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Is it Time to Revisit the *FAR's Novation Process?*

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It has been 15 years since the novation process outlined in the Federal Acquisition Regulation (FAR) was last revised.[1] Those revisions were prompted by the American Bar Association Public Contract Law Section's 1995 request that the government ease novation requirements, and came at a time of increasing consolidation within the defense industry. The last several years have seen a continued trend of mergers and acquisitions involving government contractors, in many cases, increasing the need to novate contracts, or change the name of contractors in connection with an acquisition.

Many contractors now view the FAR's novation process as a costly regulatory burden, which takes too long and imposes unnecessary requirements. In addition, contractors often cannot predict what will be required of them because the uniformity the FAR envisions is jettisoned by agencies and contracting officers who impose demands not specified in the FAR or in any publicly available agency guidance. Thus, perhaps the time has come again to revisit the FAR's novation process.

I. The Current Novation Process

The Anti-Assignment Act prohibits a contractor from transferring government contracts to a third party.[2] Nonetheless, the government may consent to the transfer of government contracts from a contractor to a successor-in-interest when it is in the government's interest and when all assets necessary to perform the contract have transferred to the third party. When a contractor wants the government to recognize a successor-in-interest, the contractor must submit a written novation request to the responsible contracting officer in accordance with the procedures in FAR Subpart 42.12 and by supplying the extensive set of documents specified in the FAR. The FAR also permits the "responsible contracting officer" reviewing the novation package to request any other relevant information to assist in their evaluation of the request. FAR 42.1202 identifies the standards for determining how to

continued on page 15

[1] See 62 Fed. Reg. 64,934 (Dec. 9, 1997).
[2] 41 U.S.C. § 15.

from page 13

identify the "responsible contracting officer (CO)," who is the government official authorized to process and execute novation agreements. FAR 42.1203 then specifies the responsible CO's duties in processing novation agreements.

Until the government novates a contract, the original contractor remains obligated to the government for performance and the contract may be terminated for default if the original contractor does not perform.[3] Thus, the original contractor must rely upon the transferee's performance to ensure the contractual obligations are met until the novation agreement is executed.

II. Flaws in the Current Novation Process and Recommendations for Reform

A. Undisclosed and Unnecessary Documentation Requirements.

Agencies often demand more than the FAR requires prior to novating contracts. One of the noncontroversial changes adopted in 1997 was a revision to the paperwork requirements. The FAR previously required the CO to obtain eight categories of documents that are not generally available until the transaction closes before the successor contractor could be recognized and the novation agreement executed. The final rule altered this requirement by providing that, in order for the successor to be recognized, the contractor need only submit a description of the transaction, a list of affected contracts between the transferor and the government, evidence of the transferee's capability to perform, and any other information deemed relevant.[4] Other documents are to be provided "as [they] become available."[5] However, in practice, the government will not begin to review a novation request until all documents identified in the FAR have been provided, and, in some cases, has rejected a novation request if just one of the documents is missing.

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In addition, in certain situations, government agencies may require the buyer's parent company to guarantee performance of the transferring contracts, even though the buyer guarantees performance in the novation agreement itself. Similarly, when a business converts from a corporation to a limited liability company (LLC), agencies have demanded a novation agreement even though a name change agreement should suffice. Likewise, agencies have demanded documents with original signatures and rejected novation requests when documents are countersigned, even though electronic signatures and countersigned documents are commonplace in the commercial market. These undisclosed requirements are problematic because contractors cannot predict what will be required of them to successfully novate contracts, especially when the demands can vary by agency and by contracting officer.

To provide increased transparency and predictability to the novation process, agencies should be willing to process novation requests upon the submission of documents listed in 42.1204(e). If other documents are or become available, contractors should provide them, or if there is other information necessary to process the request, agencies should immediately request that information. Similarly, every novation requirements should be specified in the FAR. Any added requirements an agency wants to impose should require a notice and

continued on page 16

[3] FAR 42.1204(c).
[4] 42.1204(e).
[5] 42.1204(f).

from page 15

comment process or at least be publicly available. To the extent agencies are encountering transactions, such as corporate conversions, that do not fit squarely within the existing regulatory process, they should consider providing written guidance to contractors on what will be expected of them to recognize the successor entity. Under the current system of approving novations after the transfer has occurred, each of these steps will facilitate the agency's review and accelerate timely novation execution.

B. Decentralizing of the Novation Process.

The FAR centralizes the novation process by making the administrative contracting officer (ACO) or the CO with the largest unsettled balance of contracts the single responsible official for processing and executing all of the novation(s) and subsequently modifying all of the affected contracts. Yet contractors routinely confront federal agencies and COs who want to individually novate contracts. For instance, it is common practice for GSA to require that it be the responsible agency to novate all GSA Federal Supply Schedule contracts. However, for contractors holding multiple Schedules, the General Services Administration Acquisition Manual (GSAM) does not provide any guidance as to which GSA contracting officer will be responsible for processing a novation request. Moreover, contrary to the explicit provisions in the FAR, the GSAM states that contracting officers should process a novation request once a "complete package" is received.

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This decentralizing of the novation process is problematic for two primary reasons. First, agencies vary in the requirements they impose and the length of time it takes them to novate contracts. This not only creates uncertainty for contractors, but in situations where one agency approves a novation request before the other, the government is sending an inconsistent message on who the contractor of record is for the transferred assets. Second, agencies and COs vary in their familiarity with the novation process and associated requirements. Accordingly, contractors are sometimes given differing or inconsistent directions about how to manage novation requests, thereby increasing the cost and frustration associated with the novation process to both agencies and contractors.

Novations should be handled in a uniform manner by agency officials with expertise in the novation process. Officials from DCMA, GSA, and other federal agencies should create a no-

vation working group, with industry input, to address how to most effectively and efficiently process novation requests. One possible solution could be to supplement FAR 42.1202 with more specific instructions as to which agencies are responsible for handling novation requests of specific types of contracts. For instance, there should be more transparency as to the role of GSA vs. DCMA and which contracts and associated orders each agency has authority over. Similarly, there should be more explicit instructions for how contractors should approach agencies with unique authority over contracting matters (e.g., FAA).

C. Timeline for Novation Execution.

In 1995, the FAR Council was informed about the lengthy period of time to complete the novation process. Seventeen years later, the problem persists and perhaps has been exacerbated with the volume of novation requests and limited government resources. Contractors may wait a year, two years, or even longer to have contracts novated. And because the FAR requires contractors to submit post-transfer documents evidencing the transfer of assets, most contractors wait until after the transaction closes before submitting a novation request and government officials are reluctant to approve a novation until most, if not all, of those documents are provided. This creates uncertainty and complexity after the assets are transferred, but before the government approves a novation. As a result, a seller and buyer often execute a subcontract pending novation so that the buyer can perform the contracts and get paid for the work until the contracts are novated. These interim arrangements often drag on for years and can create confusion for government customers.

To eliminate the business uncertainty and potential administrative headaches, the novation decision-making process should be time-limited.

To eliminate the business uncertainty and potential administrative headaches, the novation decision-making process should be time-limited. One potential solution would be to supplement the existing process with an express commitment by the responsible contracting officer to complete the novation review within 75 days of submission of all available information by the transferor and transferee. The Committee on Foreign Investment in the United States (CFIUS) process could serve as a useful model, in which the government has 30 days to review an acquisition that could result in foreign control of a company doing business in the U.S., with an added 45-day review period if needed. In the context of an acquisition requiring a novation, a contractor could file a novation request upon signing the asset purchase agreement and build the time for novation review into the overall closing process which routinely includes gathering other material consents, and potentially other regulatory requirements, such as anti-trust clearance. The responsible contracting officer could ask for additional information within the initial 30 days, and if necessary, extend to an additional review period, to coordinate with other agencies or confirm that all assets necessary to perform the contracts will be transferred to the transferee upon the closing of the transaction. Once approved, the transaction would close and the parties would execute the novation agreement. There are certainly other models to consider, but the original concern regarding the need for "prompt review" remains an issue, and alternatives should be explored to provide a more concrete approval timeline.

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