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## An Early Start Of Specialized Due Diligence Is Key To Successful M&A Transactions Involving Government Contractors

**Rand L. Allen,  
Daniel P. Graham,  
Kay Tatum  
and Jeremy Schofer**

**WILEY REIN LLP**



**Rand L.  
Allen**



**Daniel P.  
Graham**



**Kay  
Tatum**



**Jeremy  
Schofer**

Mergers and acquisitions involving Government contractors are on the rise again, after several years of restrained volume. This increase is being driven by a variety of factors, including a growing interest in Government contractors by private equity firms, emerging efficiencies

***Rand Allen**, Chair of Wiley Rein's Government Contracts Practice, represents clients ranging from "middle market IT" and professional services firms to the nation's largest aerospace and defense contractors, in every aspect of government contracting, including bid protests, disputes, commercial litigation, terminations, mergers and acquisitions, "procurement fraud"/False Claims Act investigations, suspension/ debarment and regulatory issues. He can be reached at (202) 719-7329.*

***Daniel Graham**, a Partner in the Government Contracts Practice, counsels and represents government contractors on a broad range of legal matters including commercial litigation, bid protests, claims preparation and litigation, mergers and acquisitions, compliance with ethics and procurement integrity laws, procurement fraud investigations and suspension/ debarment proceedings. Mr. Graham has also assisted clients in performing due diligence for large transac-*

and economies of scale and scope in the IT and professional services sectors, as well as divestitures and realignments caused by the evolving regulation of organizational conflicts of interest. With this

*tions involving government contractors. He can be reached at (202) 719-7433.*

***Kay Tatum**, Chair of the firm's Corporate Practice, represents government contractor, communications, technology, financial services, insurance, health care provider and not-for-profit corporation and trade association clients in mergers, acquisitions, dispositions, joint ventures and complex commercial contracts. She assists clients in all phases of the transaction, from initial strategy to consummation, and has experience in a variety of public and private financing methods. Ms. Tatum can be reached at (202) 719-7368.*

***Jeremy Schofer**, an Associate in Wiley Rein's Corporate Practice, represents clients in communication, government contract and corporate transactions. He has extensive experience negotiating competitive cable franchise agreements and representing clients publicly before local governments. Mr. Schofer can be reached at (202) 719-4646.*

increased deal volume comes increased attention to the unique aspects of Government contracting that affect the ability of buyer and seller to successfully consummate a transaction.

Critical but often overlooked aspects of Government contracting affect many of the tasks that must be performed during the early stages of any transaction, including: (1) understanding what is "material"; (2) valuing the seller's Government contracts backlog; (3) identifying special risks that may require adjustment to the purchase price (either pre-closing or post-closing) or other special attention in the purchase agreement; (4) obtaining financing; and (5) negotiating and executing a purchase agreement. If one party's Government contracts counsel must educate the other party's general corporate counsel on issues unique to Government contracting—such as the Anti-Assignment Act and the novation process, Truth in Negotiations Act certifications, incurred cost audits, organizational conflicts of interest, or terminations—delays and unnecessary friction will almost certainly result. This article explores some of the unique Government contracts issues that often surface during each of the tasks listed above and that can fundamentally affect the alloca-

*Please email the authors at [rallen@wileyrein.com](mailto:rallen@wileyrein.com), [dgraham@wileyrein.com](mailto:dgraham@wileyrein.com), [ktatum@wileyrein.com](mailto:ktatum@wileyrein.com) or [jschofer@wileyrein.com](mailto:jschofer@wileyrein.com) with questions about this article.*

tion of risk between buyer and seller.

### Understanding “Materiality” And The Scope of Information Needed For Due Diligence

Due diligence generally involves generating and presenting accurate information on the seller’s side and obtaining and analyzing information on the buyer’s side about the target company and its assets, strengths, and weaknesses, as well as potential for future operations. Very quickly, the question arises what information is “material” to these inquiries, but this term can have a very different meaning for transactions involving Government contractors than it does for transactions involving firms engaged solely in private commercial activity. All too often, “contract value” is used as a proxy for materiality, which can distort the buyer’s understanding of the assets and liabilities of the seller.

Certainly, it is important to review the seller’s largest dollar value contracts, and one approach to due diligence is to begin by reviewing information related to the contracts that comprise a given percentage of the seller’s revenue from the Government. A buyer, however, cannot focus on dollar value alone when doing so will exclude consideration of smaller contracts where the seller has had performance problems or where the seller faces disproportionate liability from pending or future Government/third-party claims. Another critical issue that can be overlooked when smaller contracts are ignored is organizational conflicts of interest, or “OCIs.” For a variety of reasons, a Government contractor’s work under one contract may be deemed to conflict with work under other present and future contracts of the seller or the buyer. When these OCIs surface after a transaction is consummated, they can undermine the buyer’s expectations regarding the value of the seller’s current business, as well as the buyer’s and target’s prospects for future business after closing. And, in a recent case, undisclosed OCIs on a relatively minor consulting contract resulted in a civil False Claims Act suit by the Government *five* years after the contract ended.

Ultimately, the buyer will want the seller to make a broad set of representations and warranties regarding the validity and performance status of all of its contracts. In addition to OCIs, the buyer will want the seller to represent and warrant, *inter alia*, that there have been no defaults, that it has received no “show cause” or ter-

mination notices, and that all Truth in Negotiations Act (“TINA”) cost or pricing data submitted in connection with any bid were properly certified as “current, accurate and complete.” The seller, in turn, will resist making such representations and warranties and will demand that the buyer reach its own conclusions from the information provided in the data room. The organization and population of the data room therefore becomes critical.

At a minimum, the seller’s data room should contain all documents relating to the key programs, assets, plans, and risks identified in the seller’s Offering Memorandum (and any subsequent Management Briefings), and documents related to the items that the seller plans to “schedule” in the purchase agreement. This latter category would include copies of all “material” contracts (however defined), draft and final Government audit reports and related submissions by the seller, any pending Government litigation, claims, demands, or investigations, and any “mandatory disclosures” by the seller to the Government under recent regulations requiring contractors to report “credible evidence” of certain misconduct. The data room should also include all performance assessments and fee determinations related to the material contracts, as well as any adverse assessments or determinations received on other contracts within a given time period. For contractors with cost-reimbursable contracts, the data room should include the seller’s Cost Accounting Standards Disclosure Statement and the Government’s determinations whether that statement is adequate and compliant, the seller’s forward pricing rate agreements and submissions, and any advance agreements with the Government regarding the accounting treatment of particular costs. Finally, the data room should contain information regarding the seller’s internal controls and compliance systems, as well as any Government, seller, or third-party reviews of those systems. Achieving confidence that these systems are adequate and operating as they should is critical to assessing the risk of the severe penalties and liabilities unique to Government contracting.

To the extent that the seller has classified contracts, the parties will need to address how and when these contracts are reviewed by the buyer. At a minimum, the seller should be upfront about the existence of classified contracts and be willing to provide the buyer a summary of what-

ever limited information it can about these contracts in accordance with the existing security procedures. A prudent buyer may insist on reviewing these classified contracts before closing the transaction, and it is even possible that the buyer will ask for a “walk away” in the purchase agreement if the buyer’s eventual review of these classified contracts reveals information unacceptable to the buyer. This is just one example of why the buyer’s due diligence review is not a one time review for a set period of time and will instead continue right up to the closing of the transaction.

Important additional information also may be available from third parties. For instance, a prospective buyer might want to contact the seller’s key customers and suppliers, an action that usually occurs after the possibility of a deal becomes firm and in coordination with the seller. Such contact would be especially prudent in the case of key Government contracts, particularly if they involve classified programs. Depending on the nature of the transaction and the parties involved, and consistent with non-disclosure obligations that may exist, valuable information also might be available from former employees of the seller.

The ultimate scope of documentation made available for review in the data room will also depend on the nature of the proceedings. For example, fewer documents might be made available to first round participants in an “auction” situation. In setting up the data room, restrictions on the disclosure of information subject to Non-Disclosure Agreements (NDA) and other customer-sensitive documents need to be considered along with information the seller believes to be proprietary or competition-sensitive. Proprietary seller information such as audit reports, for example, might be segregated in a separate “Red Room” which would be subject to additional restrictions, *e.g.*, allowing a buyer to review them but not take notes or make copies.

Finally, the due diligence process should continue right up through closing. In particular, the identification and negotiation of particular provisions in the purchase agreement almost always will generate a need for additional specific information to assess risks associated with those provisions. In addition, further information always will be necessary for updating schedules between the time the purchase agreement is signed and the deal is closed.

### Valuing The Seller's Government Contracts Backlog

Perhaps the most important objective of a buyer during due diligence is identifying a purchase price that reliably estimates the seller's assets and liabilities. Many Government contractors obtain most, and sometimes all, of their revenue from their contracts with Federal agencies, making the valuation of these assets a principal focus of due diligence. Although this valuation is primarily a business, as opposed to legal, function, Government contracts possess a number of unique legal features that can frustrate a buyer's valuation efforts if not properly understood and taken into account:

*First*, the value of a seller's Government contracts often will not be what the seller identifies as the "total value" or "awarded value" of those contracts. The Government uses a variety of contract vehicles to acquire goods and services, including:

- Fixed Price contracts, which provide the seller a fixed amount negotiated in advance for the specific work to be performed;
- Cost Reimbursable contracts, which allow for the reimbursement of certain seller costs plus a fee (more on how these fees are calculated and earned later); and
- Indefinite-Delivery/Indefinite-Quantity, or "ID/IQ," contracts, which permit the Government to order goods and services in the future as needed, but do not commit the Government to purchasing more than a minimum, often nominal, amount.

Valuing fixed price contracts is more of a straightforward task relative to the other two types, but there remain a number of traps for the unwary. For one, most fixed-price contracts are divided into a one-year base period followed by several one-year options. This is a function of the fact that most Government contracts are funded through annual appropriations from Congress, and the Government has broad discretion whether or not to exercise a given option. Predicting the likelihood that the Government will exercise options is primarily a business exercise, but it often should be informed by a legal assessment of the seller's compliance with contract requirements and any actual or potential disputes that may exist. Another challenge in valuing fixed price contracts is the Government's right under the standard "Changes" clause to alter the scope of the contractor's performance. Assessing when

the Government has formally or constructively issued a change, and how such a change may increase or decrease the compensation the contractor can expect to receive, is essential to a proper valuation of any given contract.

Valuing cost-reimbursable and ID/IQ contracts is more complicated. ID/IQ contracts are, by definition, "indefinite." The Government agrees to purchase a minimum amount stated in the contract, but the actual amount may vary considerably. Also, for certain large-dollar requirements, the Government awards multiple ID/IQ contracts for the same goods or services, and then separately competes orders for those goods and services among the holders of the ID/IQ contracts. Understanding the Government's ordering history and the competition requirements that may limit future orders is therefore critical.

Cost reimbursable contracts similarly do not have a "price"; instead, the amount that the Government will ultimately pay depends on the actual, "allowable" costs incurred by the contractor. These contracts are awarded only where—and precisely because—the actual level of effort to be performed cannot be reliably estimated. Moreover, whereas fixed price contracts are usually fully funded through the base year or the most recently exercised option, cost-reimbursable contracts are often incrementally funded. In other words, the Government agrees to reimburse a contractor for its costs up to a given amount that may be far below the total estimated cost of the contract, but retains the discretion not to fund the contract further if it so desires.

*Second*, cost reimbursable contracts are further subject to a host of legal rules that affect whether and how certain costs will be reimbursed. As a general matter, the contracts provide that only allowable costs, as defined by the Federal Acquisition Regulation (FAR), may be invoiced to the Government, and that penalties may be assessed if "expressly unallowable" costs are submitted for payment. Certain contracts may also be subject to the Cost Accounting Standards which require contractors to adopt, disclose, and consistently follow detailed accounting practices. Moreover, individual contracts may contain a variety of special cost allowability provisions.

A seller may invoice and be paid its costs on a regular basis, but these invoices are subject to review by Government audi-

tors, often the Defense Contract Audit Agency (DCAA). DCAA can and will question the payment of costs long after they are incurred. Currently, DCAA has backlogs of five years or more with respect to certain incurred cost submissions, meaning that potential disagreements relating to the allowability of certain costs might not have surfaced yet, and a seller may not know exactly what it will be paid on a given contract until years after the contract is completed. A careful review of the seller's incurred cost audits and correspondence with DCAA is therefore essential to valuing the seller's cost-reimbursable contracts, as is an understanding of any reserves the seller has taken to address anticipated disallowances.

*Third*, the "fee" that a seller earns on cost reimbursable contracts may be determined through a variety of different mechanisms, including:

- "fixed" fee, *i.e.*, a negotiated fee that is fixed at the inception of the contract and does not vary with actual cost or schedule performance (but that may be adjusted based on changes to the contract's scope of work);
- "award" fee, *i.e.*, a fee based on a subjective evaluation by the Government regarding the merits of the contractor's performance; and
- "incentive" fee, *i.e.*, an initially negotiated fee that is adjusted based on the contractor's actual performance using formulas tied to target costs and/or schedule milestones.

The key distinctions among the three types of fees are the variability of the fee actually paid to the contractor and the degree of discretion afforded to the Government to determine the fee actually paid. Fixed fees usually vary only when the parties negotiate a new fixed fee, usually because of a change in the scope of the underlying work being performed. Award and incentive fees, by contrast, vary based on the contractor's performance. The Government usually has no discretion regarding the amount of fixed or incentive fee paid (the former being fixed and the latter turning on a pre-negotiated formula), whereas award fee determinations are unilateral decisions made solely at the discretion of the Government. Award fee decisions can be disputed, but typically they are only reviewable for abuse of discretion, for example, if a decision was arbitrary and capricious. Moreover, some contracts contain "Conditional Payment of

Fee” clauses that permit the Government to unilaterally reduce previously earned award fee based on certain performance failures (e.g., environmental, safety and health issues).

Finally, whether included in the contract or not, the Government retains the right to terminate contracts, not only for a default by the seller, but also for the Government’s “convenience.” In the event of a termination for default, the Government may recover any increased cost incurred to hire and pay another contractor to complete the work. A default termination can also have serious repercussions for a contractor’s ability to obtain future work, and, if sufficiently egregious, may even lead to a contractor’s suspension or debarment from receiving new contract awards and new orders under existing contracts.

A termination for convenience, by contrast, permits the Government to “walk away” from its contractual obligations. In the event of a termination for convenience, the contractor generally is entitled to reimbursement of the costs it has incurred prior to the effective date of the termination, as well as a fee calculated according to the percentage of work completed. Because of the broad discretion afforded to the Government to terminate contracts for its convenience, the termination clause effectively operates as a *de facto* consent requirement for the transaction. In other words, if the Government determines that the transaction is not “in the Government’s interest,” or that the Government’s interests would be better served by recompeting the contracts immediately, the Government could elect to terminate one or more of the contracts for its convenience.

### Identifying Special Risks

Government contracting is a regulated industry. Thus, many aspects of the business exist that create risks greater than those assumed by companies under commercial contracts. This article cannot address all of those risk areas, but many standard checklists exist that can aid a buyer in this regard. Some of the key areas of risk are summarized below.

- *Audits, Investigations, and Litigation.* The government has extensive audit rights under most negotiated contracts and with these rights come remedies that can result in retroactive adjustments to the contract price and other remedies under such statutes as the Truth in Negotiations Act. Government contractors who fail to comply with these statutory and regula-

tory requirements may be subject to investigations by agency Inspectors General or the Department of Justice. These investigations can be disruptive to ongoing business, as well as harbingers of criminal and/or civil liabilities. Furthermore, contractors operate under a strict mandatory disclosure requirement that obligates them to self-report “credible evidence” of potential False Claims Act or criminal violations in connection with a government contract. A key component of due diligence is to assess any existing or potential investigations and/or ongoing litigation and the degree of attendant risk.

- *Changes/Claims/Disputes.* The government has the unilateral right under its contracts to change certain terms of performance and also to terminate a contract for virtually any reason for its convenience. In both cases, the contractor is entitled to be “made whole” through the Request for Equitable Adjustment (REA) or claims process. A buyer’s due diligence must identify all existing or brewing claims the seller may have and assess the likelihood of recovery under the unique law that has evolved in specialized courts and tribunals created to adjudicate Government contracts disputes.

- *Intellectual Property.* A company doing business with the U.S. Government must exercise considerable care to assure it does not grant to the Government an “unlimited rights” license in that company’s valued technology or some other license that would give away greater rights to its technology than it intends. That license could entitle the Government to give the design—either in the form of technical data or computer software code—to other companies and to authorize those companies to copy and sell the product illustrated in the data or code to any customer, anywhere. In a nutshell, Government contracts intellectual property rules are different from those in the commercial market, and a Government contractor must protect any intellectual property that was not developed at public or Government expense or delivered to the Government. Even if such property were developed at private expense and delivered to the Government, the contractor must institute business practices that will protect the property from transferring to the Government with unlimited rights. A thorough due diligence must assess this issue carefully when a seller’s proprietary technology accounts for a significant part of its value.

- *Organizational Conflicts of Interest.* As mentioned above, Government contractors must avoid, mitigate or neutralize OCIs, and this issue is particularly important during the due diligence process. The failure to identify and address actual or apparent OCIs can lead to potential loss of lucrative business and may, when false statements or claims are involved, result in additional liability. As part of the due diligence process, the buyer must understand any lines of business in which both the buyer and the seller share a presence, and identify whether the integration of the two companies could result in potential OCIs and, if so, the steps that can be taken to avoid or mitigate those conflicts.

- *Labor.* Government contractors can be subject to a host of Federal labor and employment rules, compliance with which must be assessed during due diligence. These rules include the Department of Labor’s affirmative action requirements, the Service Contract Act, the Rehabilitation Act of 1973 (which imposes obligations on federal contractors with respect to the disabled), the Fair Labor Standards Act, and the Drug-Free Workplace Act.

- *FCPA/OFAC/ITAR.* If the seller is a Government contractor that in whole or in part has foreign operations, due diligence must assess the seller’s compliance programs regarding import-export controls, sanctions, customs and other issues related to the International Traffic in Arms Regulations (ITAR), the Export Administration Regulations (EAR), the sanctions regulations administered by the Office of Foreign Assets Control (OFAC), the Foreign Corrupt Practices Act (FCPA), the Bank Secrecy Act and the Foreign Agents Registration Act (FARA).

- *Teaming Arrangements.* Many Government contractors “team” with other contractors to perform certain contracts. These teaming arrangements can involve a traditional prime contractor/subcontractor relationship, but they can also involve the creation of distinct legal entities, such as joint ventures. These entities may need to have their own accounting, internal controls, and other systems, and may have a separate record of contract performance that must be evaluated during due diligence. Similarly, the seller’s rights under the joint venture agreement must be analyzed to determine whether and how the seller’s interests in that entity can be transferred to the buyer.

- *Government Indemnifications.* Although there is such a thing as a “Gov-

ernment Contractor” defense to third-party tort suits, the scope of this defense is not settled and varies considerably by jurisdiction. Where the seller’s performance of its Government contracts involves hazardous activities, the seller’s contracts may contain a variety of insurance and indemnification provisions that are unique to the Federal Government. Understanding what liabilities the Government has agreed to assume or indemnify against, and what insurance the seller is required to carry, is vital to quantifying the impact of potential third-party claims on a seller’s business.

### Obtaining Financing

To the extent that the buyer intends to obtain financing by assigning to a financial institution moneys due or to become due under Government contracts, the Anti-Assignment Act and the Assignment of Claims Act will be implicated. An attempted assignment that is prohibited by a contract, or a failure to satisfy a precondition to assignment in a contract, could run afoul of these statutes. A common disappointment in acquisitions involving Government contractors is the buyer’s discovery that standard Uniform Commercial Code grants of security interests in Government contracts are not permitted.

The Anti-Assignment Act is intended to ensure that the entity awarded a Government contract will actually perform it with its own resources and provides: “No contract or order, or any interest therein, shall be transferred by the party to whom such contract or order is given to any other party, and any such transfer shall cause the annulment of the contract or order transferred, so far as the United States is concerned.” The Assignment of Claims Act addresses claims (including claims for payment) under Government contracts for work that has already been performed. The Assignment of Claims Act is intended to ensure that the Government does not lose its right to receive setoff from, or to bring counterclaims against, the assignor—defenses often unavailable to the Government as against the assignee.

Recognizing the importance of private financing to successful contract performance, however, the Assignment of Claims Act, as implemented by FAR Subpart 32.8, permits an assignment of moneys due or to become due under a contract if certain conditions are met:

- (a) The contract specifies payments aggregating \$1,000 or more.
- (b) The assignment is made to a bank,

trust company, or other financing institution, including any Federal lending agency.

(c) *The contract does not prohibit the assignment;*

(d) Unless otherwise expressly permitted in the contract, the assignment—

(1) Covers all unpaid amounts payable under the contract;

(2) Is made to one party, except that any assignment may be made to one party as agent or trustee for two or more parties participating in the financing of the contract;

(3) Is not subject to further assignment.

(e) The assignee sends a written notice of assignment together with a true copy of the assignment instrument to the—

(1) Contracting officer or the agency head;

(2) Surety on any bond applicable to the contract; and

(3) Disbursing officer designated in the contract to make payment.

FAR 32.802 (emphasis added).

Some Government contracts expressly prohibit assignment of claims, often through the inclusion of FAR 52.232-24, which provides: “The assignment of claims under the Assignment of Claims Act . . . is *prohibited* for this contract.” (Emphasis added). Other contracts require the Government to consent to any assignment pursuant to the Assignment of Claims Act or FAR Subpart 32.8. This more permissive approach is typically accomplished by inclusion of FAR 52.232-23, which permits assignments of money due under the contract subject to the conditions outlined above. Beyond these two paradigms, however, many agencies have their own standard assignment provisions that they use in lieu of the FAR clauses, and individual contracts may contain unique provisions affecting assignment where the contracting agency determines it appropriate to do so.

### Negotiating And Executing a Purchase Agreement

Just as it is important to have an early start of specialized due diligence in a transaction involving Government contracts, it is also important to have Government contracts counsel involved in early stages of negotiating the purchase agreement. Transaction counsel without Government contracts expertise cannot be expected to draft and negotiate provisions in the purchase agreement that address the unique risks of doing business with the Federal Government. Government con-

tracts expertise is important for contract provisions involving representations and warranties, preparation and review of disclosure schedules, conditions to closing, and post-closing covenants. If the principal value of a business comes from its Government contracts, contract provisions in the purchase agreement relating to those contracts must be negotiated simultaneously with other key provisions determining the allocation between the parties of the risks and rewards of owning and operating the business, such provisions as purchase price, survival of representations and warranties, and indemnification.

An acquisition in the Government contracts sector needs all of the typical representations and warranties relating to the target business such as seller’s authorization to enter into the purchase agreement, accuracy and completeness of the financial statements, compliance with labor and employment, environmental and other laws and regulations, but it also needs representations and warranties tailored to the risks and liabilities of the types of Government contracts held by the target. There is no standard set of Government contracts representations and warranties that is appropriate for all Government contractor acquisitions. The risks of an information technology systems integrator are very different from the risks of an operator of a nuclear waste treatment plant. Similarly, the risks of a fixed price construction contract are very different from the risks of a cost reimbursable weapons development contract.

Typically, the Government contracts representations and warranties are included in a separate section within the contract article containing all the representations and warranties. Keeping them separate facilitates negotiations between the Government contracts legal and accounting experts representing each party in the transaction. Negotiating the representations and warranties is an extension of due diligence. Sweeping positive statements about the nature and status of the business set forth in management presentations must be honed into more precise factual statements that can be verified by the seller before closing and by the buyer after signing and consummating the purchase agreement. If a representation or warranty is breached after signing but before closing, the buyer should have the right to walk away from the transaction. If a breach becomes apparent after closing, the buyer may have the right to make a

claim against the seller for indemnification.

Representations and warranties typically call for the seller to prepare disclosure schedules that set forth in detail the matters covered by the representations and warranties. For example, a representation might provide that, except as set forth on the disclosure schedule, no costs have been questioned in writing or disallowed by a Government auditor or contracting officer. The schedule would need to disclose every incident during the time period covered by the representation when a cost had been questioned in writing or disallowed. Preparing accurate and complete disclosure schedules is typically a significant challenge for sellers. They do not want to begin the formidable effort of preparing the schedules until they are ready to announce the potential deal to their employees who have the knowledge that needs to be disclosed. The buyer, on the other hand, needs the detailed information to make important decisions about purchase price, post-closing purchase price adjustments, how long the representations and warranties need to survive after the closing, and the extent of indemnification. The representations and warranties, complemented by the disclosure schedules, are the key contractual provisions that allocate the liabilities of the acquired business between seller and buyer. Consequently, seller and buyer must allow considerable time to prepare, review, and negotiate the disclosure schedules as well as to make other contract revisions in response to the disclosures. For these efforts, corporate counsel and special Government contracts counsel must work together closely to assure that risks disclosed in connection with the Government contracts representations and warranties are appropriately addressed in such contractual provisions as conditions to closing, indemnification, and post-closing covenants.

Sellers and buyers in a typical commercial transaction usually include in a purchase agreement a short list of conditions that, if not fulfilled between signing and closing, allow the buyer to walk away from the transaction without liability. Given the expense and risk to the business of a transaction that does not close, sellers are adamant that a buyer with which it enters into a purchase agreement not be able to walk away easily. The typical conditions are that there be no material breach that is reasonably likely to result in a

material adverse effect on the acquired business, that the parties have each complied with all of their obligations under the purchase agreement including deliveries required at closing, that necessary consents have been obtained, and that there not be any judgment or decree enjoining the consummation of the acquisition.

In a Government contracts transaction there are additional considerations to take into account in negotiating conditions to closing because a number of Government officials and agencies may have explicit, or at least tacit, power to completely undermine the buyer's ability to operate the acquired business after closing. Perhaps one of the most unique aspects of transactions involving Government contractors is the "novation" process that must be followed in order to transfer Government contracts from one entity to another. As discussed above, the Anti-Assignment Act prohibits the assignment of contracts from one entity to another without the consent of the Government. The novation process is the mechanism by which that consent is provided. It may be possible to structure a transaction to avoid the need to novate the seller's contracts—for example, where the transaction is a stock purchase. Even then, however, applicable regulations provide that there may be issues related to the change in ownership that appropriately should be addressed in a formal agreement between the contractor and the Government, thus providing a contracting officer ample discretion to require a formal agreement even when a transaction is structured as a stock sale.

Where novation is required, as is the case for any asset sale, it presents a classic "chicken or the egg" scenario. This is because the formal novation process begins only after the transaction has closed—indeed, the evidence of closing is one of the many documents that must be presented to the Government as part of the novation request. As a result, substantial planning and negotiating are required for the parties to be comfortable that it is prudent to consummate a sale even though the transfer of the key assets of the business, the Government contracts, will take place after the closing. In addition to having well devised plans to communicate with the Government about the pending transaction, the purchase agreement should have conditions to closing that equitably share the risk if the communications are not favorably received by the Government. The purchase agreement must also

include covenants for the parties to take specific steps after the execution of the purchase agreement and after the closing to accomplish the novations. The agreement must also provide for a mechanism for the seller to delegate to the buyer certain authority relating to the performance of the Government contracts during the period after the consummation of the sale but prior to the completion of the novation.

Another issue that must be analyzed during due diligence and is often addressed in a condition of closing concerns facility security clearances. In circumstances where most of a contractor's work is performed in cleared facilities, the value of the target business could be suddenly reduced to the liquidation value of its assets if it loses access to facility clearances. A transaction involving classified contracts may need the explicit or tacit approval of several Federal agencies and officials. For example, if the buyer may be subject to influence by foreign persons, the Defense Security Service may revoke or decline to renew facility clearances, and the U.S. Treasury's Committee on Foreign Investment in the United States also has broad power to block or unwind an acquisition. Similarly, contracting officers may consider the impact of a transaction on classified contracts when determining whether or not, after the closing takes place, the Government contracts may be novated from the seller to the buyer. In these and other instances where the Government has broad discretionary powers, the parties must negotiate conditions to closing that provide for an equitable sharing of the risk that the buyer will not be allowed to operate the business after closing.

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To mitigate the unique risks associated with transactions that involve Government contractors, buyers and sellers need to understand what those risks are and how to deal with them. A careful and thorough due diligence process guided by experienced Government contracts counsel will help ensure that buyer and seller agree to an equitable and efficient allocation of risk between them.

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