

NOVATIONS AND CONTRACT TRANSFERS



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PRESENTED BY

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OVERVIEW

- What is novation and what is required to effectuate such a transaction?
- When are novations necessary and when can they be avoided?
- What impact will a novation have on your small business status?
- What are some main problems that contractors encounter when novating contracts?
- What is the difference between a novation and a change of name agreement?
- What are some of the unwritten rules certain agencies have regarding novations?
- Q&A



WHAT IS NOVATION?

- Anti-Assignment Act (41 U.S.C. 15) – prohibits transfer of government contracts
 - Policy – government has selected a contractor through the procurement process and that’s who they want to perform
- Novation process provides the exception that allows for the transfer of government contracts
 - Permitted when in the “Government’s interest to recognize the proposed successor in interest”

FAR 42.1202(c); FAR 42.1204(a)



TO WHOM DO YOU SUBMIT NOVATION DOCUMENTS?

Submit to the administrative contracting officer (ACO), if applicable, or the contracting officer (CO) responsible for the largest unsettled (unbilled plus billed but unpaid) dollar balance of contracts

FAR 42.1202



WHEN DO YOU SUBMIT NOVATION DOCUMENTS?

- **Novation documents are submitted after the purchase & sale/transfer of the contract**
- **Because novation approval is based upon CO/ACO's determination that transfer is "in the government's interest," it is completely within their discretion**



HOW LONG WILL NOVATION APPROVAL TAKE?

There is no deadline provided in the FAR for how long a CO's/ACO's determination may take from the date of submission of a notification and request for novation



WHAT DO YOU SUBMIT?

- Cover Letter to the CO explaining the transaction
- Novation Agreement
- List of All Contracts to be Transferred
 - Contract Number
 - Contract Type
 - Total Dollar Value
 - Approximate remaining unpaid balance
- Statement of Transferee's Capability to Perform

FAR 42.1204(e)



WHAT DO YOU SUBMIT? (CONT'D)

- Document or “Instrument effecting the transfer of assets” (e.g., purchase agreement, bill of sale)
- Corporate authorizing resolutions of board of directors and shareholders of transferor/seller and transferee/buyer
- Opinion of Legal Counsel of transferor/seller and transferee/buyer

FAR 42.1204 (f)



WHAT DO YOU SUBMIT? (CONT'D)

- Balance sheets of transferor/seller and transferee/buyer immediately before and after the transfer of assets
 - “audited by independent accountants” – generally we have found COs will be somewhat flexible if cost for audited balance sheet makes process prohibitive
- Evidence that security clearance requirements have been met
- Consent of sureties

FAR 42.1204(f)



TRANSFERS WHEN NOVATION IS REQUIRED

- Asset Sales require novation
- Novation procedure applies “when the third party’s interest in the contracts arise out of the transfer of --
 - (1) All 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.”

FAR 42.1204(a)



TRANSFERS WHEN NOVATION MAY NOT BE REQUIRED

- Novation is generally not required for stock sales

“A novation agreement is unnecessary when there is a change in the ownership of a contractor as a result of a stock purchase ...”

FAR 42.1204(b)



TRANSFERS WHEN NOVATION MAY NOT BE REQUIRED

- Corporate reorganizations – the “by operation of law” exception
- Not in the FAR but well-established by case law
- Classic examples: intestacy and bankruptcy
- Certain types of corporate transactions: corporate mergers, consolidations or reorganizations
 - Standard mergers of subsidiary into parent or reverse vs less standard of sister subsidiary into sister subsidiary



BY OPERATION OF LAW EXCEPTION

Talking points with CO (subsidiary into parent merger):

- This is a corporate reorganization
- New subsidiary (for example) will take full responsibility for the contract
- Simply requesting that the contract holder be changed from the parent contracting party to the new wholly-owned subsidiary



WHAT'S REQUIRED FOR CHANGE OF NAME

- Change of Name Agreement
- List of All Contracts to be Transferred
 - Contract Number
 - Contract Type
 - Name and address of contracting office
- Opinion of Legal Counsel of contractor

FAR 42.1205



HOW IS CHANGE OF NAME DIFFERENT FROM NOVATION

- Fewer documents to be submitted
- Takes less time
- Less complicated



IMPACT OF NOVATION ON SMALL BUSINESS STATUS

- **Recertification is required**
- **Under regulations of the Small Business Administration, “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**

13 C.F.R. § 121.404(g)



ADDITIONAL GOVERNMENT CONTRACT ISSUES TO CONSIDER WITH NOVATIONS

- Are there active task orders?
- Is there work in the vehicle such as a STARS II contract?
- Are you trying to novate from or to a joint venture?
- Can you novate a GSA Schedule?



UNWRITTEN RULES OF AGENCIES

- ID/IQ Vehicles without any task orders may not be considered “assets” by agencies
- Under GSA Schedules, companies must have 2 years of experience to accept a novated contract, even if the buyer is a joint venture
- Transfer of “intangible” assets or low value assets such as computers or some office furniture may be disregarded by agencies
- Many agencies are scrutinizing assets much more heavily so be very careful...no guarantees



ADDITIONAL M&A ISSUES TO CONSIDER WITH NOVATIONS

Have you included post-closing/pre-novation covenants?

Knowing that novation of the government contract will be necessary post closing, together with the possible length of time the novation process may take, include post closing covenants in the purchase document to protect buyer/transferee



ADDITIONAL M&A ISSUES TO CONSIDER WITH NOVATIONS

Have you included transfer of all of the assets?

- Purchase agreement must provide for transfer (purchase/sale) of all of the assets necessary to perform the contracts and not solely the government contracts
- All of the assets necessary for the performance of the contracts must be transferred such as
 - employees
 - intellectual property (licenses necessary?)
 - equipment
 - cash



ADDITIONAL M&A ISSUES TO CONSIDER WITH NOVATIONS

Have you included strong indemnification provisions?

- **Novation agreement is a three party agreement among government agency, transferor/seller and transferee/buyer**
- **Government requires that transferor and transferee are liable for entire period of performance (i.e., transferor liable for period after transfer when transferee is performing and vice versa)**
 - **therefore, must have solid indemnification provisions in purchase agreement to cover self for period when not performing**



SUMMARY – TAKE AWAYS

- Advance notification to CO/ACO
- Make sure there is active work in the contract vehicle
- M&A/Purchase Agreement
 - Post-closing and pre-novation covenants
 - Transfer all of assets
 - Indemnification



Any Questions?

Thank you for joining us today.

If you would like to speak with Cy or Kimi about novation issues, please contact them at:

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