions”



Due Diligence – IP Pitfalls Cont.

- Campbell filed a patent application for the sonic welding process
- The patent application disclosed that the invention was made while performing an Army contract and stated that the Government was entitled to a license.
- Campbell provided a copy of the issued patent to the C.O. The cover letter acknowledged that the Government had a license.
- Because Campbell had made a misrepresentation on DD Form 882, the Army demanded that Campbell transfer the title to the patent to the Government.
- Campbell appealed what he dubbed a “draconian penalty” to the ASBCA.
- The ASBCA upheld the Army’s right to demand the title to the patent, and the Federal Circuit affirmed.



Due Diligence – Valuation



Due Diligence - Valuation

Backlog is a key factor for valuation

- Most contracts tied to options
 - What is the likelihood of the option being exercised?
- Many contracts are IDIQ with nominal minimum quantities
- Many contracts are incrementally funded
- Cost reimbursement contracts
 - Overruns?
 - LOC notice given?



Due Diligence - Valuation

- Warranty liabilities?
- Pending disputes (including subcontractor)?
- Pending indirect cost rates proposals – overpayment by government?



Due Diligence – Past Performance

- Past performance is the single most important non-price evaluation factor in source selections
- “Agencies shall prepare an evaluation of contractor performance for each contract in excess of \$1,000,000”

FAR §42.1502



Due Diligence – Past Performance

- Reviewing Contractor Performance Assessment Reports (CPARs) is an essential step in the due diligence of any government contractor.
- A vendor's failure to contest a negative CPARS under FAR 42.1503(d) should be a “red flag”.



IP Due Diligence Cont.

- Was the Seller's IP developed exclusively at private expense?

Red Flag: Seller performs government research and development (R&D) prime contracts or subcontracts

- If not developed exclusively at private expense, examine:
 - Extent of government's rights in the IP
 - Is it subject to release under FOIA?
 - Did contractor perfect its ownership (and commercial market exclusive rights) in IP developed with government funds? If not, is defect subject to cure?
 - Is original IP valuation affected? If so, by how much?



Pricing – TINA and Other Issues



GSA Schedule Contracts



If Seller Holds a GSA Schedule Contract, Review:

- Pre-award sales practices disclosures
- Procedures for monitoring post-award price reductions
- Payment of administrative fee to GSA (IFF)
- Procedures for selling only GSA-approved items
- Compliance with product country of origin rules (TAA)
- Procedures for supplying qualified professional staff



Significant Potential Buyer Exposure

- December 2004, Oracle acquires PeopleSoft
- PeopleSoft employees files qui tam False Claims Act lawsuit

Seller's new structure

- October 2006, Oracle agrees to pay \$98.5 million fine for PeopleSoft GSA contract pricing errors
- http://www.justice.gov/opa/pr/2006/October/06_odag689.html



Past Performance



Organizational Conflicts of Interest (OCIs)

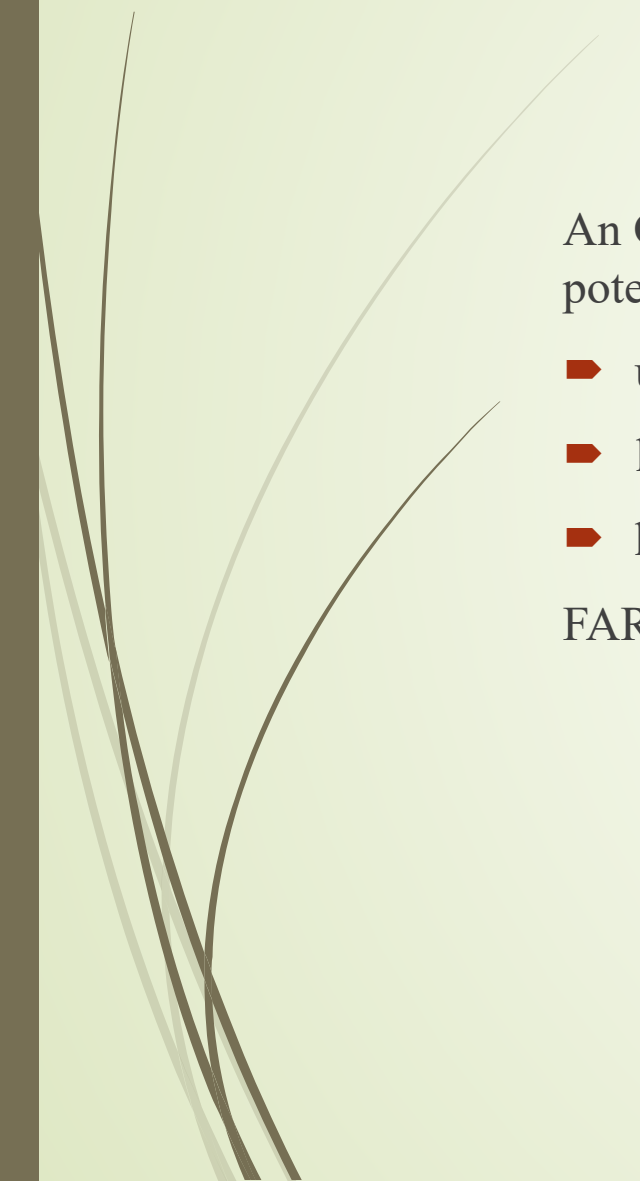


Organizational Conflict of Interest (OCIs)

An Organizational Conflict of Interest (Organizational COI) means a contractor is unable or potentially:

- unable to render impartial assistance or advice to the Government;
- lacks objectivity in performing work; or
- has an unfair competitive advantage

FAR § 2.101





Organizational Conflict of Interest (OCIs)

As part of the due diligence, ascertain if the acquisition will result in a OCI.

- Propose a mitigation plan such as firewalls separating the conflicted sectors of the merged entity.
 - The GAO has held that firewalls were “virtually irrelevant” for mitigating impaired objectivity conflicts
- Offer to divest that portion of the target’s business that creates the concerns?



The SAIC/Leidos Split

“SAIC’s old way of doing business —where units offering similar services operated in silos —meant the company often got in its own way because of organizational conflicts of interest, executives said. Its sprawling bureaucracy made it difficult to chase new markets. So the company divvied up its operating segments.”

One Year Later: The One Year Later: The Tale of SAIC And Leidos,
Washington Post, Sept 28, 2014



Torch Spinning Off nLogic

“The acquisition provided a mechanism for both companies to mitigate Organizational Conflict of Interest (OCI) issues. Historically, Torch Technologies has provided services directly to government customers, while Torch Systems, LLC, primarily focused on providing services to prime contractors. Following this divestiture, Torch Technologies can now focus exclusively on providing services to government agencies.”

<https://www.torchtechnologies.com/torch-technologies-completes-sale-of-torch-systems-llc>





Mitigation – Unequal Access

- Unequal Access
 - Firewall can preclude sharing of info.
 - Mitigation plan could include NDAs, physical and electronic access controls, tng, and audits.



Mitigation – Impaired Objectivity/Biased Ground Rules

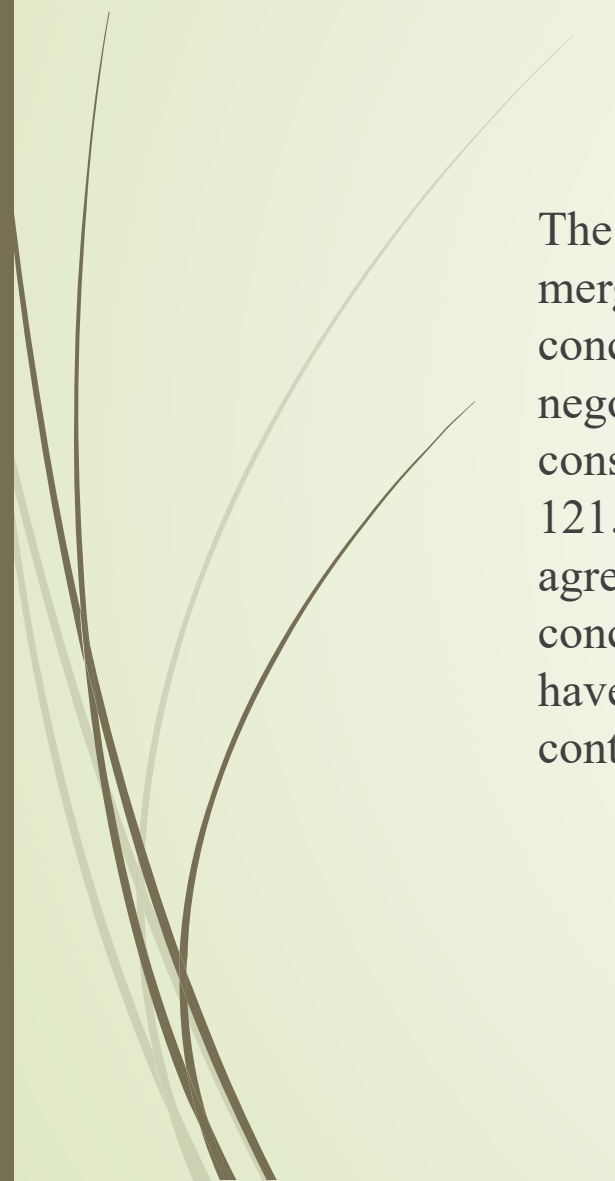
- These are more difficult to mitigate
- Often involves subcontracting out the work that would create the OCI to a 3rd party who would report directly to Government.
- Enter into a bilateral mitigation plan with Government. Government may not agree. OCI may be too pervasive to mitigate.
- Others have already discussed these issues at length.



SBA Affiliation Rules – Plans and Letters of Intent



“Present Effect Rule”



The SBA’s “present effect rule” states that, in determining size, SBA considers agreements to merge, “including agreements in principle,” to have a “present effect on the power to control a concern.” 13 C.F.R. § 121.103(d)(1). By contrast, “Agreements to open or continue negotiations toward the possibility of a merger or sale of stock at some later date are not considered ‘agreements in principle’ and are thus not given present effect.” 13 C.F.R. § 121.103(d)(2). If an LOI between two concerns contemplating an acquisition or merger is an agreement in principle, those two concerns are considered affiliated. For a small business concern, often the target in such transactions, and the buyer, entering into such an LOI may have significant implications as it may render the concern ineligible to bid on small business contracts.



SBA Affiliation Rules



Size Appeal of Telecommunications Support Services, Inc., SBA No. SIZ-5953 (2018), OHA determined that the LOI did not create an affiliation, and in *Size Appeal of Enhanced Vision Systems, Inc.*, SBA No. SIZ-5978 (2018), OHA found that the LOI did create an affiliation and drew several distinctions between the two fact patterns.



SBA Affiliation Rules

- Although many factors went into OHA's conclusions, among the most important were: if LOI establishes a price but stipulates that the price was conditional on the seller meeting certain financial targets, can result in no present affect. Also, LOI conditioned on the buyer's extensive due diligence review and stated that the LOI allowed for either party to withdraw from the agreement.
- Also, if seller could have accepted offers from other buyers.



Announcements

- Announcement of a proposed transaction can impact pending bids.
- Government perception of cost and performance risk or uncertainty is key factor.

Lockheed Martin Integrated Sys., Inc., B-410489 (Sept. 27, 2016)



Lockheed

- After submitting its proposal, Lockheed Martin announced in a press release that it entered into an agreement to separate and combine its realigned business segment that was proposed to do the work under the Task Order with Leidos.
- The Army Corps of Engineers determined that this action created risks and cost uncertainties that prevented the Army Corps from assessing the realism of Lockheed Martin's proposal and excluded Lockheed's proposal from award consideration.



Another “Effect of Sale Issues” – Pending Bids

- Past performance is a key factor in government agencies’ assessment of bids
- Federal agencies are required to consider past performance as one of several factors used to evaluate bids in completely negotiated bids
- When acquiring a business with pending bids, consider whether you are acquiring the assets and personnel that will be used to determine past performance
 - This analysis is more important for carve-out transactions and asset sales where key personnel and business lines may remain with the seller
 - For a merger or a stock purchase where the buyer is acquiring the entire target business, past performance should not be an issue



Costs



- Goodwill – government will not bear any portion of the costs related to intangible asset “goodwill” – expressly unallowable, FAR 31.205-49.
- Interest and financing – most deals require financing, but interest on borrowing is an expressly unallowable cost, FAR 31.205-20.
- Golden Parachutes – special compensation to employees if employment terminates following ownership change – unallowable – FAR 31.205-6(1).



Acquisition Agreements – Areas of Focus and Using Them To Allocate Risk

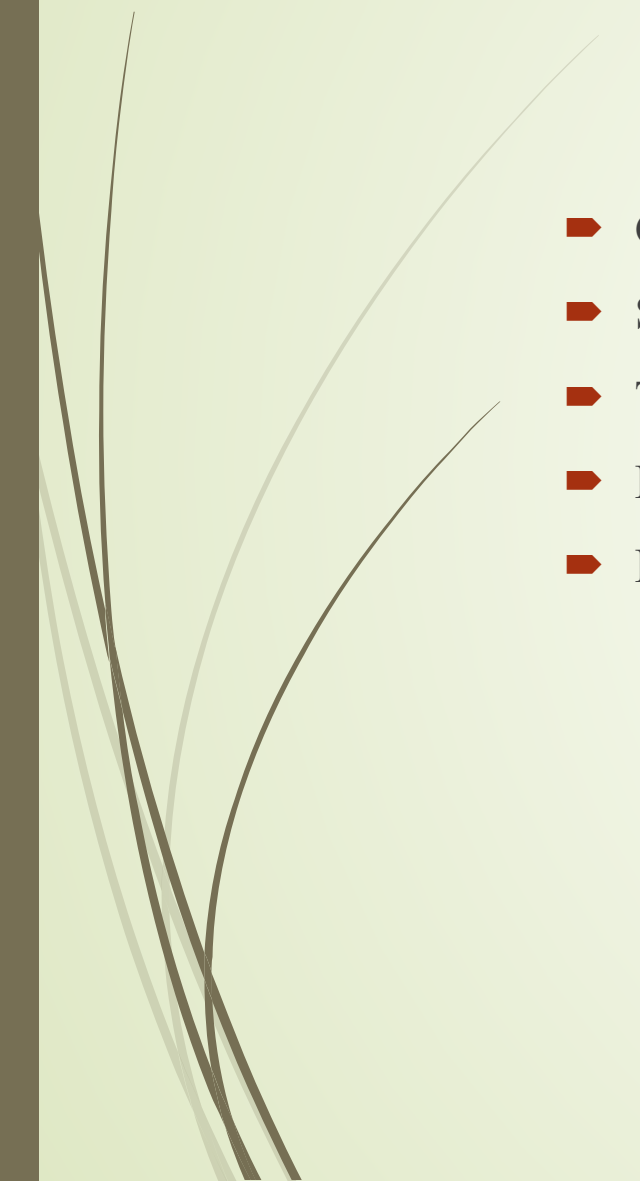


The Money (Economics)

- Price
 - Formula for computing the price
 - Purchase price adjustments (e.g., working capital)
 - Earn-out (if any)
- Consideration
 - Cash, stock or mix
 - Tax treatment of stock consideration
- Equity Award Treatment
 - Cashed out or rolled over
 - Unvested awards – how treat these?
 - Tax allocation
- Other Pre-Closing Liabilities
- In a carve out, agreeing on what assets the buyer is purchasing



Additional Considerations Regarding Closing

- Closing conditions
 - Scope of representations
 - Third party consents
 - Regulatory requirements/approvals
 - Buyer financing
- 

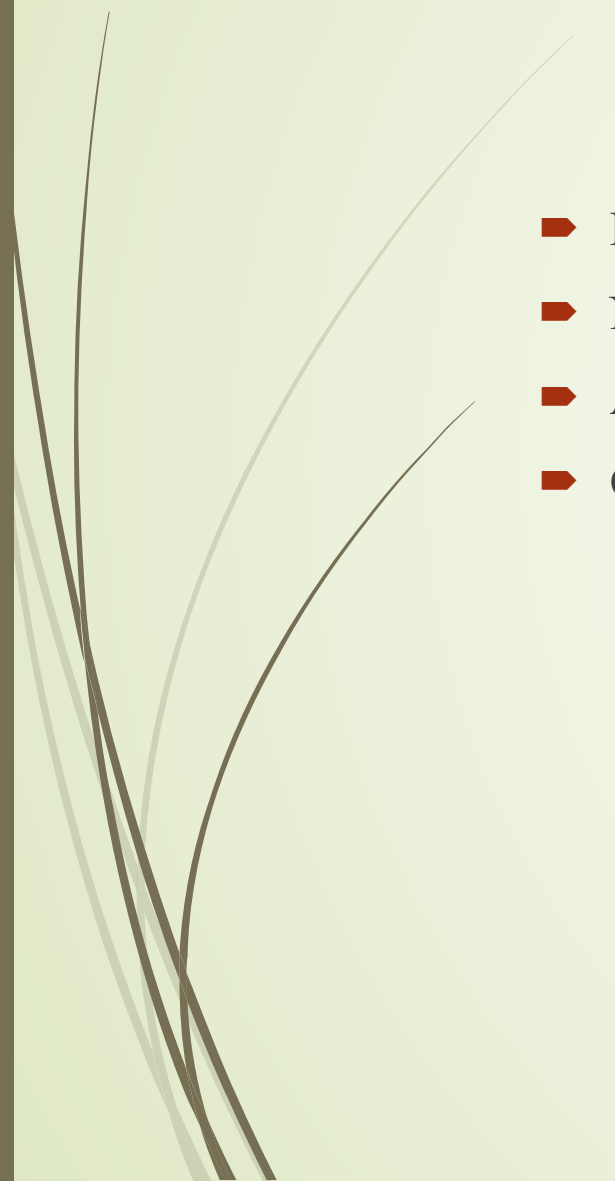


Using the Purchase Agreement to Allocate Risk

- Due diligence attempts to discover risks
- Much of the purchase agreement attempts to allocate risks, whether those risks are known or unknown
- Primary tools:
 - Closing conditions on the accuracy of reps and warranties
 - Indemnification (e.g., accuracy of reps and warranties or specific liabilities)
 - Earn-outs



Key Reps to Address Important Topics:

- Financial Statements
 - No Undisclosed Liabilities
 - Absence of Changes
 - Other Key Reps
- 



The Government Contracts Representations



The Government Contracts Reps – False Claims Act and Foreign Corrupt Practices Act



What is “Indemnification”?

- Indemnification is a contractual right of one party to be paid by the other party when something bad has happened
- Most purchase agreements provide that indemnification is the “exclusive remedy” of the parties
- This means that, post-closing, the parties cannot sue each other for causes of action such as:
 - Breach of contract
 - Violation of securities laws
 - Violation of the environmental laws
- The exclusive remedy provision is very powerful, as it prevents the parties from suing each other court



What Items are Typically Indemnified?

- Typically, indemnification is provided by the seller to the buyer, and by the buyer to the seller, for the following:
 - Breach of any representation or warranty in the purchase agreement
 - Breach of any covenant in the purchase agreement
 - Ongoing government audits
 - Ongoing False Claims Act cases
 - Obligations to make payments under settlement agreements
 - Known environmental cleanup obligations



“Your Watch/Our Watch” Indemnification



Limitations on Indemnification



OTHER



What's In A Name – Change-of-Name Procedure



Wrap Up



The End

- Seller – Retires to Island, or stays on and works for “earn-out” and may watch the stock they got as part of deal.
- Buyer – Post-closing finalizes novations, updates clearances, registrations, SAM website as may need to.
- Attorneys – Get paid (hopefully)
- Employees – Just keep on working (hopefully)



Questions?

Thanks!

Richard J.R. Raleigh, Jr.

WILMER & LEE, P.A.

100 Washington Street, Ste 100

Huntsville, AL 35801

(256) 533-0202

rraleigh@wilmerlee.com



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