

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

A presentation and webinar by:

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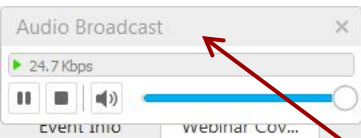
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The screenshot shows the Cisco WebEx Event Center interface. At the top, there is a menu bar with 'File', 'Edit', 'View', 'Communicate', 'Participant', 'Event', and 'Help'. Below the menu bar, there are tabs for 'Event Info' and 'Webinar Cov...'. The main content area is divided into two sections. The top section contains a large red text overlay: 'If you cannot stream audio, click phone icon and a phone number will be sent to you'. Below this text is a white box with two options: 'I Will Call In' and 'Call Using Computer' with a link 'Test computer audio'. A red arrow points from the text to the phone icon in the 'Call Using Computer' option. The bottom section of the main content area features a logo for 'Pepper Hamilton Web' and a large graphic celebrating '125 Years' from 1890 to 2015, with the text 'Pepper Hamilton LLP Attorneys at Law'. On the right side of the interface, there is a 'Participants' panel. It shows a list of participants, including 'Brian Dolan (Host)' and 'Webinar Guest (me)'. Below the list, there are icons for audio, video, and chat. At the bottom of the interface, there is a 'Q&A' section with a dropdown menu set to 'All Panelists' and a 'Send' button.

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- Attendees:
- Webinar Guest (me)

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All (0)

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Participants

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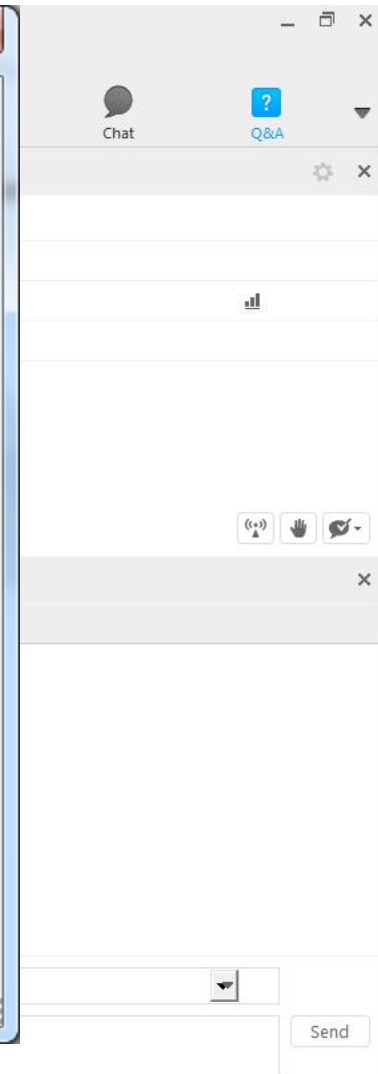
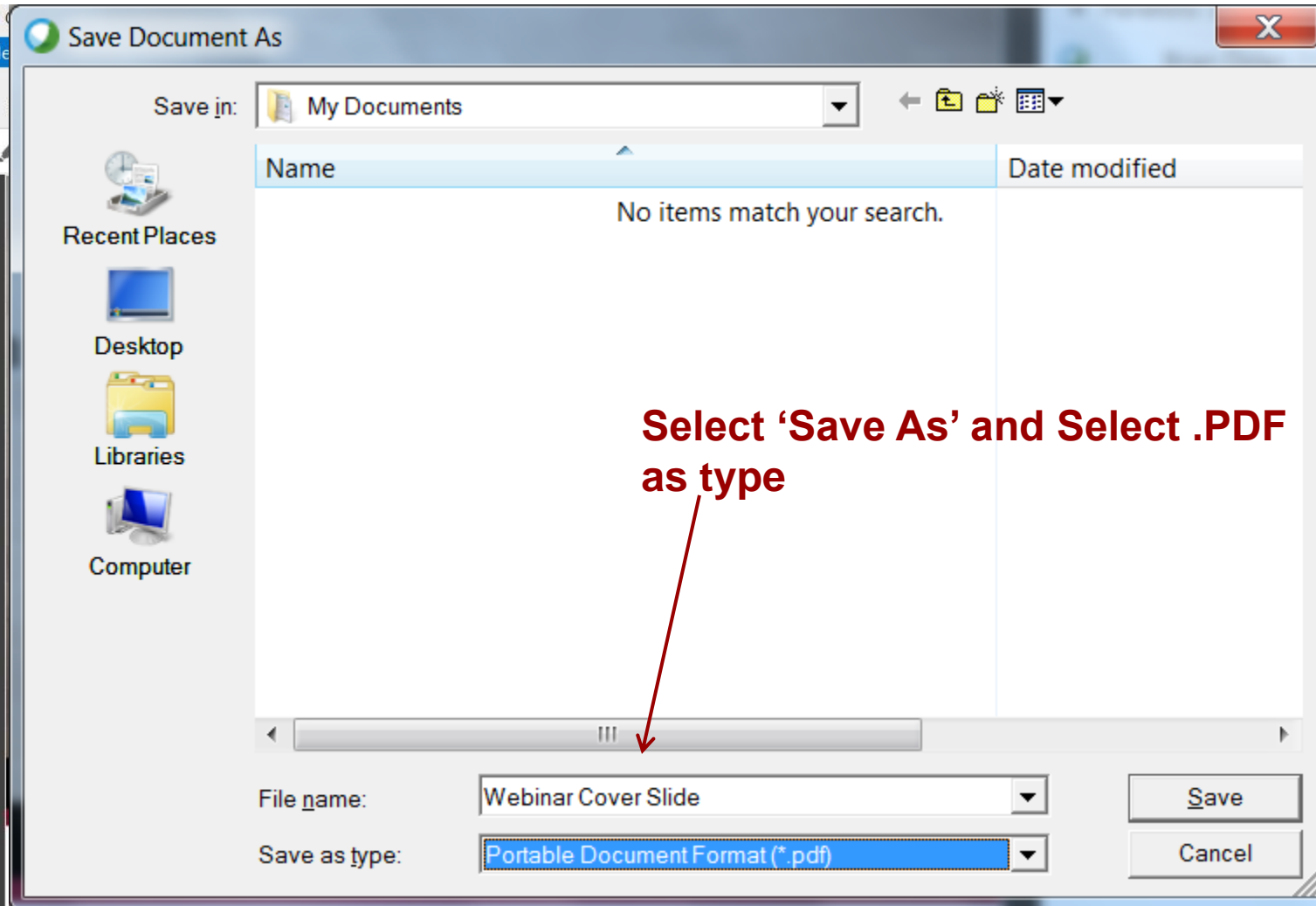
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We will be starting shortly. You will hear sound once we start.

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- ▶ Partner in the Government Contracts and White Collar and Corporate Investigations Practice Groups
- ▶ Has a broad range of experience in government contracts matters and is also a member of the firm's Sustainability, CleanTech and Climate Change Team
- ▶ Has a Top Secret/sensitive compartmented information clearance/access from the U.S. government, permitting him to assist contractors with classified matters. Mr. Hordell helps clients identify contract or grant opportunities, and works with them as the client develops its proposal addressing the government's needs as described in the solicitation documents.



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- ▶ More than 15 years of government contracting experience, both in private practice and as in-house counsel to a Fortune 100 aerospace and defense company, Mr. Campbell provides unique experience and insight on a broad range of litigation, counseling, and transactional matters to his clients that sell products and services to federal, state and local governments
- ▶ Regularly counsels his clients on the entire lifecycle of government contracting, including proposal responses and contract negotiations, ethics and compliance issues, internal investigations, mergers and acquisitions, bid protests and business disputes.



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- ▶ Focuses his practice on government contract and financial assistance agreement counseling, negotiations, investigations and litigation
- ▶ Has more than 20 years of experience representing commercial and defense contractors across a broad range of industries, including information technology, management consulting and construction, with an emphasis on matters relating to the federal Multiple Award Schedules (MAS) contract program
- ▶ Experience spans the entire lifecycle of government contracting and Mr. Koehl assists companies with market research and business development efforts, proposal responses, and contract negotiation with government customers and prime contractors.



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- ▶ Concentrates his practice on corporate finance, securities and general corporate matters, and focuses on emerging growth companies and middle market businesses
- ▶ For the past 25 years, his activities have included public and private equity and debt offerings, venture capital financings, mergers and acquisitions and Securities and Exchange Commission compliance matters. Mr. London represents, as general and special counsel, publicly traded corporations (stock exchange and Nasdaq listed), emerging high technology growth companies, and entrepreneurs in the initial start-up and development stages of business.



Introduction

- ▶ Investor interest in Government Contractors
 - Improving but sluggish conditions in commercial market
 - Homeland security
 - Cyber-security
 - Increased private equity participation
- ▶ "Government Contractors"
 - Specialty contractors (e.g., Cybersecurity)
 - Traditional defense contractors
 - 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., Federal Supply Schedule contract price reduction penalties)
- ▶ State and local government contracts have many of the same considerations
 - Often less complex and lower risk

Introduction

▶ Presentation Outline

- Background
 - Due Diligence Process
 - Sales Agreement Terms
- Transaction Structure
- Novation Agreements and Associated Issues
- Checklist of Top Government-Unique Issues
 - Other issues exist (e.g., Seller classified contracts)
- Compliance Risk and Extraordinary Penalties

M&A Process Chronology

- ▶ Buyer and Seller initiate discussions
- ▶ Execute Confidentiality Agreement
- ▶ Due diligence
- ▶ Negotiate major deal terms
- ▶ Execute Letter of Intent or Term Sheet
- ▶ Continue due diligence
- ▶ Prepare, negotiate and execute Purchase Agreement/Merger Agreement
- ▶ Secure stockholder approval and third party consents
- ▶ Satisfy other conditions to closing
- ▶ Closing
- ▶ Post closing integration

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

- ▶ Buyer may seek to modify Sales Agreement terms based upon results of due diligence
 - Increase purchase price escrow to account for possible government contracts liabilities
 - Increase duration of purchase price escrow to better match statutory limitations period for government claims
 - Make government approval of Seller's transfer of key contracts a closing condition
- ▶ For obvious reasons, Seller may not be amenable

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 can be 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
- ▶ *Federal Acquisition Regulation (FAR) Subpart 42.12, “Novation and Change-of-Name Agreements”*
 - *Attachment A* to course materials

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 often requires novation 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 Federal Supply Schedule (FSS) contract Blanket Purchase Agreements (BPAs) and large outstanding task and delivery orders on list of transferred contracts
- ▶ No government “pre-approval” of Novation Agreement
 - In some circumstances, communications with the Seller’s Contracting Officer(s) is advisable during due diligence

Novation Agreement and Associated Issues

- ▶ Time required for government review and approval varies, often takes 2-6 months to complete
- ▶ Novation “effective date” is retroactive to the transaction date, but Seller remains the legal party to the contract until novation is formally approved
- ▶ Subcontract necessary to cover this “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 (SB) concerns
- ▶ SB size standards are industry-specific, based upon
 - total employees (manufacturing) or
 - average annual revenue (services)
- ▶ SB concern is *per se* “affiliated” with its majority owners
- ▶ “Affiliate” revenue and employees count when determining a company’s size status

Small Business Set-Aside Contracts

- ▶ SB status can be a key ingredient in a company's success
- ▶ Loss of SB status could result in
 - Immediate termination of some contracts
 - Re-competition set-aside for SBs vs. exercise of contract renewal options
- ▶ Loss of SB status bars participation in future competitions for SB set-aside contracts
- ▶ Possible competitive disadvantage relative to federal subcontracts to large business prime contractors

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 SB 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 SB contracts before closing; (ii) closing condition of government approval of key SB contract transfers

Small Business Set-Aside Contracts

- ▶ Does the seller hold SB 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 SB set-aside contracts:
 - Would Seller qualify as SB post-close in key industries?
 - Assign value to contracts and contract options that could be affected by loss of size status
 - Consider impact of seller’s exclusion from future SB set-aside procurements



Checklist Issue Number Two: Intellectual Property Rights

Intellectual Property (IP) Rights

- ▶ Government gains substantial use rights to IP developed with government funds
 - Enhanced rights also for “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 Three: Cost-Reimbursable Contracts

Cost-Reimbursable Contracts

- ▶ Cost reimbursable contracts often involve complex, government-unique accounting issues
- ▶ Compliance risk areas:
 - Defective pricing penalties for inaccurate pre-award pricing disclosures
 - Note: Defective pricing also possible on fixed-price contracts for non-commercial items
 - Post-award penalties for time charging errors and billing unallowable costs

Cost-Reimbursable Contracts

- ▶ Post-close performance and integration:
 - Cost accounting issues may dictate maintaining Seller as separate division or subsidiary after close
 - “Cap” on Overhead and G&A rates often a condition of transaction approval where Seller’s rates are lower
 - Enhanced government audit rights for cost contracts and subcontracts
 - Cost contracting rules and government audit rights may impede direct collaboration after close if Buyer is a “commercial item” contractor

Cost-Reimbursable Contracts

- ▶ Is the Seller performing cost contracts?
 - Red Flags: (i) R&D contracts; (ii) contract files with incurred cost submissions
- ▶ If the Seller has cost contracts, examine:
 - Process for cost and pricing data disclosure and certification
 - Time-charging system and procedures
 - Audit reports of incurred cost submissions
 - Post-close cost accounting system options
 - Barriers to post-close Buyer/Seller collaboration



Checklist Issue Number Four: Federal Supply Schedule Contracts

Federal Supply Schedule (FSS) Contracts

- ▶ FSS contracts program is the premier sales program for “commercial items,” mostly administered by the General Services Administration (GSA)
- ▶ FSS contracts for medical supplies and services administered by Department of Veterans Affairs (VA)
- ▶ Complex pre-award pricing disclosure and post-award price reduction requirements
- ▶ Commercial companies often have compliance problems with their FSS contracts
- ▶ Office of Inspector General (GSA + VA) and Department of Justice focus on FSS contract compliance and audits

Federal Supply Schedule (FSS) Contracts

- ▶ Does the Seller hold a GSA or VA FSS contract?
 - *Red Flag.* Seller listed in the FSS E-Library database.
<http://www.gsaelibrary.gsa.gov/>
 - *Practice Tip:* Check for d/b/a and prior company names
- ▶ If Seller holds a FSS contract, review must include:
 - Pre-award sales practices disclosures
 - Procedures for monitoring post-award price reductions
 - Payment of administrative fee to GSA/VA (IFF)
 - Procedures for selling only GSA/VA-approved items
 - Compliance with product country of origin rules (TAA)
 - Procedures for supplying qualified professional staff

Federal Supply Schedule (FSS) Contracts

- ▶ Post-Close Administrative Considerations
 - Identify and confirm “tracking customer” based upon seller entity’s new structure and business model
 - Unwritten GSA policy allows only one FSS per contractor (unevenly enforced)
- ▶ Significant potential exposure for FSS contractor buyers
 - PeopleSoft employee files *qui tam* False Claims Act lawsuit
 - Oracle acquires PeopleSoft
 - 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 Five: 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
 - Some proposals may be subject to withdrawal
- ▶ Bid Protest risk from competitors (i.e., cannot award to an entity other than the bidder)
- ▶ *Practice Tip*: procedure to amend novation agreement if new contracts are awarded 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 Six: 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 right to audit government contractors
 - Especially for cost-reimbursement and FSS contracts
 - Less extensive contractual rights to audit subcontractors and “commercial item” contractors
 - OIG “waste, fraud and abuse” subpoena power
- ▶ Extended statutory limitations periods, 6 years or more
- ▶ Potential for negative press coverage

Compliance Risk/Extraordinary Penalties

- ▶ Termination for Default
 - Excess re-procurement costs
- ▶ Negative past performance ratings which negatively impact future government business prospects
- ▶ Suspension/debarment for up to 3 years

Compliance Risk/Extraordinary Penalties

▶ Civil False Claims Act

- “Reckless disregard” standard, no specific intent required
- Treble damages, up to \$11k per invoice penalty
- Oracle pays \$98.5 million (PeopleSoft) and \$46 million (Sun Microsystems) fines to settle alleged false claims submitted by these sellers prior to being acquired by Oracle

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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