

# Government Contracts Blog

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## **Novations: A Simple Checklist For A Not So Simple Requirement**

As though the risks inherent in a merger or acquisition were not enough to turn any business person prematurely gray, when one or both of the entities in play are federal contractors, the risks become even greater. One of the primary sources of these additional risks is the federal Government's novation rules. Anyone looking to buy or sell a federal contractor must be familiar with these rules, which are set out at FAR 42.1204.

In short, the Anti-Assignment Act prohibits the transfer of government contracts to a third party. The Federal Acquisition Regulation ("FAR") provides, however, that, in certain situations, the Government may consent to such a transfer. If the Government withholds its consent – or if the contractor fails to seek that consent properly – the contractor could be deprived of the benefit of its bargain. A comprehensive due diligence plan, which asks at least the following questions, can alleviate some of this risk.

### *Is A Novation Agreement Required?*

The FAR identifies three situations in which the Government may consent (through the execution of a formal "Novation Agreement") to the transfer of a federal contract:

- The sale of all a contractor's assets, or the entire portion of the assets involved in performing a contract with a provision for assuming liabilities;
- The transfer of assets incident to a merger or corporate consolidation; and
- The incorporation of a proprietorship or partnership, or formation of a partnership.

FAR 42.1204(a)(1)-(2). In contrast, the FAR also provides that a novation is not required when a stock purchase is contemplated and when "there is no legal change in the contracting party, and when the contracting party remains in control of the assets and is the party performing the contract." FAR 42.1204(b). Consistent with the theory behind this exception, federal case law also holds that a novation is not required in the context of certain transfers that occur "by

operation of law.”

In the end, a contractor’s novation obligations will depend upon the form of merger/acquisition selected by the parties. While many factors obviously will bear upon that selection, the potential novation obligations should be among them.

*What Should Be Included In The “Novation Package”?*

Once a contractor has determined that a novation agreement is required, it will need to prepare a “novation package” for submission to the responsible contracting officer (more on this below). While the contracting officer has some discretion in the matter, he/she generally will expect the parties to submit the following materials as they become available

- Three signed copies of the proposed novation agreement;
- Document describing the proposed transaction (*e.g.*, purchase/sale agreement, memorandum of understanding, etc.);
- List of all affected contracts, including: (a) Contract number and type, (b) Name and address of contracting office, (c) Total dollar value, as amended, and (d) Approximate remaining unpaid balance;
- Evidence of transferee’s capability to perform;
- Authenticated copy of instrument effecting the transfer (*e.g.*, bill of sale, certificate of merger, contract, deed, agreement, court decree, etc.);
- Appropriate corporate approval: (a) certified copies of board of directors’ resolution authorizing the transfer, and/or (b) certified copies of stockholder minutes approving the transfer;
- Authenticated copy of transferee’s certificate and articles of incorporation (if formed for the purpose of receiving the assets involved in performing the government contracts);
- Opinion of Legal Counsel for the transferor and transferee stating that the transfer was properly effected under applicable law and the effective date of the transfer;
- Balance sheets of transferor and transferee on the dates immediately before and immediately after the transfer, as audited by independent accountants;
- Evidence that any security clearance requirements have been met; and
- Consent of any sureties or a statement from transferor that none are required.

FAR 42.1204(e)-(f). The list of required documents may vary depending on the particular form of the transaction, the agency, and/or the preferences of the responsible contracting

officer. *Id.* Also, the responsible CO possesses the discretion to request an “alternative formulation of the information” so long as the Government’s interests are adequately protected. FAR 42.1204(g).

*To Whom Should The “Novation Package” Be Submitted?*

The “novation package” usually is submitted to a single administrative contracting officer (“ACO”), who will coordinate the novation process on behalf of all interested federal agencies. This single point of contact relieves the contractor of the burden of having to submit paperwork to multiple agencies, and it allows the Government to speak with a single voice.

The appropriate point of contact may vary depending on whether the acquisition involves a single transferor or multiple transferors. In situations involving only one transferor, the FAR provides that, if an ACO has been assigned to any of the contracts, then the “novation package” should be submitted to that ACO or the ACO responsible for corporate office (if the contracts are in more than one plant or division). FAR 42.1202(a)(1)-(2). Alternatively, if an ACO has not been assigned to any of the contracts, then the “novation package” should be submitted to the CO with the largest unsettled dollar balance (unbilled plus billed but unpaid). FAR 42.1202(b).

Where there are multiple transferors, the FAR provides for a slightly different process. If an ACO has been assigned to any of the contracts, the “novation package” should be submitted to the ACO administering the largest unsettled dollar balance. FAR 42.1202(c)(1). If an ACO has not been assigned to any of the contracts, then the “novation package” should be submitted to the CO having the largest unsettled dollar balance. FAR 42.1202(c)(2).

*When should I start the novation process?*

Experience suggests that companies that involve their contracting officer early in the acquisition process are rewarded with a more speedy novation process. While the FAR identifies the specific elements that should be included in a novation submission, different contracting officers have different practices and different preferences when it comes to novations. Engaging the contracting officer in advance of submitting the actual paperwork in order to get a sense of his/her expectations – or to give you the opportunity to explain why certain documents have or have not been included in the package – usually is a wise approach.

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