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PRACTICAL TIGHT-KNIT BRIEFINGS INCLUDING ACTION GUIDELINES ON GOVERNMENT CONTRACT TOPICS

MERGERS & ACQUISITIONS—SPECIAL ISSUES WHEN PURCHASING GOVERNMENT CONTRACTOR ENTITIES/EDITON II

By Agnes P. Dover, Richard T. Horan, Jr., and Todd R. Overman

The current worldwide recession has resulted in a dramatic decrease in both the number and dollar value of mergers and acquisitions transactions.[1] While this falloff has been across virtually all industry sectors, the Government contracts sector, while adversely affected, has remained relatively resilient to the overall downturn. Recent statistics demonstrate that the Government sector remains active, although not necessarily vibrant.[2]

Even as the recession continues, the purchase and sale of Government contractor entities will most likely continue as the pattern of consolidation of contractors has become a regular business strategy. In addition, with more private equity investors becoming involved in the industry, new and diverse sources of capital have promoted activity.[3] Nevertheless, no matter the level of mergers and acquisitions activity in this sector, all participants will continue to need to navigate myriad regulatory requirements to negotiate, document, close, and implement a successful transaction.

The first edition of this BRIEFING PAPER was published in 2004.[4] Five years later, this Edition II BRIEFING PAPER updates the issues raised in the original article and discusses recent developments in the Government contracts mergers

IN BRIEF

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and acquisitions arena. In particular, there have been important developments with respect to the purchase and sale of contractors with small business contracts as well as significant regulation and enforcement involving foreign-owned acquirers. This Paper also reviews issues involving the Anti-Assignment Act and novation of contracts and discusses continued developments on organizational conflicts of interests.

Anti-Assignment Act

Depending on how a transaction is structured, the Government's two anti-assignment statutes can slow or complicate the acquisition of a Government contractor entity. The first statute, the Assignment of Claims Act,[5] addresses claims under Government contracts for work that has already been performed. It provides that "a transfer or assignment of any part of a claim against the United States Government or of an interest in the claim…may be made only after a claim is allowed, the amount of the claim is decided, and a warrant for payment of the claim has been issued."[6] The Assignment of Claims Act's prohibition ensures 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.[7]

The second statute, the Anti-Assignment Act,[8] is more relevant in the mergers and acquisitions context, as it pertains chiefly to those Government contracts with continuing obligations.[9] The purpose of the Anti-Assignment Act is to ensure that the Government deals exclusively with the original contracting party, rather than with multiple or sequential parties.[10] Therefore, the transfer of a Government contract from the party holding the contract to another party is generally prohibited.[11] Under the Act, "[n]o 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."[12] By voiding, upon attempted transfer, both the assignment of performance and the underlying Government contract, the Act is designed to ensure that the entity awarded a Government contract would actually perform it with its own resources.

Although the Act appears to prohibit categorically any transfer of a Government contract from the original awardee to another party, courts and boards of contract appeals have consistently held that the Act is not violated where the Government consents to the transfer[13] or where the contract transfers occur "by operation of law," such as through a merger.[14] Because the statute is intended for the protection and benefit of the Government, it is reasonable that the Government's consent to an assignment should preclude application of the Act's general prohibition. Thus, the Government may waive the protections of the Act if it deems that such a waiver furthers its interests.[15] A waiver may be given implicitly by Government knowledge, assent, and action consistent with the terms of the assignment[16] or explicitly the execution of a *novation agreement*, the process by which the Government formally grants its consent to contract transfers.[17]

Absent an implicit waiver, failure to obtain a novation may bar future claims against the Government regardless of whether rights to claims

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have ostensibly transferred with the acquisition of assets from the contractor.[18] This is especially true when the transaction involves the sale of only a portion of the assets or personnel involved in the Government contract as opposed to the transfer of the entire entity responsible for the contract. For example, where a party seeking to bring claims against the Government had acquired only a portion of the business entity responsible for performance of the contract from which the claims derived, the U.S. Court of Appeals for the Federal Circuit concluded that the sale of the assets contravened the Anti-Assignment Act.[19]

As mentioned above, the judicially created "by operation of law" exception to the Anti-Assignment Act generally exempts assignments to statutory receivers and transfers that result from mergers.[20] The "by operation of law" exception is premised on the assumption that such transfers do not contravene the Act's purpose of ensuring that the entity awarded a Government contract actually performs it because the same entity is generally still performing the contract after a merger.[21] The exception typically applies to assignments made pursuant to "transfers by intestate succession or testamentary disposition, judicial sale, the process of subrogation to an insurer, and where the assignment or transfer of a claim is effected through consolidation or merger."[22] The issue with respect to statutory mergers may be further complicated by the regular use of triangular mergers using subsidiaries pursuant to which the surviving entity may or may not be the contracting entity (depending on whether a reverse or forward merger is used).

Consistent with the judicial exception for transfers by operation of law, the Federal Acquisition Regulation specifically indicates that a novation agreement is not necessary when a change in ownership results from a sale of stock that causes no legal change in the contractor—leaving the contractor in control of the relevant assets and continuing to perform the contract.[23] Furthermore, the case law supports the conclusion that a novation process is not necessary in the context of statutory mergers because of the "by operation of law" exception.[24]

However, some courts and boards of contract appeals have limited the categorical exemption, holding that a statutory merger will only excuse a contractor from the requirement of obtaining governmental consent if the merger will have little or no effect on the personnel, management, and resources engaged in performing those contracts. Specifically, when considering whether a given contract transfer occurred by operation of law, courts look to whether the Government continues to deal with the party with which it first contracted (i.e., the same employees, management, and other resources) and whether the Government continues to receive the benefits for which it contracted.[25] Therefore, some Administrative Contracting Officers still seek to obtain a formal novation agreement when there is a merger, even though the transfer of contracts occurs by operation of law.

The recent economic downturn of 2008–2009 has highlighted the danger that companies may face when purchasing Government contracts and related assets from a bankruptcy estate. Though the Government Accountability Office, most of the boards of contract appeals, and the U.S. Court of Federal Claims generally hold that bankruptcy court assignments are within the "by operation of law" exception, the U.S. Courts of Appeals have not uniformly followed their lead.[26] Some circuits hold that bankruptcy will immediately terminate affected contracts while other circuits say that it depends on whether or not the debtor was "actually" trying to assign the contract.[27] With this split in opinion among the courts, the issue should be carefully examined before assigning contracts out of bankruptcy.

Thus, while novation agreements can be avoided in some circumstances, securing the Government's explicit consent remains the surest way of protecting your contract rights after the assignment of a Government contract.

Novation Of Contracts Process

Under the FAR, the Government may recognize a successor in interest to a Government contract when there is a transfer of all of the contractor's assets or the entire portion of the assets involved in performing the contract.[28] The process used for recognizing a successor in interest is to enter into a three-party novation agreement between the Government, the transferor, and the transferee. Under the agreement, the Government recognizes the transferee as the successor to the transferor, but the transferor remains liable as guarantor of the transferee's performance.[29]

Notwithstanding the necessity to get Government consent to transfer a Government contract, the novation process begins only after the transfer has been completed. In some cases, ACOs take many months or a year to process a novation request. In the interim, between the closing and the execution of any necessary novation agreement, it is advisable for the transferee to enter into a subcontract under which it is given the authority to perform the contract in the transferor's name and receive payments pending approval of the novation agreement. Of course, any subcontract must conform to the provisions of the prime contract.

When required to enter into a novation agreement, the transferor must notify the ACO administering the largest unsettled balance on an open contract about the pending acquisition[30] and provide that ACO with documentation as specified in the FAR.[31] The required documentation includes (1) an authenticated copy of the instrument effecting the transfer of assets, (2) a certified copy of each resolution of the corporate parties' boards of directors authorizing the transfer of assets, (3) a certified copy of the minutes of each corporate party's stockholder meeting necessary to approve the transfer of assets, (4) if a corporation was formed to receive the assets involved in performing the Government contract, an authenticated copy of the transferee's certificate and articles of incorporation, (5) the opinion of legal counsel for the transferor and transferee stating that the transfer was properly effected under applicable law, (6) balance sheets of the transferor and transferee as of the dates immediately before and after the transfer of assets, audited by independent accountants, (7) evidence that any security clearance requirements have been met, and (8) the consent of all sureties on all contracts if bonds are required, or a statement from the transferor that none are required.[32] Importantly, the regulations grant ACOs the discretion to waive some of the documentation requirements,[33] but it is imperative for the transferor and transferee to cooperate with the ACO to expedite the novation process.

Assignment Of Proposals

An issue closely related to the novation of Government contracts is the effect of a merger or acquisition on outstanding bids and proposals. This issue often arises in the context of bid protests or responsibility determinations when an offeror changes ownership after its proposal has been submitted but before contract award. Although the Anti-Assignment Act does not apply to Government contract bids and proposals, the GAO has relied upon court decisions that interpret the Act to hold that assignments of bids and proposals are not precluded when made by operation of law and the "transfer is to a legal entity which is the complete successor in interest to the bidder or offeror [whether] by virtue of merger, corporate reorganization, the sale of an entire business or the sale of [the] entire portion of a business embraced by the bid or proposal."[34] The key requirement is that the original offeror remains intact with access to the same resources and with an intention to honor its prior commitments.[35]

Although the transfer of outstanding bids and proposals is not precluded by the Anti-Assignment Act or GAO case law, special steps may nonetheless need to be taken. The FAR requires that before awarding a contract, the CO must determine whether the offeror submitting the proposal is a "responsible" offeror, with adequate financial resources and a satisfactory record of integrity and business ethics.[36] To avoid any confusion as to the identity of the offeror whose financial resources are being evaluated and thereby possibly preventing potential bid protests by competitors if the transferee should get the award, it may be prudent to notify the Procuring CO of the transfer of the pending bid or proposal.[37] Before notifying the PCO, however, the transferee should determine on a case-by-case basis whether the transfer could negatively impact the evaluation of the outstanding bid or proposal. The transfer could, for example, affect the agency's evaluation of the proposal in areas such as past performance.

Change-Of-Name Procedure

Even when a novation is not required, such as when there is a stock purchase or merger transaction, if the name of the Government contracting entity is expected to change, you must prepare and provide several documents to the Government in support of an application for recognition of the name change.[38] In particular, the "Change-of-Name Agreement" package must include (1) three signed copies of a "Change-of-Name Agreement," (2) an authenticated copy of the document effecting the name change, (3) a legal opinion stating that the change of name was properly effected under applicable law, and (4) a list of all affected contracts, showing the CO for each.[39]

It is prudent to contact the Government early in connection with the preparation of the "Change-of-Name-Agreement" package. However, raising the change-of-name issue with the ACO may prompt a request to undertake the novation process even when a novation is not legally required.[40]

Similar to the notification process for novations, contractors must notify the ACO administering the largest unsettled balance on an open contract about the pending merger and name change.[41] The notice should inform the ACO of the planned merger, the structure of the merger, and the contracts affected by the merger. In addition, the notice should inform the ACO that you will be forwarding the change-of-name package described above. The process to approve the change in name may require anywhere from a few weeks to a few months to accomplish. Once approved by the ACO, each contract should be modified to reflect the change in name.

Organizational Conflicts Of Interest

Mergers and acquisitions in which both the buyer and seller are Government contractor entities—particularly service contractors[42]—may raise additional unique issues. When the buyer and seller operate in related business areas, especially advisory and assistance services, the acquisition of one entity by another could create organizational conflicts of interest (OCIs) that jeopardize existing or future Government contract work. Therefore, to plan for and guard against an unexpected loss of business or future business opportunities, identifying OCIs that may result from an acquisition is an important step in regulatory due diligence.

■ Basic Rules

Under FAR Subpart 9.5, an OCI "may result when factors create an actual or potential conflict of interest on an instant contract, or when the nature of the work to be performed on the instant contract creates an actual or potential conflict of interest on a future acquisition."[43] Acquisitions that create an OCI can cause the resulting entity to be disqualified from certain competitions or can force the acquirer to relinquish some of its or the target's existing contracts to avoid or mitigate OCI concerns.

COs are charged with identifying and evaluating potential OCIs as early in the acquisition process as possible.[44] Once an OCI is identified, the CO must "[a]void, neutralize, or mitigate significant potential conflicts before contract award."[45] In executing this responsibility, COs are guided by two underlying principles: (1) preventing the existence of conflicting roles that might bias a contractor's judgment, and (2) preventing unfair competitive advantage.[46]

To protect against OCI concerns, the regulations specifically limit the award of some contracts to contractors providing specific services. For instance, a contractor providing systems engineering and technical direction cannot be awarded a contract to supply the system or any of its major components.[47] Similarly, if a contractor prepares and furnishes contract specifications, that contractor is generally not allowed to provide the items called for under the those specifications.[48] In addition, FAR 9.508 provides examples of nine different situations in which questions regarding OCIs might arise.[49]

In May 2009, President Obama signed the Weapon Systems Acquisition Reform Act of 2009, which requires revisions to the Defense FAR Supplement to provide uniform guidance and tighten existing requirements for OCIs by contractors in major defense acquisition programs.[50] The Act provides four additional examples of situations where an OCI might arise, including the ownership of business units by the same contractor performing different functions within major defense acquisition programs.[51]

■ OCI Avoidance & Mitigation

The possibility of an OCI remains throughout the life of an awarded contract, and any mitigation approach adopted at contract award must be sufficient to guard against any actual or potential OCI issues that may arise in the event of a subsequent change of ownership or organizational structure. Therefore, a careful review of potential OCI concerns is an important and necessary consideration of any merger or acquisition involving Government contractors. To protect against unintended consequences of an otherwise attractive acquisition, the companies must be forward-thinking and suggest strategies to the CO for avoiding or mitigating any potential OCI concerns.

The initial step in an OCI due diligence review is for the companies involved in the merger or acquisition to identify those sectors of their businesses where OCI issues are likely to develop. For example, if the target specializes in advisory and assistance services, the acquirer should review whether it is currently supplying products connected to those services. Similarly, if the target is providing systems engineering and technical assistance services for certain products, the acquirer should evaluate what effect the provision of these services will have on its future business opportunities.

Once an actual or potential OCI issue is identified in a particular contract, parties should determine whether existing mitigation plans, if any, are sufficient to handle the potential OCI after the acquisition or merger closes. The parties must also determine whether the owner of the contract is prepared to take the necessary steps to avoid or mitigate the resulting OCI issue. For instance, a mitigation plan can provide for firewalls separating the conflicted sectors of the merged entity. However, the GAO has held a firewall to be insufficient in several situations. For example, the GAO recently held that firewalls were "virtually irrelevant" for mitigating impaired objectivity OCIs.[52] Even in "unfair access to information" OCIs, which firewalls can usually mitigate, firewalls have been held insufficient when there is evidence that the firewall has been breached.[53] Also, if the nature of the activities involved in the OCI are too interrelated, a firewall may not be sufficient.[54] Therefore, if an OCI presents itself the acquirer may have to consider the more drastic approach of divesting the portion of the target's business that creates the OCI concerns.[55]

The management of this process during the period of time between the announcement and close of the transaction is extremely important. Under applicable antitrust rules, both parties need to manage their existing contracts independently.[56] However, to the extent that an announced transaction has the potential to create OCI issues, contractors need to communicate with their respective COs and be prepared to implement mitigation plans immediately upon closing.

Acquisitions Of Small Business Entities

Special issues also arise when a large business acquires a small business concern that is receiving contracts under various Small Business Administration programs. In the last five years, one of the major regulatory developments to affect transactions involving small businesses was the imposition of a requirement for small business contractors to recertify their size status within 30 days of completing a novation agreement or merger or acquisition.[57] In addition, buyers or investors must continue to pay careful attention to the rules and regulations surrounding the acquisition of small businesses that are the recipient of set-aside contracts under the SBA's 8(a) program[58] or Small Business Innovation Research program grants.[59]

■ General Rules

Generally, a business that qualifies as a "small business concern" may be eligible to receive certain Government contracts or grants that are set aside for small businesses. The term "small business concern" means a concern, including its affiliates, that is independently owned and operated, not dominant in the field of operation in which it is bidding on Government contracts, and is qualified as a small business under the SBA's size standards.[60] Importantly, the SBA determines the size status of a firm, including its affiliates, as of the date the firm submits to the procuring agency, as part of its initial proposal, a written self-certification that the firm is "small."[61] Thus, an agency need not terminate a contract where a small business concern becomes "large" after the self-certification.[62]

■ Recertification Requirements

Historically, small businesses receiving Government contract awards under the SBA's preference programs could continue to receive orders for many years even though they may have become large through acquisition by another company or by their own internal growth. This was because, under long-standing SBA regulations, a company's initial size determination continued throughout the life of the contract, regardless of actual changes in the contractor's size. This principle also governed long-term federal contracts (e.g., General Services Administration multiple award schedule contracts, Government-wide acquisition contracts, etc.), under which many contractors received orders long after being acquired by large companies or otherwise exceeding applicable small business thresholds. As a result, many large businesses were topping the list of recipients of small business contracts year after year.[63]

To narrow this alleged "loophole," the SBA proposed in April 2003 to require contract awardees to recertify their "small" status on all "long-term" contracts annually.[64] After receiving more than 600 comments on the proposed rule, on November 15, 2006, the SBA issued a final rule requiring recertification on *all* Government contracts (1) whenever a contractor is acquired by or merges with another company, and (2) for long-term contracts, before the sixth year of contract performance and whenever an option is exercised thereafter.[65] In either situation, if a concern becomes large during contract performance, the agency is not required to terminate the contract but may stop issuing orders to the company under long-term indefinite-delivery, indefinite-quantity contracts.

The final rule changed two SBA regulations: 13 C.F.R. § 121.404(g) ("When does SBA determine the size status of a business concern?"), and 13 C.F.R. § 121.1004(a) ("What time limits apply to size protests?"). As amended, 13 C.F.R. § 121.1004(a) permits size protests regarding size recertifications made for long-term contracts, option periods, and orders and requires receipt of the size protest within five business days after receipt of notice of the prospective awardee or award. Under the new 13 C.F.R. § 121.404(g), a small business must recertify its small size status or inform the procuring agency that it is large (1) within 30 days of an approved contract novation (i.e., following an asset purchase), and (2) in a merger or acquisition where a novation is not required (i.e., stock purchase), within 30 days of the transaction becoming final.[66] For long-term contracts of five years or more (e.g., multiple award schedule, multiple agency, and Government-wide acquisition contracts), the CO must request that a concern recertify within 120 days before the end of the fifth year and within 120 days before exercising any option thereafter.[67]

In each situation, the recertification will not affect the contract's terms and conditions, and the contractor may continue its performance and receive payment for it.[68] However, if the contractor reports that it has become large, the contracting agency cannot from that point forward count orders or options issued to the concern towards the agency's annual small business contracting goals.[69] The final rule took effect on June 30, 2007, and applied to all solicitations and contracts issued thereafter, as well as to contracts and solicitations existing on the effective date (i.e., only older, completed contracts were not affected).[70] In July 2007, the FAR Councils implemented the SBA's final rule through amendments to the FAR, including the addition of the "Post-Award Small Business Program Rerepresentations" contract clause at FAR 52.219-28.[71]

■ Practical Impact

The final rule attempts to strike a balance between the Government's need to verify that small business federal contractors are truly "small," and the small business concerns' ability to grow and develop during contract performance. However, the requirement to recertify every time a concern novates a contract or merges with another company could substantially affect the valuations of small business concerns that stand to lose orders after acquisition by a large business.[72] Specifically, because agencies can no longer count dollars paid to an entity as "small business" dollars and other small businesses are available to provide similar products or services, the agencies are likely to issue orders to the other small businesses so they can continue to receive small business credit.

For example, if a concern that is determined "small" as one of several awardees of a GSA MAS contract later reports it has become "large," the Government may choose to issue further orders only to the other awardees recertifying as "small." Similarly, if a concern reports that it has become "large" early in its performance of a contract due to a sale or acquisition, the agency may adjust its procurement strategy and conduct a new parallel procurement to direct dollars to small concerns. In either case, the contract will have been effectively terminated for the formerly small concern. Thus, any party evaluating a small business that derives a significant portion of its revenue from small business set-aside contracts must be aware that a sale, acquisition, or merger involving another company may significantly limit or destroy that revenue source.

■ 8(a) Contractors

The general rules described above are different if the contract is performed by a small disadvantaged business concern participating in the SBA's 8(a) program and the contract was set aside for award to 8(a) contractors. Technically, 8(a) contracts are subcontracts to the SBA, which acts as the prime contractor to the actual buyer agency.[73] In general, 8(a) contracts must be performed by the company that obtained the original 8(a) contract award.[74] The SBA's affiliation rules require that the acquired company be considered together with the controlling parent company for purposes of determining both size status and ownership by qualifying disadvantaged persons, even if the business were to continue in existence as a subsidiary.[75]

Additional rules and procedures come into play when an 8(a) contractor (or its assets) are sold to a non-8(a) company. Importantly, an 8(a) contract, whether in the base or an option year, must be terminated for the convenience of the Government if the 8(a) concern to which it was awarded transfers ownership or control of the firm, unless the Administrator of the SBA waives the termination requirement (e.g., ownership and control passes to another 8(a) concern).[76] The same waiver requirement applies in an asset sale, which requires a novation to assign contract performance to the acquiring entity.

The 8(a) contractor must notify the SBA "immediately upon entering an agreement (either oral or in writing) to transfer all or part of its stock or other ownership interest to any other party."[77] The contracting agency also must be notified.[78] This requirement is inartfully worded in that it refers to the 8(a) "concern" entering an agreement to sell, whereas, at least in the case of a stock transaction, it is the shareholders of the concern who transfer the ownership interest. However, the notice must be given whether it is the concern itself or third-party owners who are transferring interests, and whether it is an asset or stock deal. The notice requirement is generally triggered by entering into a purchase agreement. However the signing of a nonbinding, but detailed, letter of intent may cause an immediate change in size status.[79]

To continue performance of an 8(a) contract after a transfer of ownership or control by a non-8(a) concern, a timely waiver must be obtained from the SBA. As noted above, if a waiver is not obtained, the CO must terminate the contract for the convenience of the Government.[80] The contractor must request a waiver from the SBA before "actual relinquishment of ownership or control," i.e., the closing.[81] In doing so, the 8(a) contractor must specify the grounds on which it requests the waiver and demonstrate that such grounds are met.[82]

According to representations by the SBA, it is often the case that closing or finalizing of the acquisition is made contingent upon obtaining the waiver. In this regard, potential deal negotiation issues may be whether waivers are a condition to closing and whether waiver rejection is a ground for a price adjustment at closing. If the parties close while waivers are still pending, it may be appropriate to have a contingent deferred payout of part of the price based on contract revenues.

To obtain a waiver, the SBA requires a certification from the head of the contracting agency or another authorized agency official that "termination of the contract would severely impair attainment of the agency's program objectives or missions."[83] Upon notice of the transfer, the CO must take action "immediately to preserve the option of waiving the termination requirement."[84] In this regard, if the CO determines that transfer of the contract from the current 8(a) contractor to another firm would impair attainment of the agency's program objectives, the CO *must* notify the SBA in writing and indicate that the agency is requesting a waiver.[85] The CO "shall either confirm or withdraw" the request within 15 days or "such longer period as agreed to by the agency and the SBA."[86] As a practical matter, if contract performance is well underway at the time of the acquisition, an agency generally will find it easier and less disruptive to continue the contract than to terminate and conduct a new procurement.

The SBA suggests that requests be made as early as possible and notes that it will process requests submitted before a definitive purchase agreement is signed. In any event, the contract will not be terminated before the CO has had an opportunity to opine to the SBA on the waiver request, since only the CO can terminate the contract. Should a waiver request be denied, the 8(a) contractor may appeal the decision to the SBA Office of Hearings and Appeals under the procedures set forth at 13 C.F.R. Part 134.[87]

■ SBIR Grants

The Small Business Innovation Research (SBIR) program is a highly competitive research and development program reserved for "small businesses."[88] The SBA oversees the program and assists the 11 participating federal agencies in awarding Phase I and Phase II grants to eligible small business concerns. In recent years, the SBIR program has become a vital source of R&D funds for various types of small businesses looking to expand their offerings through technological innovations. An additional advantage of the program is that all data developed under SBIR awards is protected from disclosure outside of the Government for up to five years after final acceptance by the Government.[89] This nondisclosure period provides small businesses with a competitive advantage as they have additional time to exclusively develop or "commercialize" data first produced under an SBIR award.

The universe of "small businesses" eligible to receive SBIR funding, however, differs from the universe of "small businesses" that may participate in the SBA's other preference programs. Specifically, through a series of rulings by its Office of Hearings and Appeals and regulatory developments, the SBA has narrowly interpreted the definition of "small businesses" for purposes of the SBIR program, effectively preventing many businesses from attracting significant venture capital fund financing and jeopardizing future SBIR awards.

Buyers of small business concerns, particularly venture capital funds looking to take minority positions in small businesses, should be aware of the eligibility criteria for receiving SBIR funds. Specifically, to be eligible, a small business concern must (1) be a for-profit business concern incorporated in the United States, (2) together with its affiliates, have no more than 500 employees, and (3) be at least 51% owned and controlled by one or more *individuals* who are citizens of, or permanent resident aliens in, the United States. Notably, a concern may also be eligible if it is 51% owned and controlled by another business concern if that concern is at least 51% owned and controlled by one or more individuals who are citizens of, or permanent resident aliens in, the United States.[90]

Therefore, for a small business concern to continue to receive SBIR grants after some form of a capital infusion, the entity must remain at least 51% owned and controlled by one or more human beings. Venture capital funds are unable to take majority positions, or even dominant minority positions,[91] even if the small business concern, with the fund and its affiliates, has less than 500 employees. If the concern no longer meets this test, it will lose eligibility for future SBIR awards and, therefore, a potentially important R&D funding stream. Nevertheless, the concern will retain the exclusive intellectual property rights granted in SBIR data even if it no longer qualifies as a "small business."

Foreign Ownership, Control & Influence

Many of the recent acquisitions in the defense contractor space have involved foreign buyers and investors.[92] These transactions illustrate the special issues that arise when a foreign entity acquires a U.S. company that performs work requiring access to classified materials. The rules apply equally to indirect ownership (e.g., foreign investment in a U.S.-based private equity fund) and direct investments. This is a result of the U.S. Government's policy to limit access to classified information to entities and individuals who hold a security clearance, a qualification for which only U.S. citizens are eligible. Thus, non-U.S. corporate citizens or companies under foreign ownership, control, or influence (FOCI) are not eligible to receive a security clearance, unless they mitigate the FOCI through one of several authorized approaches.

■ NISPOM Requirements

Executive Order 12829 established the National Industrial Security Program, which is administered by the Defense Security Service (DSS), and authorized the establishment of policies and procedures concerning access to classified information.[93] Key regulations implementing the program include Department of Defense Regulation 5220.22-M, known as the National Industrial Security Program Operating Manual (NISPOM).[94] To have access to classified information, a contractor must have a valid facility security clearance granted by the appropriate cognizant security agency administering the classified contract at issue, such as the DSS or the Department of Energy.[95] As a general rule, the NISPOM requires that a company structured as a single corporation with multiple facilities obtain a facility clearance for its corporate parent at a level equal to the highest security classification of any contract performed by any facility within the corporation.[96] Importantly, facility clearances are granted only to contractors organized under U.S. law and located within the United States or a U.S. territory.[97] In addition, the contractor must not be subject to FOCI.[98]

Thus, a purchaser's ability to retain a security clearance held by a target company may be adversely affected if all or a portion of the target's ownership is acquired by a foreign entity. As an initial point, the NISPOM requires contractors holding security clearances to report any change of ownership to the Government.[99] Likewise, contractors must inform the Government when they enter into discussions that may result in a merger, acquisition, or takeover by a foreign interest.[100] The NISPOM defines a "foreign interest" as follows: [101]

> Any foreign government, agency of a foreign government, or representative of a foreign government; any form of business enterprise or legal entity organized, chartered or incorporated under the laws of any country other than the United States or its territories, and any person who is not a citizen or national of the United States.

■ FOCI Factors

The NISPOM indicates that a U.S. company is considered to be under FOCI in the following circumstances:[102]

> [W]henever a foreign interest has the power, direct or indirect, whether or not exercised, and whether or not exercisable through the ownership of the U.S. company's securities, by contractual arrangements or other means, to direct or decide matters affecting the management or operations of that company in a manner which may result in unauthorized access to classified information or may affect adversely the performance of classified contracts.

When considering whether a contractor is under FOCI, the cognizant security agency will consider the following different factors in the aggregate:[103]

> a. Record of economic and government espionage against U.S. targets.
>
> b. Record of enforcement and/or engagement in unauthorized technology transfer.
>
> c. The type and sensitivity of the information that shall be accessed.
>
> d. The source, nature and extent of FOCI, including whether foreign interests hold a majority or substantial minority position in the company, taking into consideration the immediate, interme-

> diate, and ultimate parent companies. A minority position is deemed substantial if it consists of greater than 5 percent of the ownership interests or greater than 10 percent of the voting interest.
>
> e. Record of compliance with pertinent U.S. laws, regulations and contracts.
>
> f. The nature of any bilateral and multilateral security and information exchange agreements that may pertain.
>
> g. Ownership or control, in whole or in part, by a foreign government.

In addition to consideration of these factors, a company applying for a facility clearance must provide the cognizant security agency with the following information, which will also be considered and reviewed in the aggregate, as part of its "Certificate Pertaining to Foreign Interests":[104]

(1) Ownership or beneficial ownership, direct or indirect, of 5% or more of any class of the applicant company's securities by a foreign person.

(2) Ownership or beneficial ownership, direct or indirect, of 5% or more of the applicant company's total capital commitment by a foreign person (for entities that do not issue stock).

(3) Ownership of 10% or more of any foreign interest.

(4) Management positions such as directors, officers, or executive personnel of the applicant company held by non-U.S. citizens.

(5) Foreign person power, direct or indirect, to control the election, appointment, or tenure of directors, officers, or executive personnel of the applicant company and the power to control other decisions or activities of the applicant company.

(6) Contracts, agreements, understandings, or arrangements between the applicant company and a foreign person.

(7) Details of loan arrangements between the applicant company and a foreign person and details of any significant portion of the applicant company's financial obligations that are subject to the ability of a foreign person to demand repayment.

(8) Total revenues or net income in excess of 5% from a single foreign person or in excess of 30% from foreign persons in the aggregate.

(9) 10% or more of any class of the applicant's voting securities held in "nominee shares," in "street names," or in some other method that does not disclose the beneficial owner of equitable title.

(10) Interlocking directors with foreign persons and any officer or management of the applicant company who is also employed by a foreign person.

(11) Any other factor that indicates or demonstrates a capability on the part of foreign persons to control or influence the operations or management of the applicant company.

Notably, as of June 1, 2009, U.S. companies applying for a facility clearance, requesting a clearance upgrade, or reporting a material change to FOCI must use the Department of Energy's web-based e-FOCI application to submit new information to the DSS.[105] The system still requires much of the same information reported in the past, including a "Certificate Pertaining to Foreign Interests," list of key management personnel, list of stockholders, articles, bylaws, and any other supporting documentation deemed necessary by the DSS.[106]

■ FOCI Mitigation

A foreign-owned company that acquires a cleared U.S. company may take steps to "mitigate" the FOCI concerns and thereby maintain the company's security clearance. First, if the foreign interest at issue does *not* own sufficient voting stock to elect board members and is not otherwise entitled to board representation, a simple resolution by the U.S. company's board will generally prove adequate to resolve the situation. The resolution must (a) identify the foreign shareholder and describe the number and type of the foreign-owned shares, (b) acknowledge the need to comply with the industrial security program and export control laws, (c) certify that the foreign owner does not require, shall not have, and can be effectively precluded from unauthorized access to all classified and export-controlled information entrusted to or held by the company, and (d) agree to provide an annual certification acknowledging the resolution's continued effectiveness.[107]

Other options to mitigate FOCI include implementing a Voting Trust or Proxy Agreement whereby the voting rights of foreign-owned stocks are vested in three trustees or proxy holders who are U.S. citizens and have been cleared by the U.S. Government.[108] The trustees or proxy holders must be disinterested individuals with no prior involvement with the U.S. company, corporate affiliates, or the foreign owner and must be made directors of the applicant company.[109]

The Voting Trust or Proxy Agreement approach is the most stringent mitigation approach in that it requires the foreign owner to relinquish day-to-day control of the cleared U.S. entity. For example, once the arrangement is approved, the proxy holders exercise all prerogatives of ownership with complete freedom to act independently from the foreign parent, except that the foreign parent must approve the following matters: (1) the sale or disposal of the company's assets or a substantial part thereof, (2) pledges, mortgages, or other encumbrances on the company's capital stock, (3) corporate mergers, consolidations, or reorganizations, (4) the dissolution of the corporation, and (5) the filing of a bankruptcy petition.[110] In addition, most communications and visits between the cleared company and the foreign parent must be approved in advance by a proxy holder.[111] The foreign parent is entitled to attend at least one shareholder meeting a year, and nonclassified information related to the financial condition of the cleared company can be shared freely with the foreign parent.[112]

The third, and more commonly used option, is to implement a Special Security Agreement (SSA) or Security Control Agreement (SCA) that (1) imposes substantial industrial security and export control measures within the U.S. company's policies and procedures, (2) necessitates considerable involvement of senior management and board members, and (3) creates a Government Security Committee to monitor the above-referenced policies and procedures.[113] The SSA approach is used when a foreign interest effectively owns or controls the U.S. company, while, in contrast, an SCA is used when the foreign interest is entitled to representation on the governing board without having effective control of the company.[114] Accordingly, a key element of the SSA is the appointment of generally three outside directors to the cleared company's board of directors. The outside directors must be U.S. citizens who are approved by the cognizant security agency and eligible to receive a security clearance.[115]

In general, these types of arrangements preserve the foreign interest's right to board representation. However, the total number of outside directors may not be more than the combined total of independent directors and cleared officer-directors.[116] Therefore, the SSA allows the foreign owner to have a vote on issues coming to the board but gives the outside directors considerable power over actual company management. The key goal, however, is to protect against unauthorized access to classified information.[117]

Importantly, a company under an SSA, unlike a company under a Voting Trust or Proxy Agreement, is still considered foreign owned. A company under an SSA is authorized to have access to "Secret" information; however, to receive a contract at the "Top Secret" level or above, the applicable agency must make a so-called "national interest determination" to justify the award.[118] Having to obtain a national interest determination for certain classified contracts may put a company at a competitive disadvantage if other U.S. companies are available to perform the work.

The final option is a "limited" facility clearance where, in very rare circumstances, the DSS may consider a foreign-owned company eligible for a facility clearance without FOCI mitigation. In these situations, the DSS will impose various access limitations on the company as well as on all of the company's employees (regardless of citizenship).[119] First, a Limited Facility Clearance (LFCL) may be granted when the U.S. Government has an Industrial Security Agreement (ISA) in place with the foreign government of the country from which the foreign ownership is derived. In addition, release of the classified information must be in conformity with the U.S. National

Disclosure Policy.[120] Second, "in extraordinary circumstances," an LFCL may be granted if there is a compelling need to do so consistent with U.S. national security interests, even if there is not an ISA in place. In such a case, the Government customer must provide a compelling need statement to the DSS to justify the facility clearance and verify that access to classified information is essential for contract performance, and the DSS will acknowledge the existence of an LFCL only to that Government customer.[121] In either situation, it is imperative for the contractor to have the support of the Government customer when making a request for a LFCL. Because there is no FOCI mitigation in place, the Government customer has to determine that the release of the classified information, in theory, would be appropriate for release to the foreign government of the foreign parent.

Exon-Florio Process

Over the last several years, a significant development with regard to foreign investment in the United States has been the enactment of the Foreign Investment and National Security Act of 2007 (FINSA), which amended the Exon-Florio Amendment to the Defense Production Act of 1950.[122] Congress passed FINSA in the wake of two highly controversial transactions with companies owned by foreign governments. Specifically, the Chinese Government-owned China National Offshore Oil Corporation (CNOOC) attempted to purchase a large U.S. oil company, and Dubai Ports World (DPW), a company owned by the Government of Dubai in the United Arab Emirates, successfully acquired a United Kingdom company that operated six major U.S. ports.

In 2005, CNOOC attempted to acquire Unocal, a U.S. oil company.[123] The proposed transaction raised concerns regarding the national security implications of a Chinese firm acquiring American energy interests.[124] The public sentiment associated with the deal prompted several members of Congress to call on the President to block the sale.[125] Although CNOOC filed a voluntary notice with the Committee on Foreign Investment in the United States (CFIUS) after it submitted its offer to Unocal, the Committee decided to delay the process until Unocal's board of directors approved the transaction.[126] Ultimately, neither CFIUS nor the President was required to review the proposed transaction because CNOOC eventually withdrew its bid in the face of strong political opposition.[127]

The following year, however, CFIUS reviewed and approved the controversial acquisition of Peninsular and Oriental Steam Navigation Company (P&O), a U.K. company, by DPW, a company owned by the Government of Dubai in the United Arab Emirates.[128] The transaction resulted in DPW operating terminals at six major U.S. ports.[129] Although the ports were already being managed by a foreign company, numerous politicians expressed outrage that an Arab government would be responsible for such critical components of the U.S. economy. DPW responded to the pressure by voluntarily divesting P&O's U.S. assets to American Insurance Group.[130]

The fallout over the DPW transaction convinced many members of Congress that the CFIUS review process under the Exon-Florio Amendment required reform. In particular, some members of Congress were concerned that the review had been conducted by officials who had decided not to initiate a 45-day investigation even though the Department of Homeland Security had reportedly raised security concerns. Congress considered a number of far more restrictive proposals before eventually passing FINSA in mid-2007.[131]

■ Revised Exon-Florio Process

Under the Exon-Florio Amendment, the President is authorized to suspend or prohibit a proposed transaction that could result in control of a U.S. business by a foreign national, government, or entity if, in the President's judgment, there is credible evidence that the investor might take actions that will threaten the national security.[132] The President can also require divestment of a completed acquisition.[133] However, a foreign investor can avoid such a drastic result by taking advantage of a voluntary review process that, if satisfactorily completed, generally gives the buyer a safe harbor to proceed.[134]

Neither the statute, as amended, nor the implementing regulations that took effect in December

2008[135] define the term "national security" and, in fact, both are ambiguous in permitting the President to exercise broad decisionmaking authority.[136] The regulations also fail to specifically define what constitutes "control."[137] As a result, the applicability of the Exon-Florio Amendment is based on a functional approach that looks at each case individually.

CFIUS is the interagency committee responsible for reviewing covered transactions. CFIUS is chaired by the Secretary of Treasury and composed of representatives from the Departments of Commerce, Defense, Energy, Homeland Security, Justice, and State, the U.S. Trade Representative, the Director of the Office of Science and Technology Policy, and the heads of any other executive department, agency, or office that the President or Secretary of Treasury determines to be necessary on a case-by-case basis.[138] The Secretary of Labor and Director of National Intelligence are also designated as nonvoting, ex officio members of the Committee by statute.[139]

The review process can be initiated by either a member of the Committee or voluntarily by the parties to the transaction.[140] Parties to a transaction are not required to file with CFIUS at any particular time, i.e., before or after the transactions closes. However, the President retains complete authority to block a transaction or order a divestment of any assets that may threaten national security until a review has been completed and CFIUS determines that no action shall be taken.[141]

Under the new regulations, a voluntary notice must describe, among other things, the nature and value of the transaction, the assets of the U.S. person being acquired, the business activities of the parties, information concerning contracts relating to products and services relevant to critical technology or infrastructure needs, the foreign person's plans with respect to the U.S. person, and detailed information on the foreign person engaged in the transaction, its corporate parents, and their governing boards and senior officers.[142] All information is treated confidentially and protected from public disclosure except in the case of an administrative action or judicial proceeding.[143]

CFIUS has 30 days to conduct a preliminary review.[144] At the end of that period, it must decide whether to terminate the proceedings or initiate an in-depth investigation.[145] The Secretary of the Treasury and the head of the lead agency are also required to send a certified notice to Congress that describes any actions taken by the Committee to that point.[146] If CFIUS approves a transaction following its preliminary review, the Department of the Treasury will notify the parties of the result and conclude the process.[147]

However, if an investigation is initiated, it must be completed within 45 days.[148] Under the new regulations implementing FINSA, CFIUS must conduct the in-depth investigation if a foreign government is involved or if the foreign person would gain control of certain critical infrastructure, unless the Secretary of the Treasury or the lead agency affirmatively determines that the transaction will not impair national security.[149] If the Committee approves a transaction at this stage, it must provide a detailed report to Congress explaining its rationale.[150]

At the conclusion of its investigation, if the Committee recommends to suspend or prohibit a transaction or it cannot reach a decision, CFIUS must send the matter to the President for a decision.[151] The President must decide whether to exercise his authority to block or unwind a transaction within 15 days of the completion of the investigation and then publicly announce any decision.[152] A determination that a particular transaction poses a threat to national security is not subject to judicial review.[153]

The President has exercised his formal divestiture authority only once since the Exon-Florio Amendment was enacted in 1988. In that case, the China National Aero-Technology Import and Export Corporation (CATIC) acquired MAMCO Manufacturing, Inc., a Seattle, Washington company that fabricated metal parts for aircraft. The transaction closed before the completion of the Exon-Florio proceeding. At the conclusion of the proceeding, the President concluded that CATIC might take action that threatened the national security and ordered CATIC to divest its interest in MAMCO.[154] In all other cases, CFIUS or the President has found no national security threat or, as described above, the threat has been eliminated by action taken by the parties to the transaction.

■ CFIUS' Relationship To The NISPOM

Although the Exon-Florio and FOCI review processes have different time constraints and considerations, they are closely related and often carried out in parallel.[155] For example, if it appears that an agreement to mitigate FOCI terms cannot be reached or the U.S. company fails to comply with its reporting obligations, the cognizant security agency may recommend a full investigation of the transaction to determine the effects on national security.[156] The NISPOM also requires the cognizant security agency to notify CFIUS if it becomes aware of a proposed transaction that should be reviewed and the parties have not filed a voluntary notice within a reasonable time.[157]

Therefore, a company seeking to avoid the more rigorous investigational stage of the Exon-Florio process is advised to take steps early in the transaction to develop a FOCI mitigation plan that is acceptable to the cognizant security agency.[158] As a practical matter, it is prudent to have the FOCI mitigation plan in place at the time the voluntary notice is submitted because of the short timeframes for the review.[159] In some cases, the parties to a transaction have chosen to withdraw their voluntary notice under Exon-Florio and adjust the terms of the deal if CFIUS or the cognizant security agency raised any national security concerns.

■ Annual Report To Congress

CFIUS must submit an annual report to Congress on all of the reviews and investigations of covered transactions completed during the preceding 12-month period.[160] For each matter, the report must include (1) basic information on parties to the transaction, (2) the nature of the business activities or products of all pertinent persons, (3) whether the parties withdrew from the process or filed revised notices, (4) the types of security arrangements and conditions the Committee used to mitigate national security concerns about a transaction, and (5) any decision or action by the President.[161] It must also provide trend information regarding the numbers of filings, investigations, withdrawals, and decisions or actions by the President as well as the business sectors and foreign counties involved in the filings.[162] Finally, the report must provide an evaluation of whether foreign companies or countries are attempting to acquire U.S. companies and trade secrets involved in the development and production of critical technologies.[163]

On November 14, 2008, the Committee sent Congress a classified version of its first annual report since the enactment of FINSA.[164] The public version contains only general trend information and the statutorily required critical technologies analysis.[165] It specifically omitted the table listing the details of the 138 transactions reviewed during 2007 based on the Exon-Florio Amendment's prohibition against the disclosure of confidential information.[166]

GUIDELINES

These *Guidelines* are intended to assist you in understanding and addressing the special issues that arise when mergers and acquisitions involve Government contractors. They are not, however, a substitute for professional representation in any particular situation.

1. Recognize that the negotiation and documentation of a mergers and acquisitions transaction involving a Government contractor requires careful consideration of the various regulatory requirements governing the target contractor and the transaction. Parties should consider the allocation of the regulatory risk in such transactions and implement contractual provisions to address possible developments after an acquisition agreement is signed. Issues around allocation of regulatory risk can be addressed through (a) closing conditions, (b) covenants regarding divestitures and similar actions, (c) termination rights and remedies (including termination fees and cost reimbursement), and (d) indemnification.

2. Remember that the Anti-Assignment Act will not bar the transfer of a Government contract from the original awardee to another party as long as the Government consents to the transfer, either implicitly by ratification or waiver or explicitly through a novation agreement, or where the contract transfers occur "by operation of law."

3. Be aware that application of the "by operation of law" exception to the Anti-Assignment Act, which generally exempts assignments of contracts to statutory receivers and assignees in bankruptcy, as well as transfers that result from mergers, depends on whether the Government continues to deal with the party with which it first contracted (i.e., the same employees, management, and other resources) and whether the only change is a change in ownership of the company's stock.

4. Bear in mind that obtaining the Government's explicit consent through a novation agreement remains the surest way of protecting your contract rights if the transaction does not come within one of the established exceptions. To request a novation agreement in which the Government recognizes the successor in interest to Government contracts, notify the ACO administering the largest unsettled contract balance about the pending acquisition and provide that ACO with all of the documentation specified in the FAR.

5. Even when no novation is required in a stock purchase or merger transaction, if the name of the Government contractor entity is expected to change, notify the ACO administering the largest unsettled contract balance about the pending transaction and name change and submit a complete "Change-of-Name Agreement" package.

6. Make certain that your due diligence review of a proposed merger or acquisition includes careful consideration of any potential organizational conflicts of interests that could disqualify the resulting entity from certain types of Government business. For acquisitions of defense-related businesses, pay careful attention to the new OCI situations that may arise with major defense acquisition programs.

7. Keep in mind that an 8(a) contract must be terminated by the CO for the convenience of the Government if the 8(a) concern to which it was awarded transfers ownership or control of the firm to a non-8(a) entity, unless the Administrator of the SBA waives the termination requirement. An 8(a) contractor may appeal the denial of a waiver to the SBA Office of Hearings and Appeals.

8. When acquiring Government contractors that have received small business set-aside contracts or represented themselves to the procuring agency as a small business concern at time of award of a Government contract, remember to provide the CO for each of those contracts the appropriate size status recertification upon closing the transaction.

9. Recognize that a U.S. contractor's ability to retain its security clearance may be adversely affected if all or a portion of the contractor's ownership is acquired by a foreign entity and the contactor is considered to be under foreign ownership, control, and influence. To maintain a valid security clearance, the foreign company must take steps to mitigate FOCI concerns. The possible mitigation steps depend on the amount of control the foreign entity will have over the U.S. company.

10. Be aware that a proposed foreign investment in a U.S. company may trigger a review of the transaction by the Committee on Foreign Investment in the United States and potentially its blockage by the President under the Exon-Florio process. Consider filing a voluntary notice under Exon-Florio with a proposed mitigation plan and be prepared to adjust the terms of the deal if CFIUS or the cognizant security agency raises any national security concerns.

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2/ See GrantThornton, Current M&A Environment for Government Contractors: 2008 (July 2008), available at http://www.grantthornton.com/staticfiles/GTCom/files/Industries/Government%20contractor/2008M&A_WhiteFinal.pdf.

3/ Houlihan Lokey, "Presentation: New Administration and Economic Crisis— Implication to Corporate Strategy for Federal Contractors " (Apr. 21, 2009).

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5/ 31 U.S.C.A. § 3727(b).

6/ 31 U.S.C.A. § 3727(a), (b).

7/ Centers v. United States, 71 Fed. Cl. 529, 534 (2006) (finding that mortgage lender's assignment of claim against Department of Housing and Urban Development for breach of mortgage insurance contract to lender's former president upon sale of the company violated 31 U.S.C.A. § 3727 as it presented possibility of double claimants and would adversely affect the availability of defenses and setoffs that the Government would have had against the assignor).

8/ 41 U.S.C.A. § 15.

9/ See White, "To Dance With the One You Came With: Federal Government Regulation of Assignments of Contractual Performance," 29 Pub. Cont. L.J. 601, 603 n.11, 620 n.126. (Summer 2000).

10/ See Westinghouse Elec. Co. v. United States, 56 Fed. Cl. 564, 570 (2003), 45 GC ¶ 251, aff'd, 97 Fed. App'x 931 (Fed. Cir. 2004) (concluding that the policy concerns necessitating enactment of the Anti-Assignment Act are implicated in this case because "[h]aving closed out of the…contract with [the original contracting party]…the government now faces additional claims arising under the contract" brought by the party that acquired a portion of the original contracting entity); Johnson Controls World Servs., Inc. v. United States, 44 Fed. Cl. 334, 343 (1999).

11/ 41 U.S.C.A. § 15.

12/ 41 U.S.C.A. § 15(a).

13/ Rochester Gas & Elec. Corp. v. United States, 65 Fed. Cl. 431, 437 (2005) (explaining that the prohibitions of the Anti-Assignment Act will not apply, and the assignment will be valid, if the "government consents to and recognizes the assignment").

14/ See Johnson Controls World Servs., 44 Fed. Cl. at 342 (tracing history of Anti-Assignment Act and discussing development of "by operation of law" exception); see also Thompson v. Comm'r, 205 F.2d 73 (3d Cir. 1953) (extending to 41 U.S.C.A. § 15 a "by operation of law" exception that previously had only been applied to the interpretation of 31 U.S.C.A. § 3727).

15/ Delmarva Power & Light Co. v. United States, 542 F.3d 889, 893–94 (Fed. Cir. 2008), 50 GC ¶ 388 (finding that because the Anti-Assignment Act is for the protection of the Government, the Government may waive application of the Act even when, but for the waiver, the assignment would violate the Act).

16/ Texas Nat'l Bank v. United States, 86 Fed. Cl. 403, 413 (2009) (looking at the totality of the circumstances to determine whether the Government had implicitly waived the protections of the Anti-Assignment Act, including the specific factors set forth in Tuftco Corp. v. United States, 614 F.2d 740, 745 (Ct. Cl. 1980)); Kawa v. United States, 86 Fed. Cl. 575, 591 (2009), 51 GC ¶ 158 (citing Tuftco Corp., 614 F.2d at 745–46). The Tuftco factors ask "whether: (1) the assignor and/or the assignee sent notice of the purported assignment to the Government; (2) the contracting officer signed the notice of assignment; (3) the contracting officer modified the contract according to the assignment; and (4) the Government sent payments to the assignee pursuant to the assignment." Kawa, 86 Fed. Cl. at 591.

17/ See FAR subpt. 42.12; see also L-3 Commc'ns Integrated Sys., L.P. v. United States, 84 Fed. Cl. 768, 776 n.13 (2008) (finding that sale by disappointed offeror (Raytheon) of its business unit that bid on project to L-3, and its transfer of any claims to L-3, occurred "by operation of law," and thus postaward bid protest of L-3 was not precluded by 31 U.S.C.A. § 3727, since transfer was not deleterious to Government's interest).

18/ Westinghouse Elec. Co. v. United States, 56 Fed. Cl. 564, 567, 569 (2003), 45 GC ¶ 251, aff'd, 97 Fed. App'x 931 (Fed. Cir. 2004) (noting that a sale of assets, on its own, does not entitle the purchaser to bring a claim pursuant to a Government contract).

19/ Westinghouse Elec. Co., 56 Fed. Cl. at 570.

20/ See Seaboard Air Line Ry. v. United States, 256 U.S. 655, 657 (1921) (holding that mergers fall within the 31 U.S.C.A. § 3727 "by operation of law" exception); see also Omega Envtl., Inc., ASBCA No. 51639, 99-1 BCA ¶ 30253, 41 GC ¶ 174 (concluding that merger of subsidiary into parent resulted in parent succeeding to the subsidiary's interests, including the subsidiary's interest in claims arising from its Government contract); Hood Lumber Co., AGBCA No. 98-156-1, 99-2 BCA ¶ 30560 (finding that merger of subsidiaries into parent was "not affected by the Anti-Assignment Act").

21/ L-3 Commc'ns, 84 Fed. Cl. at 777 (noting that the exception often arises where the Government contract continues with "essentially the same entity, which has undergone a change in its corporate form or ownership").

22/ L-3 Commc'ns, 84 Fed. Cl. at 776–77.

23/ FAR 42.1204(b).

24/ See Pettibone Corp., ASBCA No. 41073, 91-2 BCA ¶ 23952 (holding that following a merger between Pettibone Corp. and the contract awardee, Pettibone Corp. could file an appeal as the successor in interest to the contract even though the parties did not enter a novation agreement).

25/ See L-3 Commc'ns, 84 Fed. Cl. at 777 (holding that the transfer of claims occurred by operation of law because the asset transferred—an entire business unit—was the same unit that originally possessed the claims for the bid and proposal costs at issue); Johnson Controls World Servs., Inc. v. United States, 44 Fed. Cl. 334, 343 (1999) (finding a transfer was by operation of law, and thus not affected by the Anti-Assignment Act, when the parent transferred the entity performing the Government contract to the parent's subsidiary); Lyons Sec. Servs. Inc. v. United States, 38 Fed. Cl. 783, 786 (1997), 39 GC ¶ 530 (explaining that "where the transfer is incident to the sale of an entire business, the transfer is considered to have occurred 'by operation of law'"); Isotopes, Inc., ASBCA 15663 et al., 74-1 BCA ¶ 10371 (recognizing the right of a successor contractor in a merger to bring a claim under the Contract Disputes Act).

26/ Cockerell & Bartlett, "A Government Contract and Bankruptcy Law Conundrum: Interpretation of the Anti-Assignment Act and Related Matters," 43 Procrmt. Law. 1 (Fall 2007).

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28/ FAR 42.1204(a).

29/ See FAR 42.1204(h)(3).

30/ See FAR 42.1202, 42.1203.

31/ See FAR 42.1204(e), (f).

32/ FAR 42.1204(f).

33/ FAR 42.1204(g).

34/ Premier Sec., Comp. Gen. Dec. B-275908, 97-2 CPD ¶ 15; Sunrise Int'l Group, Comp. Gen. Dec. B-266357, 96-1 CPD ¶ 64; J.I. Case Co., Comp. Gen. Dec. B-239178, 90-2 CPD ¶ 108, 32 GC ¶ 303 (agency properly awarded contract to successor in interest where the original bidder, a wholly-owned subsidiary of the parent-successor, merged with the parent company after bid opening); see also L-3 Commc'ns Integrated Sys., L.P. v. United States, 84 Fed. Cl. 768, 776 (2008).

35/ Consortium HSG Technischer Service GmbH, Comp. Gen. Dec. B-292699.6, 2004 CPD ¶ 134; see also Lyons Sec. Servs. Inc. v. United States, 38 Fed. Cl. 783, 787 (1997), 39 GC ¶ 530; Victorino, Shirk & Kennedy, "Acquisitions & Mergers," Briefing Papers No. 85-9, at 5 (Sept. 1985), 7 BPC 159.

36/ FAR 9.104-1.

37/ See Ionics Inc., Comp. Gen. Dec. B-211180, 84-1 CPD ¶ 290 (indicating that the interests of the Government dictate that the contracting agency be notified of a transfer of an offer).

38/ FAR 42.1205.

39/ FAR 42.1205(a).

40/ See Science Mgmt. Corp. Sys. & Tech. Group, Inc., GSBCA No. 6283-TD, 82-2 BCA ¶ 16039 (concluding that the Anti-Assignment Act is not implicated where, following a merger that results in a change of name, the contractor "survive[s] the merger…leaving unaffected the rights and obligations of the contracting parties").

41/ See FAR 42.1202, 42.1203.

42/ The transaction volume of mergers and acquisitions deals in this sector has doubled since 2001. Berteau, et. al., Ctr. for Strategic & Int'l Studies, Structure and Dynamics of the U.S. Professional Services Industrial Base 1995–2007 (2009).

43/ FAR 9.502(c). See generally Cantu, "Organizational Conflicts of Interest/Edition IV," Briefing Papers No. 06-12 (Nov. 2006); Goddard, "Business Ethics in Government Contracting—Part I," Briefing Papers No. 03-6 (May 2003); Madden, Pavlick & Worrall, "Organizational Conflicts of Interest/Edition III," Briefing Papers No. 94-8 (July 1994).

44/ FAR 9.504(a)(1).

45/ FAR 9.504(a)(2).

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47/ FAR 9.505-1(a).

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52/ Nortel Gov't Solutions, Inc., Comp. Gen. Dec. B-299522.5, 2009 CPD ¶ 10, 51 GC ¶ 58.

53/ Johnson Controls World Servs., Inc., Comp. Gen. Dec. B-286714.2, 2001 CPD ¶ 20, 43 GC ¶ 76.

54/ Alion Sci. & Tech. Corp., Comp. Gen. Dec. B-297342, 2006 CPD ¶ 1, 48 GC ¶ 29.

55/ See, e.g., Biesecker, "Titan's Growth Remains Solid But Large Losses Expected in Second Quarter," Def. Daily, July 12, 2004.

56/ See Calspan Corp., Comp. Gen. Dec. B-258441, 95-1 CPD ¶ 28 (indicating that when evaluating elements of a mitigation plan the "appropriate inquiry concerns the current situation…not speculation regarding past teaming agreement and rumored mergers"). See generally Victorino, Church, Sullivan & Miller, "Antitrust Implications of Defense Industry Business Combinations," Briefing Papers No. 93-7 (June 1993).

57/ See 13 C.F.R. § 121.404(g); FAR 19.301-2.

58/ See FAR subpt. 19.8.

59/ See 15 USCA § 638.

60/ FAR 2.101; see 13 C.F.R. pt. 121.

61/ 13 C.F.R. § 121.404.

62/ See Empire Home Med., Inc., SBA No. 4291, 1998 WL 79209 (Feb. 18, 1998) (firm was properly considered a small business where the firm self-certified itself as small on September 24, but signed merger agreement on October 2); Service Eng'g Co., Comp. Gen. Dec. B-235958, 89-2 CPD ¶ 71 (indicating that the SBA determined firm to be a small business despite its subsequent merger with a large business because its size status as of the date of the self-certification was controlling).

63/ See Castelli & Hemingway, "Hire a Small Business: Perhaps Lockheed or SAIC; Industry Giants Still Eligible for Preferences—For Now," Fed. Times, July 18, 2007.

64/ 68 Fed. Reg. 20350 (Apr. 25, 2003).

65/ 71 Fed. Reg. 66434 (Nov. 15, 2006).

66/ 13 C.F.R. § 121.404(g)(1)–(2).

67/ 13 C.F.R. § 121.404(g)(3).

68/ 13 C.F.R. § 121.404(g)(3)(ii).

69/ 13 C.F.R. § 121.404(g)(3).

70/ 71 Fed. Reg. 66434.

71/ 72 Fed. Reg. 36852 (July 5, 2007).

72/ See Rice, "Government Contractors With Small Business Set-Asides Having Trouble Getting Liquidity, Sources Say," Mergermarket, June 25, 2008.

73/ See 15 U.S.C.A. § 637(a); 13 C.F.R. pt 124; FAR subpt. 19.8.

74/ See 13 C.F.R. § 124.515(a); FAR 19.812(d).

75/ See 13 C.F.R. § 121.103; see also 13 C.F.R. §§ 124.104, 124.105.

76/ 15 U.S.C.A. § 637(a)(21)(A); 13 C.F.R. § 124.515(a)(1); FAR 19.812(d).

77/ 15 U.S.C.A. § 637(a)(21)(D); 13 C.F.R. § 124.515(g).

78/ FAR 52.219-12, para. (b)(4) (standard 8(a) contract clause requiring 8(a) contractor to notify contracting agency of transfer of ownership or control); FAR 52.219-11, para. (f) (clause requiring SBA to notify contracting agency).

79/ See WRS Infrastructure & Env't, Inc. v. United States, 85 Fed. Cl. 442 (2009) (affirming SBA decision giving present effect to a letter of intent and concluding that companies were affiliates at time of signing letter of intent rather than at time of signing purchase agreement).

80/ 15 U.S.C.A. § 637(a)(21)(A); 13 C.F.R. § 124.515(a)(1); FAR 19.812(d).

81/ 15 U.S.C.A. § 637(a)(21)(C)(i); 13 C.F.R. § 124.515(c); FAR 19.812(d).

82/ 15 U.S.C.A. § 637(a)(21)(C)(i); 13 C.F.R. § 124.515(c); FAR 19.812(d).

83/ 15 U.S.C.A. § 637(a)(21)(B)(ii); 13 C.F.R. § 124.515(b)(4).

84/ FAR 19.812(d).

85/ FAR 19.812(d).

86/ FAR 19.812(d).

87/ 13 C.F.R. § 124.515(i).

88/ See 15 USCA § 638.

89/ FAR 52.227-20; DFARS 252.227-7018.

90/ See 13 C.F.R. § 121.702.

91/ See 13 C.F.R. § 121.103(c)(1).

92/ See PriceWaterhouseCoopers, Aerospace & Defence Deals, 2008 Annual Review, Merger and Acquisition Activity in the Global Aerospace and Defence Industry 6–8, 10 (2009), available at http://www.pwc.com/Extweb/pwcpublications.nsf/docid/C74A798FF2D4AC8485257574001DFD14/$File/aerospace_defence_deals.pdf.

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105/ Electronic Facility Clearance and Foreign Ownership, Control or Influence (e-FOCI), DSS Website, https://www.dss.mil (follow the "e-FOCI" hyperlink under the "Applications" button). DSS is in the process of developing its own e-FOCI application with deployment scheduled for late 2009. Id.

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110/ NISPOM § 2-303.b.

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133/ 50 U.S.C.A. app. § 2170(d)(3); 31 C.F.R. § 800.101.

134/ 31 C.F.R. § 800.601; see 50 U.S.C.A. app. § 2170(b)(1)(D)(ii), (iii); 31 C.F.R. § 800.801

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136/ 50 U.S.C.A. app. § 2170; 31 C.F.R. pt. 800.

137/ 31 C.F.R. § 800.204. See 73 Fed. Reg. at 70706–07 (noting that "the regulations provide no ownership threshold or other bright lines above which CFIUS would find control in all circumstances").

138/ 50 U.S.C.A. app. § 2170(k); Exec. Order No. 11858, 40 Fed. Reg. 20263 (1975), as amended by Exec. Order No. 13456, 73 Fed. Reg. 4677 (2008) (requiring that the Director of the Office of Management and Budget, Chairman of the Council of Economic Advisers, and Assistants to the President for National Security Affairs, Economic Policy, and Homeland Security and Counterterrorism observe and report to the President on CFIUS' activities).

139/ 50 U.S.C.A. app. § 2170(k)(2); see also 31 C.F.R. § 800.508.

140/ 50 U.S.C.A. app. § 2170(b)(1); 31 C.F.R. § 800.401.

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160/ 50 U.S.C.A. app. § 2170(m)(1).

161/ 50 U.S.C.A. app. § 2170(m)(2).

162/ 50 U.S.C.A. app. § 2170(m)(2).

163/ 50 U.S.C.A. app. § 2170(m)(3).

164/ Committee On Foreign Investment in the United States Annual Report To Congress Public Version 1 (Dec. 2008), available at http://www.treas.gov/offices/international-affairs/cfius/docs/CFIUS-Annual-Rpt-2008.pdf.

165/ See id. at 3–38.

166/ Id. at 1–2 (citing 50 U.S.C.A. app. § 2170(c)).

BRIEFING PAPERS