

Acquiring a Company with Government Contracts: A Checklist of Unique Issues

A Presentation and
Webinar by **Matt Koehl**

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Introduction

Introduction

- ▶ Investor Interest in Government Contractors
 - Improving but sluggish conditions in commercial market
 - Homeland security
 - Foreign wars
 - Cyber-security

- ▶ “Government Contractors”
 - Specialty contractors (e.g., IT security, biodefense)
 - Traditional government contractors (“USA, Inc.”)
 - Commercial companies with some public sector customers

Introduction

- Presentation focus is Federal government prime contracts
- Federal subcontracts
 - Many of the same unique considerations apply via “flow down” clauses (e.g., intellectual property)
 - Some issues implicated to lesser extent (e.g., GSA multiple award schedule contract program)
- State and local government contracts have many of the same considerations
 - Often less complex and lower risk



Background

Due Diligence and Sales Agreement Negotiations

- Due diligence process follows the term sheet and letter-of-intent between Buyer and Seller
- Buyer assesses quality and risk areas in Seller's business (i.e., "am I really buying what I think I am?")
- Negative findings can affect valuation or terminate transaction
- Buyer provides list of questions and requests for key documents to Seller
 - Customized list for government contractors
- Discussions with Seller's management and key employees

Due Diligence and Sales Agreement Negotiations

- Sales agreement with Seller representations and warranties
 - E.g., no litigation except as disclosed
- Customized Seller representations and warranties for government contracts
 - E.g., no subpoenas or on-going government contract audits
- Refine Seller representations and warranties based upon due diligence
 - E.g., specific technical data developed exclusively at private expense

Due Diligence and Sales Agreement Negotiations

- Modify other Sales Agreement terms based upon results of due diligence
 - E.g., increase size of purchase price escrow to account for possible government contracts liabilities
 - E.g., increase duration of purchase price escrow to better match statutory limitations period for government claims
 - E.g., make government approval of Seller's transfer of key contracts a closing condition

Transaction Structures

- **Asset Purchase**
 - Buyer purchases some or all of seller's assets. Buyer may or may not assume liabilities
- **Stock Purchase**
 - Buyer purchases seller's stock. Corporation continues to exist with assets and liabilities, but with new stockholders
- **Merger**
 - Combination of firms where one survives to hold the assets and liabilities of the combined firms and the others are dissolved

Transaction Structures

- **Asset Purchase**
 - 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
- **Stock Purchase**
 - Pro: (i) no government approval; (ii) no Seller guaranty of future performance
 - Con: retain all government contract liabilities, including penalties. Note: limitations period 6 years or more
- **Merger**
 - Same as stock purchase except novation agreement may be required depending upon government agency

Novation Agreement and Associated Issues

- Government contracts and contract claims are transferable only with government consent (41 U.S.C. § 15; 31 U.S.C. § 3727)
- Concern about persons of influence selling government contracts dates to Civil War
- Consent to transfer routinely granted, but must be in “government’s best interests”
- 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”

Novation Agreement and Associated Issues

- 3-party agreement between Seller, Buyer and Government
- 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 and Associated Issues

- “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

Novation Agreement and Associated Issues

- 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
- Subcontract necessary to cover approval “gap”
 - Buyer performs in the Seller’s name
 - Invoicing and payment issues
 - Government approval (not for “commercial items”)
 - Transition services agreement should include required assistance on government contracts



Checklist Issue Number One: “Small Business” Set-Aside Contracts

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 Set-Aside Contracts

- 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

Small Business Set-Aside Contracts

- 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 “rerepresent” its size status within 30 days of stock purchase or merger.
FAR 52.219-28
- Practice Tips: (i) reach out to CO for key small business contracts before closing; (ii) closing condition of government approval of the contract transfer

Small Business Set-Aside Contracts

- 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)
- If the Seller holds set-aside contracts:
 - Would Seller qualify post-close in key industries
 - Value of contracts and contract options that could be affected by loss of size status
 - Impact of Seller’s exclusion from future Small Business set-aside procurements



Checklist Issue Number Two: GSA Schedule Contracts

GSA Schedule Contracts

- GSA's "Schedule" contracts program is the premier sales program for "commercial items" (\$37.5 billion in FY 2012 sales)
- Medical supplies and services Schedules administered by Department of Veterans Affairs
- Complex pre-award pricing disclosure and post-award price reduction requirements
- Commercial companies often have compliance problems with their GSA Schedule contracts
- Office of Inspector General and the Department of Justice focus on GSA Schedule contract audits

GSA Schedule Contracts

- Does the Seller hold a GSA Schedule contract?
 - Red Flag. Seller listed in GSA Schedules E-Library. Check for d/b/a and previous names.
<http://www.gsaelibrary.gsa.gov/>
- 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

GSA Schedule Contracts

- Post-Close Administrative Considerations
 - Identify and confirm “tracking customer” based upon Seller’s new structure
 - Unwritten GSA policy allows only one Schedule per contractor (unevenly enforced)
- Significant Potential Buyer Exposure
 - December 2004, Oracle acquires PeopleSoft
 - PeopleSoft employee files *qui tam* False Claims Act lawsuit
 - 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



Checklist Issue Number Three: Intellectual Property Rights

Intellectual Property (IP) Rights

- Government gains substantial rights in IP developed with government funds
 - Enhanced rights also to “mixed-funding” IP (public/private)
- IP includes Inventions, Technical Data and Software
- Potentially unrestricted competitor access to government-funded IP on future procurements
- The Contractor gains exclusive commercial market rights to IP, but only if it meets notice and marking requirements
 - Possibly releasable under Freedom of Information Act (FOIA)

Intellectual Property (IP) Rights

- 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?



Checklist Issue Number Four: Open Proposal Submissions

Open Proposal Submissions

- Seller often has outstanding, open proposals
- Proposals can sometimes result in a new contract without further action by Seller
- Buyer may inherit unanticipated, new obligations
- Protest risk (confusion with regard to “offeror”)
- Practice Tip: Create procedure to amend novation agreement if awarded new contracts in Seller’s name after close but before novation agreement approval

Outstanding Proposals

- Does the Seller have outstanding proposals?
 - Red Flags: (i) recently dated proposals; (ii) recently dated “discussion” letters with a government agency; (iii) “notice of intent to award” letters
- If so, examine:
 - Performance requirements, terms and price
 - If unfavorable, subject to withdrawal?
 - Whether to exclude/include resulting contract in asset purchase



Checklist Issue Number Five: Organizational Conflicts of Interest

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

Organizational Conflicts of Interest (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



Government Contracts: Compliance Risks and Extraordinary Penalties

Compliance Risk/Extraordinary Penalties

- Substantial government audit rights
 - Especially for cost-reimbursement and GSA Schedule contracts
- Extended statutory limitations periods
- Potential for negative press coverage

Compliance Risk/ Extraordinary Penalties

- Termination for Default
 - Excess re-procurement costs
- Negative past performance ratings
- Suspension/debarment for up to 3 years

Compliance Risk/ Extraordinary Penalties

- Civil False Claims Act
 - “Reckless disregard” standard, no intent required
 - Treble damages, \$11k per invoice
 - Oracle pays \$98.5 million fine (PeopleSoft) and \$46 million fine (Sun Microsystems) to settled alleged false claims submitted by acquired companies
 - http://www.justice.gov/opa/pr/2006/October/06_odag_689.html
 - <http://www.justice.gov/opa/pr/2011/January/11-civ-128.html>
- Criminal penalties for intentional violations



Questions?



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