October 2, 1995

Eleanor R. Spector
Director of Defense Procurement
OUSD (A&T)
Room 3B144
3060 Defense Pentagon
Washington, D.C. 20310-3060

Dear Ms. Spector:

On behalf of the Section of Public Contract Law of the American Bar Association (the "Section"), I am submitting the attached suggested revisions to the current Subpart 42.12 of the Federal Acquisition Regulation concerning novation and related agreements necessitated by changes in a contractor's business form or identity. As you are aware, Department of Defense contractors have been consolidating and restructuring in response to substantial reductions in defense-related procurements, and these downsizing efforts have frequently required Government approval through novation agreements. Because the process of novating contracts has historically been misunderstood, protracted and difficult for both the Government and the parties to the transaction, the Section has adopted proposed revisions to the applicable regulations intended to facilitate the process and provide guidelines for responsible contracting officers while preserving the Government's legitimate interests in business combinations affecting its contracts.

The Section consists of attorneys and associated professionals in private practice, industry and Government Service. The Section's governing Council and substantive committees include members from each of these groups in order to assure the presentation of a balanced point of view. The Section seeks to improve the process of public contracting for needed supplies, services and public works.1

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1 The Section is authorized to submit comments on the acquisition regulations under special authority granted by the Association's Board of Governors. The views expressed herein are those of the Section and have not been approved by the House of Delegates or Board of Governors of the American Bar Association and, therefore, should not be construed as representing the policy of the American Bar Association.
BACKGROUND

In late 1993, the Section initiated a project to revise the current regulations governing transfers of contractor assets pursuant to business combinations in response to the increased pace of defense industry consolidation. The intent of this effort was to propose substantive changes to the existing procedures where specific guidance or improvement was necessary to correct identified problems, as well as to assure that the regulations reflected the actual process being implemented. The project had widespread support and Section members representing Government and private sector views actively participated in developing the proposed revisions to Subpart 42.12.

While it was engaged in the process of formulating specific proposed changes to the FAR, the Section agreed to seek interim relief in the form of a policy letter from the Secretary of Defense. By letter dated May 3, 1994, the Section suggested formal adaptation of certain practices and procedures affecting the downsizing and restructuring of the defense industry, which could be implemented within the framework of the existing regulations. On June 24, 1994, Deputy Under Secretary Longuemare responded to many of the concerns stated in the Section's May 3 letter. However, the Longuemare letter was not a substitute for regulatory change, and the Section continued its effort to reach a consensus on specific improvements to the current regulations.

The attached suggested draft revision to FAR 42.1200 et seq. is the result of a collaborative effort between Government and private sector representatives.

SUMMARY OF CHANGES

Section 42.1203 Processing Agreements

One of the principal concerns with the existing procedures for novating Government contracts raised by representatives from both the public and private sector is the inordinate length of time it frequently takes to complete the process. In many cases contracts are not novated until months after the transaction has closed, thus creating an undesirable period of business uncertainties and administrative problems. Unlike the review period for approving transactions mandated by Hart-Scott-Rodino and Exon-Florio, the current novation regulations implementing the Anti-Assignment Act do not specify a time period in which the Government must decide whether to recognize a successor in interest and novate the contract. Although some members of the Section supported the inclusion in the FAR of a definitive deadline for governmental approval of successors in interest, Government representatives objected to such an amendment. In order to address the concern about protracted decision making, while preserving flexibility for complicated transactions, by consensus, the Section recommends insertion of a new subparagraph which requires prompt action by the responsible contracting officer in identifying and requesting information from the contractor necessary to evaluate the Government's interests, and a prompt decision following receipt of the requested information.
The Section is also concerned with the lack of consistency in processing novation agreements experienced by parties to business combinations. The current regulations provide no guidance or limitations on the appropriate factors that the responsible contracting officer may consider in deciding whether to recognize a proposed successor in interest. In some instances, this lack of guidance has led to abuses of the Government's right to approve a change in contractor. In his letter to the ABA, Deputy Under Secretary Longuemare recognized that the novation process should not be used to exact concessions from contractors or improve the Government's negotiating position with respect to matters covered by other regulations and subject to the disputes process. However, the Section unanimously agreed that inclusion in the regulations of the permissible factors upon which a responsible contracting officer's novation decision may be based will provide more consistency and certainty than an interpretation of the regulations by DoD. Accordingly, the Section recommends the insertion of five new subparagraphs delineating these factors which may be considered by responsible contracting officers in deciding whether to execute a novation agreement.

At the same time, the Section recognized that the Government may have other legitimate concerns arising out of a transfer of contractor assets. For that reason, the Section agreed to a savings provision which specifically preserves the Government's right to use any method other than a change of name or novation agreement available to the contracting officer for resolving such issues. By including this provision, it is the Section's expectation that contracting officers will use this authority to resolve issues independent of the novation agreement, which should eliminate a significant cause of delay and expedite the process of recognizing the successor.

Section 42.1204—Applicability of Novation Agreements

The most controversial aspect of the current novation regulations is the statement of the law authorizing the Government's right to refuse recognition of a successor in interest to a Government contract, and thus the legal authority for the Government's right to demand a novation agreement. As written, Section 42.1204(a) states that 41 U.S.C. 15 prohibits transfer of Government contracts from the contractor to a third party without Government consent. Some members of the Section representing private sector views consider this statement to be an incorrect statement of the law. In their view, the language fails to reflect judicial interpretations of the Anti-Assignment Act which exempt certain transfers from the prohibitions of that statute. Other Section members representing Government views object to any change in the statement of law in Section 42.1204(a). The Section takes no position with respect to whether the regulation is an accurate reflection of the applicable law and the provision remains as it is currently written.

There was also a private sector concern that subparagraph 1204(b), which limits the applicability of novation agreements when a change in ownership of contractor assets results from a stock purchase, fails to address other situations such as business
reorganizations in which a novation agreement should not be required, and that the failure to identify such situations expressly in the regulations could result in unwarranted or improper demands for novation agreements. However, the consensus was to identify only stock purchases as a specific example of situations in which novation agreements are unnecessary.

Far less controversial is the Section’s recommendation to revise the regulations’ current paperwork requirements. As written, the regulations require the contracting officer to obtain eight categories of documents that are not generally available until the transaction closing before he or she can recognize the successor contractor and execute a novation agreement. Because the Government does not generally need these documents to evaluate whether recognition of the successor is in its interest, and a determination to novate the affected contracts prior to the closing provides greater business certainty, reduces disruptions and facilitates the transition, the Section recommends that the contracting officer need only submit a copy of the document describing the transaction, a list of major open contracts, evidence of the transeree’s capability to perform the transferred contracts, and other information relevant to the determination if promptly requested by the contracting officer, in order for the successor to be recognized. The remaining categories of documents concerning the transfer itself are to be provided as they become available. These changes were agreed upon with little discussion.

Finally, the Section suggests insertion of a paragraph requiring the responsible contracting officer to identify and evaluate organizational conflicts of interest during the novation process in accordance with the FAR provisions governing organizational conflicts of interest (Subpart 9.5). Because OCI issues can be very disruptive to business and in some instances may materially affect the transaction, the consensus of the Section was to cross-reference the OCI rules in Subpart 42.12 in order to force resolution of OCI issues early in the business combination approval process.

We thank you for the opportunity to present these suggestions for improving practices affecting defense industry downsizing, and our members are available to discuss the specific proposals at your convenience or provide you with other assistance in achieving these goals.

Very truly yours

Frank H. Menaker, Jr.
Chair, Section of Public Contract Law
SUBPART 42.12 - NOVATION AND CHANGE-OF-NAME AGREEMENTS

42.1200 Scope of subpart

This subpart prescribes policies and procedures for --

(a) Recognition of a successor in interest to Government contracts when contractor assets are transferred;

(b) Recognition of a change in a contractor's name; and

(c) Execution of novation agreements and change-of-name agreements by the responsible contracting officer.

42.1201 Definitions

"Change-of-name agreement" means a legal instrument executed by the contractor and the Government that recognizes the legal change of name of the contractor without disturbing the original contractual rights and obligations of the parties.

"Novation agreement" means a legal instrument executed by (a) the contractor (transferor), (b) the successor in interest (transferee), and (c) the Government by which, among other things, the transferor guarantees performance of the contract, the transferee assumes all obligations under the contract, and the Government recognizes the transfer of the contract and related assets.

42.1202 Responsibility for executing agreements

The contracting officer responsible for processing and executing novation and change-of-name agreements shall be determined as follows:

(a) If any of the affected contracts held by the transferor have been assigned to an administrative contracting officer (ACO) (see 2.1 and 42.202), the responsible contracting officer shall be--

   (1) This ACO; or

   (2) The ACO responsible for the corporate office, if affected contracts are in more than one plant or division of the transferor.
(b) If none of the affected contracts held by the transferor have been assigned to an ACO, the contracting officer responsible for the largest unsettled (unpaid plus billed but unpaid) dollar balance of contracts shall be the responsible contracting officer.

(c) If several transferors are involved, the responsible contracting officer shall be --

(1) The ACO administering the largest unsettled dollar balance; or

(2) The contracting officer (or ACO) designated by the agency having the largest unsettled dollar balance, if none of the affected contracts have been assigned to an ACO.

42.1203 Processing agreements

(a) When a firm performing Government contracts wishes the Government to recognize (1) a successor in interest to these contracts or (2) a name change, the contractor shall submit a written request to the responsible contracting officer (see 42.1202).

(b) The responsible contracting officer shall --

(1) Accurately identify and request the contractor to submit the information necessary to evaluate the proposed agreement for recognizing a successor in interest or a name change. This information should include the items identified in 42.1204(a) or 42.1205(a), as applicable.

(2) Promptly notify each contract administration office and contracting office affected by a proposed agreement for recognizing a successor in interest;

(3) Provide these offices with a list of all affected contracts; and

(4) Request submission within 30 days of their comments, which shall include technical considerations, if appropriate.

(c) [Upon receipt of the necessary data, ] The responsible
contracting officer shall [promptly evaluate the change-of-name request] determine whether or not it is in the Government's interest to recognize the proposed successor in interest on the basis of --

(1) the comments received from the affected contract administration officers and contracting officers (failure to comment by the specified date shall be taken as consent); and

(2) a determination that the proposed successor is responsible under Subpart 9.1, Responsible Prospective Contractors;

(3) The proposed successor's past performance on contracts with the Government, including both negative and positive evaluations or other indicia of the proposed successor's performance;

(4) The proposed successor's ability to continue performance of the contract with the Government, considering, among other things: (i) the qualifications of the proposed successor's key personnel and their availability to perform managerial, administrative, or technical services in the performance of the contract with the Government; (ii) the sufficiency and availability of other resources of the proposed successor that could be utilized in performing the contract with the Government; and (iii) the current financial capability of the proposed successor;

(5) The business integrity of the proposed successor, in the event it involves a change not included within the delegation of responsibility under FAR Subpart 9.1, including compliance with federal and state environmental laws and other laws relevant to the proposed successor's business integrity; and

(6) Any factor relating to the proposed successor's performance of contracts with the Government which the Government determines would impact the proposed successor's ability to perform the contract satisfactorily.

(9) The execution of a retention agreement does not
(d) Before novation and change-of-name agreements are executed, the responsible contracting officer shall ensure that Government counsel has reviewed them for legal sufficiency.

(e) The responsible contracting officer shall (1) forward a signed copy of the executed novation or change-of-name agreement to the transferor and to the transferee and (2) retain a signed copy in the case file.

(f) Following distribution of the agreement, the responsible contracting officer shall:

1. Prepare a Standard Form 30, Amendment of Solicitation/Modification of Contract, incorporating a summary of the agreement and attaching a complete list of contracts affected;

2. Retain the original Standard Form 30 with the attached list in the case file;

3. Send a signed copy of the Standard Form 30, with attached list to the transferor and to the transferee; and

4. Send a copy of this Standard Form 30 with attached list to each contract administration office or contracting office involved, which shall be responsible for further appropriate distribution.

42.1204 Applicability of novation agreements Agreement to recognize a successor-in-interest (novation agreement).

(a) The law (41 U.S.C. 15) prohibits transfer of Government contracts [from the contractor to a third party]. However, [the Government may, when in its interest, recognize a third party as the successor in interest to a Government contract when the third party's interest in the contract arises out of the transfer of (1) all the contractor's assets or (2) the entire portion of the assets involved in performing the contract. (See 14.404-2(k)
for the effect of novation agreements after bid opening but
before award. Examples of novation transactions include but
are not limited to 

(i) Sale of these assets with a provision for assuming
liabilities;

(ii) Transfer of these assets incident to a merger or
corporate consolidation; and

(iii) Incorporation of a proprietorship or
partnership, or formation of a partnership.

(b) A novation agreement is unnecessary when there is a
change in the ownership of a contract as a result of a court
purchase, with no legal change in the contracting party, and
where the contracting party remains in control of the assets and
is the party performing the contract. However, there may be
issues related to the change-in-ownership that should be
addressed in an agreement between the contractor and the
Government.

(c) When it is in the Government's interest not to
concur in the transfer of a contract from one company to
another company, the original contractor remains under contractual
obligation to the Government, and the contract may be terminated
for reasons for default, should the original contractor not
perform.

(d) When considering whether to recognize a third party as
a successor in interest to Government contracts, the responsible
contracting officer shall identify and evaluate any significant
organizational conflicts of interest in accordance with FAR
Subpart 9.2. If the responsible contracting officer determines
that a conflict of interest cannot be resolved, but that it is in the
best interest of the Government to approve the novation
request, a request for waiver can be submitted in accordance
with the procedures contained in FAR section 9.302.

(e) When a contractor asks the Government to recognize
a successor in interest, the contractor shall submit to the
responsible contracting officer three signed copies of the proposed
novation agreement and one


copy each, as applicable, of the following:
A copy of the document describing the proposed transaction, e.g., purchase/sale agreement, memorandum of understanding.

(2) A list of all affected contracts and purchase orders remaining unsettled between the transferee and the Government, showing for each the (i) contract number and type, (ii) name and address of the contracting officer, (iii) total dollar value as amended, and (iv) [approximate] remaining unpaid balance.

(3) Evidence of the transferee's capability to perform.

(4) Any other relevant information promptly requested by the responsible contracting officer.

(5) The transferee shall provide to the responsible contracting officer one copy of each of the following documents as the documents become available:

(1) An authenticated copy of the instrument effecting the transfer of assets, e.g., bill of sale, certificate of merger, contract, deed, agreement, or court decree.

(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) An authenticated copy of the transferee's certificate and articles of incorporation, if a corporation was formed for the purpose of receiving the assets involved in performing the Government contracts.

(5) The opinion of legal counsel for the transferor and transferee stating that the transfer was properly effected under applicable law and the effective date of transfer.

(6) Evidence of the transferee's capability to perform the contracts.
(3) Balance sheets of the transferor and transferee as of the dates immediately before and after the transfer of assets; certified for accuracy by independent accountants.

(4) Evidence that any security clearance requirements have been met.

(5) The consent of sureties on all contracts listed under subparagraph (c)(2) above if bonds are required, or a statement from the transferor that none are required.

(d) When recognizing a successor in interest to a Government contract is consistent with the Government’s interest, the responsible contracting officer shall execute a novation agreement with the transferor and the transferee. It shall ordinarily provide in part that --

(1) The transferee assumes all the transferor’s obligations under the contract;

(2) The transferor waives all rights under the contract against the Government;

(3) The transferor guarantees performance of the contract by the transferee (a satisfactory performance bond may be accepted instead of the guarantee); and

(4) Nothing in the agreement shall relieve the transferor or transferee from compliance with any Federal law.

(e) The responsible contracting officer shall use the following format for agreements when the transferor and transferee are corporations and all the transferor’s assets are transferred. This format may be adapted to fit specific cases and may be used as a guide in preparing similar agreements for other situations.
NOVATION AGREEMENT

The ABC CORPORATION (Transferor), a corporation duly organized and existing under the laws of ____________ [insert State] with its principal office in ____________ [insert city]; the XYZ CORPORATION (Transferee), [if appropriate add "formerly known as the EFG Corporation"] a corporation duly organized and existing under the laws of ____________ [insert State] with its principal office in ____________ [insert city]; and the UNITED STATES OF AMERICA (Government) enter into this Agreement as of ____________ [insert the date transfer of assets became effective under applicable state law].

(a) THE PARTIES AGREE TO THE FOLLOWING FACTS:

(1) The Government, represented by various Contracting Officers of the ____________[insert name(s) of agency(ies)], has entered into certain contracts with the Transferor, namely: ____________[insert contract or purchase order identifications]; [or delete "namely" and insert "as shown in the attached list marked 'Exhibit A' and incorporated in this Agreement by reference."]]. The term "the contracts," as used in this Agreement, means the above contracts and purchase orders and all other contracts and purchase orders, including all modifications, made between the Government and the Transferor before the effective date of this Agreement (whether or not performance and payment have been completed and releases executed if the Government of the Transferor has any remaining rights, duties, or obligations under these contracts and purchase orders). Included in the term "the contracts" are also all modifications made under the terms and conditions of these contracts and purchase orders between the Government and the Transferee, on or after the effective date of this Agreement.

(2) As of ____________, 19__, the Transferor has transferred to the Transferee all the assets of the Transferor by virtue of a ____________[insert term descriptive of the legal transaction involved] between the Transferor and the Transferee.
(3) The Transferee has acquired all the assets of the Transferor by virtue of the above transfer.

(4) The Transferee has assumed all obligations and liabilities of the Transferor under the contracts by virtue of the above transfer.

(5) The Transferee is in a position to fully perform all obligations that may exist under the contracts.

(6) It is consistent with the Government's interest to recognize the Transferee as the successor party to the contracts.

(7) Evidence of the above transfer has been filed with the Government.

[When a change of name is also involved; e.g., a prior or concurrent change of the Transferee's name, an appropriate statement shall be inserted (see example in paragraph (8) below)].

(8) A certificate dated ________, 19__, signed by the Secretary of State of _________ [insert State], to the effect that the corporate name of EFG CORPORATION was changed to XYZ CORPORATION on ________, 19__, has been filed with the Government.

(b) IN CONSIDERATION OF THESE FACTS, THE PARTIES AGREE THAT BY THIS AGREEMENT --

(1) The Transferor confirms the transfer to the Transferee, and waives any claims and rights against the Government that it now has or may have in the future in connection with the contracts.

(2) The Transferee agrees to be bound by and to perform each contract in accordance with the conditions contained in the contracts. The Transferee also assumes all obligations and liabilities of, and all claims against, the Transferor under the contracts as if the Transferee were the original party to the contracts.
(3) The Transferee ratifies all previous actions taken by the Transferor with respect to the contracts, with the same force and effect as if the action had been taken by the Transferee.

(4) The Government recognizes the Transferee as the Transferor's successor in interest in and to the contracts. The Transferee by this Agreement becomes entitled to all rights, titles, and interest of the Transferor in and to the contracts as if the Transferee were the original party to the contracts. Following the effective date of this Agreement, the term "Contractor," as used in the contracts, shall refer to the Transferee.

(5) Except as expressly provided in this Agreement, nothing in it shall be construed as a waiver of any rights of the Government against the Transferor.

(6) All payments and reimbursements previously made by the Government to the Transferor, and all other previous actions taken by the Government under the contracts, shall be considered to have discharged those parts of the Government's obligations under the contracts. All payments and reimbursements made by the Government after the date of this Agreement in the name of or to the Transferor shall have the same force and effect as if made to the Transferee, and shall constitute a complete discharge of the Government's obligations under the contracts, to the extent of the amounts paid or reimbursed.

(7) The Transferor and the Transferee agree that the Government is not obligated to pay or reimburse either of them for, or otherwise give effect to, any costs, taxes, or other expenses, or any related increases, directly or indirectly arising out of or resulting from the transfer or this Agreement, other than those that the Government in the absence of this transfer or Agreement would have been obligated to pay or reimburse under the terms of the contracts.¹

¹ Contractors currently have the option of including the following language in the (b)(7) clause of novation agreements associated with the transfer of DoD contracts. When the final DFARS rule on restructuring costs is issued, the language will be
(8) The Transferor guarantees payment of all liabilities and the performance of all obligations that the Transferee (i) assumes under this Agreement or (ii) may undertake in the future should these contracts be modified under their terms and conditions. The Transferor waives notice of, and consents to, any such future modifications.

(9) The contracts shall remain in full force and effect, except as modified by this Agreement. Each party modified in accordance with the final rule.

(i) Except as set forth in subparagraph (7)(ii) below, the Transferor and the Transferee agree that the Government is not obligated to pay or reimburse either of them for, or otherwise give effect to, any costs, taxes, or other expenses, or any related increases, directly or indirectly arising out of or resulting from the transfer or this Agreement, other than those that the Government in the absence of this transfer or Agreement would have been obligated to pay or reimburse under the terms of the contracts.

(ii) The Government recognizes that restructuring by the Transferee incidental to the acquisition/merger may be in the best interests of the Government. Restructuring costs that are allowable under Part 31 of the Federal Acquisition Regulation or Part 231 of the Defense Federal Acquisition Regulation Supplement (DFARS) may be reimbursed under flexibly-priced novated contracts, provided the Transferee demonstrates that the restructuring will reduce overall costs to the Department of Defense (DoD) and/or the National Aeronautics and Space Administration (NASA), and the requirements included in DFARS 231.205-70 are met. These costs and the contracting parties' responsibilities shall be addressed in a Memorandum of Understanding to be negotiated between the cognizant contracting officer and the Transferee. The Memorandum of Understanding will specify the types and treatment of restructuring costs and the methodology to be used to demonstrate reduced costs to DoD and/or NASA. Restructuring costs shall not be allowed on novated contracts unless there is an audit of the restructuring proposal; a determination by the contracting officer of overall reduced costs to DoD/NASA; and an Advance Agreement setting forth cost ceiling amounts on restructuring projects and the period to which such costs shall be assigned.
has executed this Agreement as of the day and year first above written.

UNITED STATES OF AMERICA,

By__________________________________________

Title________________________________________

ABC CORPORATION,

By__________________________________________

Title________________________________________

[CORPORATE SEAL]

XYZ CORPORATION,

By__________________________________________

Title________________________________________

[CORPORATE SEAL]