Overview

- Government contractors are subject to statutory, regulatory and contractual obligations that pose unique business risks
- Due diligence involving a government contractor in an M&A setting requires attention to a range of industry-specific issues to identify and mitigate post-transaction risks
- In conducting due diligence, a Buyer should request and expect to receive detailed information about a Seller’s government contracting activities
- Transactions involving a government contractor will typically involve standard representations and warranties (“R&W”) regarding the Seller’s government contracting activities
Unique M&A Risks

- Due to the regulated nature of the industry, government contractors have potential operational risks and hidden liabilities that do not exist in the commercial market:
  - Potential civil and criminal penalties for non-compliance with contractual, statutory or regulatory requirements
  - Long-term revenue/valuation projections are challenging due to favorable government termination rights, short-term contract structure and funding profiles, and budget uncertainty
  - Government audit rights pose risk of retroactive cost/price adjustments
  - Mandatory reporting obligations and whistleblower risks heighten need to address potential compliance problems proactively to avoid harsh suspension/debarment risks

- Government contractor due diligence focuses on assessing these risks
Background: A Heavily Regulated Industry

- Federal procurement is subject to myriad statutes and regulations that impact business, *e.g.*:
  - Competition in Contracting Act (41 USC § 3301)
  - False Claims Act (31 USC § 3729, et seq.)
  - False Statements Act (18 USC § 1001)
  - Truth in Negotiations Act (now Truthful Cost or Pricing Data) (10 USC § 2306a)
  - Ethics & Procurement Integrity Rules
    - Anti-Kickback Act (41 USC § 8701, et seq.; FAR 3.502)
    - Procurement Integrity Act (41 USC § 2101; FAR 3.104)
    - Code of Ethics, Compliance Program, and Mandatory Disclosure Rules (FAR 52.203-13)
  - Various socio-economic policies and implementing rules
    - Equal employment obligations
    - Minimum wage and benefit rules (Service Contract Act, Davis Bacon Act, etc.)
    - Small and Disadvantaged Business contracting requirements
Government contractor performance and compliance risks are heightened due to:

• Increasing Transparency
  – Freedom of Information Act; FAPIIS, SAM, FPDS and FedSpending public databases; mandatory disclosure obligations; whistleblower protections

• Increasing Oversight
  – IG subpoenas; DOJ investigations; Congressional & GAO audits/reports; DCAA and DCMA audits & reviews

• Increasing Enforcement
  – False Claims Act exposure; suspension/debarment; business systems withholdings; Department of Labor actions
Background: Unique Operational Risks

Government contractors are also subject to operational challenges that are unique from the commercial space, *e.g.*:

- Funding limitations
- Termination principles
- Bid protests
- Restrictions on eligibility
- Subcontracting, teaming & joint venture issues
- Changes
- Audit exposure

- Cost contracting issues and certifications
- Intellectual Property rules
- Requests for equitable adjustments, claims & disputes process
- Security clearances
- Organizational conflicts of interest
- Past Performance
Transaction Reps & Warranties

- Transactions involving government contractors will typically include special “Government Contracts” R&Ws addressing industry-unique issues described below
  - The R&Ws are often heavily negotiated between the parties and tailored to address unique issues that arise during due diligence
  - R&Ws can be used to shift post-transaction risk to the Seller regarding latent performance and compliance problems that due diligence does not uncover
    - Breaches of R&Ws often tied to Seller indemnities, R&W insurance, escrowed purchase price, or earn-outs that shift financial risk to Seller
    - If Seller can negotiate “knowledge of the seller” qualifications, it can reduce the risk of warranting the unknown

- R&Ws are often accompanied by detailed schedules of material contracts and contract-related data
  - Disclosure schedules are a key source of due diligence information
  - Transaction leverage may dictate scope and extent of R&Ws and disclosure schedules
Transaction Reps & Warranties

Standard government contract issues that are addressed in R&Ws include the following areas (subject to scheduled exceptions):

- Contract backlog amount
- No performance breaches or pending terminations on material contracts
- No notice of government intent to not exercise contract options
- No notice of intent to renegotiate lower contract pricing or rates
- No incurred costs have been disallowed or are subject to an advance agreement
- No liquidated damages being paid or are reasonably expected to be owed
- No prior terminations for default or adverse past performance evaluations
- Adequacy of business systems & no notice of significant deficiencies
- Compliance with statutes and regulations governing government contractors, including ethics & integrity, export control, etc.

- All statements, certificates, certifications, invoices and other submissions in connection with government contracts have been current, accurate and complete
- No pending or anticipated cure notices, show cause notices, or stop work orders
- No contracts subject to set-off, recoupment or withholding
- No pending audits, claims, disputes, litigation or investigations
- No set of facts that could reasonably give rise to False Claims Act liability, TINA price adjustments, or defective pricing claims
- No OCIs related to current contracts
- No non-responsibility determinations, suspension, debarment or administrative agreements for Seller or key personnel
Due Diligence Documentation

Government contractor due diligence typically involves access to standard documentation, including:

- Current contracts, task and delivery orders, including modifications (may require gov’t consent to provide to third parties)
  - Note: Although the parties may agree to limit the scope of contracts to only “material” contracts, even comparatively “small” contracts can pose outsized compliance risks, such as suspension/debarment, False Claims Act liability, etc.
- Contract backlog estimates and new business pipeline projections
- Management reports or baseline reviews for key programs
- Audit reports, mandatory disclosures, and documents related to ongoing protests, claims, or other litigation
- Forward pricing rate agreements or advance agreements on costs
- Major subcontracts and/or vendor agreements
- Documents related to seller’s internal controls, business systems and reviews
- Company compliance plans, code of ethics, and training materials
- Standard licenses or data rights assertions for key IP
Assessing Contractor Responsibility

- The government may conduct business only with contractors who are deemed responsible, and may not deal with suspended/debarred contractors (FAR 9.103)
- An initial due diligence step includes verifying contractor’s qualifications as a responsible contractor
  - System for Award Management (www.sam.gov)
    - Information confirming a company’s registered DUNS and CAGE codes
    - Current suspension/debarment records
    - SAM consolidates capabilities previously provided by CCR/FedReg, ORCA and EPLS databases
  - Federal Awardee Performance & Integrity Information System (www.FAPIIS.gov)
    - Information on previous terminations, non-responsibility determinations, and other responsibility information
- Standard R&Ws will typically include affirmations that Seller:
  - Has not been found to be non-responsible in any matter in previous 3-5 years
  - Is not currently suspended or debarred and has no notice of any pending action
  - Does not know of any suspension/debarment actions of key management in personal capacity
Assessing Outstanding Proposals

- Assess the number of proposals and nature of programs that the Seller is competing to win:
  - Does Seller have capability to perform the work if it wins the contract(s)?
  - Are outstanding proposals consistent with the company’s projected pipeline of new work, business model, and revenue projections?
  - Does pipeline of work consist of winning new contracts, or new orders under existing contracts?

- Potential contract value
- Type of contracts (i.e., cost-reimbursable or firm-fixed price)
  - Potential for cost overruns or losses on FFP contracts
- Unusual/non-standard representations or certifications
- Unusual or potentially high-risk clauses
  - E.g., T&M rate or other cost/indirect rate “caps” or challenging award fee or performance criteria that could cause financial pressure; unfavorable indemnifications or high liquidated damages provisions that pose out-sized financial risks, etc.
- Potential organizational conflict of interest risks with buyer’s contracts
Validating the “Backlog”

- Many Sellers will provide a Buyer with a “backlog” report of remaining funding on existing contracts
  - Typically captures all active/current contracts, including contract value, year-to-date revenue, remaining contract funding, and remaining contract ceiling
  - Representative of seller’s anticipated revenue stream from existing contract inventory, and often key to the buyer’s valuation

- Backlog estimates may need to be discounted to account for risk associated with:
  - Ability to earn future orders on IDIQ contracts, especially where there are multiple awardees competing for orders
  - Likelihood of earning revenue associated with unexercised options
  - Likelihood that incrementally-funded contracts and those approaching a funding ceiling will continue to receive funding
  - Negative trends affecting future revenue, such as performance problems or deductive changes reducing scope of work
  - Contract terminations (convenience or default) due to performance-related issues or changes in government programmatic objectives

- Some Buyers may require a backlog “guarantee” that establishes a minimum revenue benchmark from the current backlog
Assessing Current Contracts

- Due diligence should include a review of as many current/active contracts as practical under the circumstances
  - Includes both contracts issued directly by the government, and subcontracts issued by higher-tier government contractors
- Parties may negotiate more limited review based on agreed standard of “materiality”
  - Materiality may be based on dollar value, customer, type of work/program, etc.
- For material contracts to be reviewed, seller typically furnishes copies of base contract and all modifications
  - Buyer may also require additional “contract file” documentation including any correspondence, changes, etc.
- Contract review focuses on contract administration, financial and performance issues
Basic Contract Administration Issues

- Number and type of contracts
  - Periods of performance, including structure/timing of options
  - Contract types (FAR Part 16)
    - E.g., cost, firm fixed price, T&M, etc.
  - Number and value of orders (if IDIQ or multiple order)

- Contract funding or financial risks
  - Fixed price contracts in or nearing “loss position” where contractor’s costs exceed contract price
  - Work being performed “at risk” on cost-reimbursable contracts where costs are incurred above current funding on contract in anticipation of future funding modifications
  - Fixed price development contracts where contractor bears open-ended price risk to overcome technical challenges

- Terms of any small business set-aside awards and impact of transaction on ability to continue performing, receiving options, and competing for new task/delivery orders
Other Contract Administration Issues

- Assess potential risk associated with unusual terms that could shift contract risks or costs
  - Liquidated damages clauses and the likelihood that any damages will be owed
  - Extended warranties or unique quality/performance guarantees
  - Indemnification agreements or clauses
  - Multi-year T&M or indirect rate ceilings, or other contractual cost/price discounts & adjustments
  - Special provisions re option exercise or termination

- Assess transactional risks associated with clauses that require notice and/or approval of change in ownership
  - In addition to standard novation process outlined in FAR Subpart 42.12
Potential Contract Administration Risk “Warning Signs”

- Seller lacks complete contract file, has material gaps in documentation, or is reluctant to furnish documentation
- Seller lacks centralized contract management structure, systems, personnel and procedures or manages contracts on *ad hoc* basis
- Seller lacks institutional knowledge/understanding of unique or high-risk clauses in contracts
- Seller routinely works “at risk” without contract funding and lacks adequate internal “at risk” approvals/controls
- Seller has multiple fixed-price research & development contracts
Assessing Contract Performance

- Due diligence should probe the quality, timeliness, and status of Seller’s performance on current/recent contracts
  - Buyer will typically require R&Ws regarding adverse performance
- Performance problems can lead to breach or other liquidated damages, termination, poor past performance evaluations, decisions not to exercise options, etc.
- Cure notices, show cause notices, stop work orders, and deductive changes may be obvious signs of risk
  - Due diligence should focus on seller’s response and resolution
- Many potential sources of performance info:
  - Program management reports and other program and/or internal tracking reports
  - Government audit reports
  - Past performance and award fee evaluations
Changes

- Formal procedures regarding changes outlined in FAR Part 43 and Changes Clauses
  - Government may make unilateral changes within scope of contract
    - Changes must be issued/ratified by contracting officer with actual authority to change contract
  - Contractor generally required to continue performing, even if change disputed
  - Contractor required to provide notice of any changes w/in 30 days

- Contractor should have processes in place to document changes and separately account for cost/schedule impacts

- Due diligence should assess the existence of directed or constructive changes and their cost, schedule and financial impacts
  - High frequency of changes, especially constructive changes, can signal a project in flux or heightened risk that changes will go uncompensated or be subject to litigation
  - Review documentation re change orders and contractor notice to government of any constructive changes that will have material cost/schedule impact

- If Buyer has or will submit a request for equitable adjustment (REA) or claim for changes, due diligence should assess the merits of entitlement and quantum arguments and likelihood of litigation success
  - There may be additional revenue risks if Seller has already “booked” revenue related to a change or a pending REA or claim
  - Potential fraud counterclaim risks if claims include false statements/certifications
# REAs vs. Claims Procedural Overview

<table>
<thead>
<tr>
<th></th>
<th>REA</th>
<th>Claim</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Nature</strong></td>
<td>Often initial step of the claim process. Less formal. Allows for negotiation of adjustment before a formal dispute arises</td>
<td>Normally appropriate when parties are in dispute</td>
</tr>
<tr>
<td><strong>Decision Maker</strong></td>
<td>Contracting Officer</td>
<td>Contracting Officer</td>
</tr>
<tr>
<td><strong>Decision Time Frame</strong></td>
<td>None</td>
<td>Within 60 days, CO must render final decision or state when a final decision will be rendered</td>
</tr>
<tr>
<td><strong>Interest</strong></td>
<td>None</td>
<td>Starts with submission of claim (41 U.S.C. § 7109; FAR 33.208)</td>
</tr>
<tr>
<td><strong>Appeal Process</strong></td>
<td>None, but REA may be converted to a claim; claims subject to 6-year statute of limitations on claim submission</td>
<td>File appeal with cognizant Board of Contract Appeals or U.S. Court of Federal Claims; strict timeframes for appeals</td>
</tr>
<tr>
<td><strong>Certification</strong></td>
<td>DoD REAs must be certified. DFARS 252.243-7002. Misstatements can result in penalties, fines, criminal liability. See False Statements Act and False Claims Act</td>
<td>CDA claims must assert a written demand for payment as a matter of right; claims &gt; $100,000 must be certified. Misstatements can result in penalties, fines, criminal liability. See False Statements Act and False Claims Act</td>
</tr>
<tr>
<td><strong>Preparation Costs</strong></td>
<td>Professional expenses for legal and accounting services (FAR 31.205-33)</td>
<td>None (FAR 31.205-47)</td>
</tr>
</tbody>
</table>
Claims & Disputes

- Due diligence should assess all potential or pending REAs, claims and other contract disputes
  - Assess merits of entitlement & quantum arguments
  - For claims not already submitted, determine who will be able to certify the claim and the process in place to determine that claim data is current, accurate and complete

- Potential risk factors include:
  - Six-year statute of limitations on any claims
  - Waiver/release language in contract modifications or contract close-out documentation that would negate a claim
  - Revenue recognition on pending claims/REAs, in event that litigation does not yield revenue already recognized
  - Government counterclaims, including fraud counterclaims for false statements in contractor claim

- The government may also assert claims against a contractor for late/defective performance, defective pricing, etc.
  - Buyer should assess any outstanding government claims and inquire about potential government claims that could be asserted on any current contracts
  - Buyer may require standard R&Ws regarding potential government claims
Risks Related to Prior Contracts

- Depending on transaction structure, Buyer may acquire risks from Seller’s prior contracts
  - Negative past performance evaluations and default terminations affect future competitions
  - Outstanding disputes related to prior work could result in government claims, False Claims Act liability, etc.

- Contract closeout process can affect buyer:
  - Waivers/releases can limit future claims
  - Incurred cost audits & final rate negotiations can trigger retroactive payment adjustments

- Buyer will typically require standard R&Ws regarding prior contract performance and closeout risks
Small Businesses & Set Asides

- Acquisitions involving small businesses pose unique risks to be assessed during due diligence
- Contracts awarded to a small business may be at risk if contractor would no longer qualify as a small business after transaction
  - SBA rules require recertification of size status following a change in ownership (13 C.F.R. § 121.404(g)), preventing agency from receiving credit toward its small business contracting goals on future orders & options
  - Although the agency generally has the option to continue contract performance, several factors could affect that decision:
    - Agency’s small business goals & impact of contract on meeting goals
    - Uniqueness of work provided by contractor versus other potential small businesses (i.e., can the contractor be replaced with another small business)
- Contracts awarded as small business set asides could be at risk of agency not exercising options, or contractor prevented from competing for new orders
  - Some IDIQ set aside contracts require contractors to recertify size status in connection with each task or delivery order competition
- What is Seller’s business plan to compete for new work?
  - If a Seller will no longer qualify for small business set asides or qualify toward an agency’s (or prime contractor’s) small business goals, how will it compete in full and open competitions?
Subcontracts, Teaming Agreements & Joint Ventures

- A Seller’s contractual relationships with other companies to perform government contracts should also be assessed for, e.g.:
  - Exclusivity and non-compete provisions
  - Other unusual terms, conditions, or restrictions
  - Adequacy of description of scope of work between contractors
  - Any terms guaranteeing workshare or revenue percentages
  - Change in ownership notice/approval requirements
  - Existence of potential breach events
- The subcontract review process should also include the Seller’s internal processes/procedures to select subs & vendors:
  - Status of contractor purchasing system and any approvals/reviews
  - Adequacy of FAR “flowdown” clauses in subcontractor/vendor agreements
- The Buyer should attempt to identify any key or essential subcontractors or teammates that are required to successfully perform work
  - Assess likelihood or risk of losing any key subcontractors and the potential impact on contract performance
CFIUS Requirements for Foreign Buyers

- Significant changes in 2018 in disclosure and approval process for transactions involving foreign entities via Committee on Foreign Investment in the United States (CFIUS)
  - Foreign Investment Risk Review Modernization Act of 2018 (Secs. 1701-28 of the National Defense Authorization Act (NDAA) for Fiscal Year 2019)
  - Implementing regulations effective Nov. 10, 2018
- Mandatory declarations required for acquisitions of a substantial interest in any company dealing with critical technology, critical infrastructure, or personal data, by a foreign person in which a foreign government holds a substantial interest
  - Authorizes CFIUS to require the submission of declarations for covered transactions involving critical technology companies
  - Penalties for non-compliance
- Significant CFIUS filing fees (up to $300,000)
- Expanded mitigation and enforcement authority
Due Diligence Challenges Involving Classified Contracts

- If Seller has classified contracts or performs work requiring security clearances, there are additional due diligence challenges
  - Restrictions on access to classified information
  - Facility and personnel security clearance requirements for Buyer and Buyer’s management
  - Notification requirements for change in ownership, change in management, and any potential foreign ownership/control interest (FOCI) situation

- Security guidelines imposed by National Industrial Security Program Operating Manual (NISPOM)
  - Publication DoD 5220.22-M
  - DOD, CIA, NRC, DOE
    - Other federal agencies administered by DOD
  - Administered by the Defense Security Service (DSS)
Practical Due Diligence Challenges Involving Classified Contracts

- At a minimum, the following business issues should be covered during due diligence:
  - Number, scope and value of classified contracts
  - Number of cleared employees, and at what levels, including any designated key management personnel
- Additional compliance obligations may require data room disclosures and special reps & warranties
  - Briefing & training materials, policies, procedures
  - DSS audits & any notices of security compliance deficiencies
  - Reports of any noncompliance or adverse events, including reports for employees
  - Compliance with NISPOM change-in-ownership reporting obligations
- Restrictions on access to information can complicate a full vetting process:
  - NISPOM 5-511 limits scope of information that can be disclosed to “the public”
  - Seller may typically disclose fact that contract has been received; general subject matter; method or type of contract; and total contract value
  - However, other case-by-case restrictions may apply if contract involves “special access programs” or other unacknowledged programs, if the subject matter is classified, or if the contract value could reveal classified information regarding scope or quantities
  - Legal & financial advisors with security clearances who can be cleared to material programs are invaluable
The Buyer is typically required to have appropriate corporate facility and personnel clearances if it will acquire classified assets, hold Seller as new subsidiary or merge Seller into Buyer’s corporate structure.

- **Facility Clearance (FCL), NISPOM 2-100**
  - Administrative determination that a company is eligible for access to classified information
  - Parent/Subsidiary Clearances (NISPOM 2-109)
    - General rule: Parent must have same or higher FCL as a subsidiary
    - Case-by-case exceptions may be available through negotiation with DSS

- **Personnel Clearance (PCL), NISPOM 2-200**
  - Corporate security officer and senior management official are required to hold clearance at or above level needed for any classified contracts
  - Other senior officials may need clearances or be subject to formal “exclusion” procedures outlined in NISPOM 2-106

- **Approved storage capability & facility**
  - If Seller is required to generate and store classified information at its own facility, additional security protocols must be met
Reporting Changed Conditions Affecting the Facility Clearance

- Change in **ownership**, including stock transfers that affect control of the company (NISPOM 1-302(g)(1))
- Change to **key management personnel**, including PCL status of successors (NISPOM 1-302(g)(3))
- Material change concerning any **foreign ownership, control or influence** (FOCI) (NISPOM 1-302(g)(5))
  - “When entering into discussions, consultations or agreements that may reasonably lead to effective ownership or control by a foreign interest, the contractor shall report the details by letter.”
- Other reporting obligations involving adverse events or potential security compromises
Foreign Ownership, Control, Influence

- FOCI rules mitigate risk of unauthorized access to classified information
  - FOCI exists “whenever 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 adversely affect the performance of classified contracts.” NISPOM 2-300(a)

- FOCI factors considered in aggregate
  - Source, nature and extent of foreign ownership
    - Majority or substantial minority position
    - > 5% ownership or > 10% voting interest
  - Nature/record of foreign interest and its government

- FOCI restrictions: “A U.S. company determined to be under FOCI is ineligible for an FCL unless and until security measures have been put in place to negate or mitigate FOCI.” NISPOM 2-300(c)
  - Mitigation techniques (NISPOM 2-303) can include a Board resolution, voting trust or proxy agreement, or a Special Security Agreement (SSA) or Security Control Agreement (SCA)
  - Level of mitigation often depends on degree of effective ownership/control
Organizational Conflicts of Interest

- OCIs exist where a contractor plays two or more roles that conflict with one another

- Two primary OCI risks in due diligence:
  - **Transaction risk:** conflicts between Buyer’s and Seller’s contract portfolios could prevent Buyer from acquiring or performing certain contracts
  - **Business risk:** Buyer’s or Seller’s existing portfolio could prevent parties from pursuing business plans for certain work in the future

- FAR 2.101 (definition) and FAR Subpart 9.5
  - Three “types” of OCIs: impaired objectivity; biased ground rules; and unequal access to information
  - Bid protest caselaw plays significant role in shaping interpretation and application of regulations
OCI Risk Factors

- Certain types of contracts/work involve heightened OCI risks:
  - Contracts with OCI clauses prohibiting specific work
  - Management support, consultant or other professional services efforts may involve heightened OCI risk (FAR 9.502(b))
  - Systems engineering and technical assistance contracts
  - Contracts to prepare system or product specifications, or otherwise develop work statements to be used in future procurements are high risk if the contractor supplies goods/services in that sector (FAR 9.505-2)
  - Providing evaluation services (FAR 9.505-3)
  - Any contract where a contractor receives a vendor’s or competitor’s proprietary information, or agency source selection information has high OCI risk (FAR 9.505-4)

- Although the regulations do not address risks posed by former Government employees, they can pose risks similar to those in unequal access to information OCIs
  - Risk exists where former government employee had access to proprietary or source selection sensitive information that creates competitive advantage in new competition
OCI Due Diligence

- OCIs can have significant business consequences:
  - Affect business decisions about work or lines of business to pursue
  - Efforts to avoid, neutralize or mitigate OCIs can require significant contract administration and management oversight
  - Bid protest exposure

- Due diligence effort required to assess the nature and scope of work Buyer and Seller perform (or plan to perform) in overlapping industry segments
  - Possible for “new” OCIs to emerge out of a business combination, when Seller’s contracts are added to Buyer’s portfolio
  - Often requires contract-by-contract assessment by Buyer/Seller management teams to identify risk areas
    - May require parties to establish firewalled “clean teams” to mitigate informational risks
  - May require notification to, and guidance from contracting officer to avoid, neutralize, mitigate, or waive potential conflicts
  - If conflicts are unavoidable, the contracting officer may require Buyer to:
    - Divest certain contracts or lines of business causing OCI
    - Terminate contracts as last resort
Code of Ethics & Compliance Programs

- FAR 52.203-13 imposes ethical and procedural obligations that should be assessed in due diligence:
  - Maintain a written code of business ethics & conduct
    - Required to be distributed to contractor employees
  - Exercise diligence to prevent and detect criminal conduct & promote ethical conduct/culture
    - *i.e.*, the ethical “tone at the top”
  - Timely disclose, in writing, any of the following related to award or performance of gov’t contracts or subcontracts:
    - (a) violations of law involving fraud, conflict of interest, bribery, or gratuity violations in Title 18
    - (b) False Claims Act violations
    - (c) significant overpayments
  - Maintain ongoing business ethics awareness and compliance program and internal control system
    - Includes periodic employee training program
    - Must include an internal reporting tool, such as a hotline, that allows for anonymous or confidential reporting of wrongdoing
    - Small businesses and commercial item contractors excepted (but still subject to other obligations above)

- FAR 52.203-14 requires contractor to display fraud hotline poster that identifies internal reporting tools

- Failure to comply with mandatory reporting obligations can be basis for suspension/debarment
Code of Ethics & Mandatory Reporting Due Diligence

- At a minimum, Buyer should review Seller’s company code of ethics, any employee codes of conduct, and all training materials
  - Assess extent to which materials cover unique government contracting ethical and compliance obligations
  - Review training records to verify that all employees received initial and “refresher” training and new hires receive training during HR intake
  - Determine whether Seller has experienced any compliance-related problems, and assess corrective action steps that were implemented
- Request and review all recent hotline reports and investigation reports (if any)
  - Verify that hotline posters are properly displayed to employees
- Review and assess all mandatory disclosures (if any)
  - Scope of disclosure and reported wrongdoing
  - Agency’s response and any follow-up or corrective actions
- Standard R&Ws will frequently include commitment that Seller has not failed to disclose or report any mandatory disclosure event
Hiring Former Government Employees

- Former government employees pose a range of compliance risks for a contractor
- “Rovolving Door” restrictions can prevent certain government officials from working on certain matters (18 U.S.C. 207)
  - Lifetime restriction for matters in which the employee had “personal and substantial” participation
  - Two-year ban for matters in which the employee had “official responsibility”
  - One-year ban for certain senior personnel
  - Restrictions limit ability for employee to make representations back to Government or agency, but may permit “behind the scenes” work
    - BUT even “behind the scenes” work prohibited for high level military and DOD officials
- DOD requires certain senior government officials to obtain ethics opinion letters prior to receiving any compensation from a new contractor employer (74 Fed. Reg. 2408 (Jan. 15, 2009))
- Former government employees with access to proprietary or source selection sensitive information could give rise to OCI-like unfair competitive advantage in new procurement
  - See, e.g., HealthNet Federal Services, LLC, B-401652.3, Nov. 4, 2009 (GAO)
Hiring Former Government Employees

- Due diligence best practice is to review hiring practices & HR records for former government employees

- Assess whether the Seller consistently obtains copies of ethics opinion letters from qualified ethics officer for all former government employee hires
  - Ethics opinions and HR files should outline scope of future restrictions
  - Seller and employee should adhere to restrictions and not place employee in position to violate restrictions

- Assess steps Seller takes to formally firewall former government employees from bid/proposal efforts related to employee’s government work
  - Many companies overlook risk of unfair competitive advantage based on information to which former government employees may have had access
Bribery, Gifts & Gratuities

- **Federal law prohibits bribery and improper gifts & gratuities to federal officials**
  - **Bribery, 18 U.S.C. § 201:** It is a federal crime to give *anything of value* to a public official with specific intent to influence an official act or induce the public official to commit fraud or violate an official duty.
  - **Gifts/Gratuities, 18 U.S.C. § 201:** It is a federal crime to give, promise or offer a public official *anything of value* for or because of an official act performed or to be performed by such public official.
    - *E.g.*, meals & entertainment; tickets to sporting events; golf rounds, transportation, etc.
    - Exceptions for refreshments/snacks, items with little intrinsic value (plaques & certificates), or gifts within the “20/50” rule - *i.e.*, less than $20 per gift, with a $50 aggregate annual limit for gifts from one corporation

- **Many standard commercial sales practices can violate these restrictions, increasing compliance risks for contractors**

- **Due diligence should assess Seller’s written policies & procedures and employee training as measure of compliance**
Anti-Kickback Act

- The Anti-Kickback Act (41 U.S.C. § 51) makes it a federal crime to give anything of value to any prime contractor or subcontractor for the purpose of improperly obtaining or rewarding favorable treatment in connection with a U.S. prime contract or subcontract
  - Restrictions extend to relationships between private companies.
  - Contractor has an affirmative disclosure obligation any time it has reasonable grounds to believe the company, a subcontractor, or an employee has violated the Act. FAR 3.502-2.

- Many standard commercial sales practices can be construed as potential “kickbacks” in the federal market, increasing compliance risks for contractors
  - “Referral fees,” broker fees and success fees
  - Rebates or volume-based discounts not passed on to the Government
  - “Reward” or “incentive” programs involving cash payments/prizes or other valuable incentives such as meals, entertainment, clothing, transportation, lodging, vacations, gift cards, etc.

- Due diligence should focus on sufficiency of employee training, sales practices & tactics, and any unique sales referral, reward, or incentive programs
Cybersecurity

- Cyber is a growing area of compliance risk for government contractors
- Many contractor cyber obligations are contract-specific, and must be determined on a contract-by-contract basis
  - Contracts likely to pose greatest risk include those involving access to personally identifiable information (PII) or sensitive government information
  - Any contract that requires contractor IT system to connect to a government IT system/network likely to include heightened cybersecurity protocols
  - Contracts for development, testing, operations & maintenance of government IT systems/networks involve heightened compliance risks
- New rules impose technical, operational & training requirements, as well as mandatory disclosure obligations for cyber breaches
  - DFARS 252.204-7012, Safeguarding Unclassified Controlled Technical Information
    - Imposes ~ 50 minimum data security safeguards for DOD technical data with military/space applications
    - Includes 72-hour mandatory reporting requirement for breaches
  - DOD Instruction 8582.01, Security of Unclassified DOD Information on Non-DOD Information Systems (June 6, 2012) is often incorporated by reference into DOD contracts and imposes basic IT safeguarding requirements
- Expect expanded DOD obligations and similar requirements for civilian agency contracts
Cybersecurity Due Diligence

- Assess whether Seller’s DOD contracts include DFARS Clause 252.204-7012 and whether performance involves any covered “unclassified controlled technical information”
  - If so, determine what steps Seller has taken to implement the security protocols outlined in the rule, or whether the Seller has obtained any waivers from the contracting officer

- Assess whether Seller’s contracts include other cybersecurity requirements, which are often incorporated by reference into Section H or the statement of work
  - Confirm whether Seller’s IT systems and protocols comply with these requirements
  - Identify potential “gaps” in requirements vs. capabilities

- Identify any non-standard or burdensome default, indemnification, or liquidated damages provisions tied to cyber breaches
  - E.g., obligations to provide credit monitoring or other payments in event of cyber breach involving PII

- Assess Seller’s IT compliance training materials and rigor of basic IT/network security protocols, such as use of encryption, user ID/password integrity, etc.

- Assess any known cyber intrusions/breaches involving Seller’s IT systems & networks and any related disclosures made to the government

- Buyer may insist on R&Ws to cover Seller’s compliance with cyber requirements and risk of any cyber breaches
Supply Chain Integrity

- Government contractors are coming under increased scrutiny for supply chain integrity and avoiding/eliminating counterfeit parts in government systems
- DOD contractors & subs required to implement risk-based procedures to detect & avoid counterfeit electronic parts (DFARS 252.246-7007)
  - Clause applies only to CAS-covered prime contractors, but is a mandatory flowdown clause to all subcontractors
  - Establishes a dozen “minimum systems criteria” that a contractor’s risk-based detection and avoidance system must address
  - Contractor’s counterfeit detection & avoidance system may be subject to review during purchasing system audits
  - Costs of any counterfeit electronic parts, and any rework needed to remove/replace counterfeits, are expressly unallowable
  - Mandatory reporting of counterfeit or suspect counterfeit parts and quality escapes
  - Procedures to retain counterfeit and suspect counterfeit parts for inspection/investigation
  - Procedures to screen GIDEP reports and avoid use and delivery of listed items
Supply Chain Due Diligence

- Contractors subject to these rules should have conducted and documented internal risk assessments to determine scope of processes/procedures they need to implement
- Contractor purchasing systems should include documented policies/procedures for reducing/eliminating risk of counterfeit parts in supply chain
- Due diligence should focus on the scope and thoroughness of contractor self-assessments, policies, procedures, and any adverse reports or events
  - DCMA reviews & reports on purchasing systems
  - GIDEP or other reports by Seller disclosing instances of counterfeit or suspect counterfeit parts
  - Procedures for screening GIDEP reports
  - Extent to which Seller’s supply chain relies on non-OEM or OEM-approved sources for parts, spares and components
  - Purchasing system procedures in place to use “trusted vendors” or to authenticate potential new sources of supply
  - Procedures for detecting counterfeit parts, such as testing or visual inspection, from secondary “gray market” or other potentially high-risk sources
- Buyer may require R&Ws to protect against risk of future “rework” costs that could be imposed to replace counterfeit electronic parts under DFARS 252.246-7007
IP & Data Rights

- Government contractors subject to unique allocation of IP rights
  - Patents, copyrights, trademarks & trade secrets
  - Technical data and computer software
  - Contract clauses may convey greater rights to government than traditional commercial contracts
- Government IP and data rights outlined in FAR Part 27, DFARS Part 227, and related contract clauses
- In general, government rights in technical data and computer software determined by source of funding
  - Unlimited Rights – item/software developed exclusively with U.S. funds
  - Government Purpose Rights – item/software developed with mixed funds
  - Limited/Restricted Rights – item/software developed exclusively at private expense
- Restrictions on government’s rights not self-executing
  - Contractor must identify all technical data/computer software provided with less than Unlimited Rights
  - Contractor must mark delivered data with restrictive legends
IP & Data Rights Due Diligence

- Assess IP/data rights clauses incorporated into key contracts and identify any non-standard terms/conditions

- Identify key IP, technical data or computer software that Seller owns/develops that is material to future business
  - Understand funding used to develop IP and extent to which Government may have obtained unlimited rights

- Evaluate Seller’s procedures for asserting data rights restrictions on IP developed at private expense or with mixed funding
  - Does Seller have sufficient understanding and expertise to avoid “traps for the unwary” regarding data rights allocation?
  - Confirm that Seller uses appropriate restrictive markings on data deliverables to preserve any data rights assertions
  - In cases of mixed funding, assess Seller’s documentation supporting private investment
  - In case of product modifications developed at government expense, confirm that Seller has adequately segregated and marked any pre-existing technical data for the unmodified item previously developed at private expense
Cost Accounting Issues

- Cost-reimbursable contracts (including incentive fee contracts) may be subject to retroactive cost adjustments:
  - Periodic incurred cost and/or contract close-out audits will review cost allowability and allocability
    - Government has broad audit rights under FAR 52.215-2
    - Audits may also take place in connection with terminations, claims, REAs, etc.
    - Cost Accounting guidelines in FAR Part 31 regulate allowability
    - Some contracts subject to Cost Accounting Standards – costs must comply with CAS and be accounted for consistent with established/disclosed accounting practices
  - Unallowable costs charged improperly to a contract (as direct costs) or to an indirect cost pool (e.g., overhead or G&A) may be reversed
  - Cost-type contracts negotiated with provisional or estimated fringe benefit, overhead, or G&A cost rates may be “trued up” after award/performance

- Due diligence risks related to pending or post-closing government audits & claims must be assessed for:
  - Retroactive cost adjustments based on overpayments; government can take several years to complete incurred cost or contract close-out audits
  - Cost adjustments based on changes to a contractor’s disclosed accounting practices, or contractor cost allocations that are inconsistent with contractor’s disclosed accounting practices
Contractor Business Systems

- Some contracts subject to one or more business system requirements
- “Business Systems Rule” can lead to contract payment withholdings for inadequate business systems
  - Inadequacies based on “Significant Deficiencies,” defined to include “shortcoming in the [business] system that materially affects the ability of [DoD officials] to rely upon information produced by the system that is needed for management purposes”

- “Contractor Business Systems” include six systems (and subsystems):
  - Accounting System; Earned Value Management System; Estimating System; Material Management and Accounting System; Property Management System; Purchasing System
  - Each system must meet various minimum standards/requirements

- Cost-type contracts subject to withholdings if adverse audit findings and contracting officer determinations
  - Up to 10% for significant deficiencies in multiple business systems
  - Up to 5% for significant deficiencies in a single business system

- Rigorous process for responding to adverse audit findings and implementing corrective action plans
Contractor Business Systems

- Due diligence should assess integrity of Seller’s business systems, including:
  - Results of internal business system audits/reviews
  - Results of any DCMA (for Purchasing, EVMS and Property) or DCAA (for Accounting, Estimating, MMAS) audits
  - Notices of any “approved” systems or reports identifying any “significant deficiencies”

- Due diligence should assess status of any withholdings:
  - Contracting Officer “initial determinations” of significant deficiencies & contractor’s responses
  - Contracting Officer “final determinations” on any withholdings, including amounts and subject contracts
  - Contractor “corrective action plans” and status of approval/implementation
Truthful Cost or Pricing Data (previously Truth in Negotiations Act (TINA))

- When it applies, TINA requires contractor to submit cost or pricing data to Government and certify that it is current, accurate and complete as of date of price agreement
  - TINA applies to negotiated prime contracts and contract modifications over $2M
    - May also apply to subcontracts if prime contract covered by TINA
  - There are many TINA exceptions, including awards based on adequate price competition and commercial item procurements, and waivers are available
  - FAR 52.215-20 and 52.215-21
- Cost or pricing data includes all facts that a prudent buyer or seller would reasonably expect to have significant effect on price negotiations
  - Examples could include historical costs, vendor quotes, nonrecurring costs, unit cost trends, labor and overhead cost efficiencies, etc.
- Defects or omissions in cost or pricing data submitted to Government can lead to government claims for retroactive price adjustments
- Defective pricing claims can also be a prelude to fraud/False Claims Act investigations
TINA Due Diligence

- To assess the risk of TINA defective pricing claims, a Buyer should identify all contract awards and modifications that were subject to TINA when issued
  - Rule of thumb is to review info dating back at least 6 years, corresponding to the statute of limitations period in CDA
  - Longer period may be prudent in light of alternative SOLs for fraud and False Claims Act cases
- Review all TINA certifications and supporting data for material contracts
  - Review the Seller’s estimating procedures for developing pricing proposals
  - Assess the Seller’s procedures for performing cost/pricing data “sweeps” prior to certification date to ensure data being certified were current, accurate and complete on that date
  - Evaluate the knowledge/education of senior leadership and any company official who signed certifications
- Identify and determine status of any defective pricing audits
Labor Law Compliance

Unique labor laws and regulations apply to government contractors, requiring focused due diligence:

- Service Contract Act
- Davis-Bacon Act
- Fair Labor Standards Act
- E.O. 11246 (Equal Employment)
- E.O. 13658 (Contractor Minimum Wage)
- Occupational Safety and Health Act
- Migrant and Seasonal Agricultural Worker Protection Act
- National Labor Relations Act
- Americans with Disabilities Act
- Vietnam Era Veterans’ Readjustment Act
- Family and Medical Leave Act
- Title VII of the Civil Rights Act
- Age Discrimination in Employment Act
- State-law “equivalents” to the prior 13 laws, regulations, and EOs
- FAR subparts 22.12, 22.17, 22.19
- Section 503 of the Rehabilitation Act of 1973
Labor Due Diligence: Recent Trends

- Buyers should give extra scrutiny to a Seller’s compliance with existing and emerging labor requirements
- Increased DOL enforcement of EEO requirements increases risk of adverse findings and penalties
  - Seller should have well-organized recordkeeping procedures to track data and enable responses to audits
- Increased DOL enforcement involving Service Contract Act compliance has increased risk of adverse findings re SCA-covered contracts
  - If Seller performs service contracts subject to SCA, assess SCA compliance protocols, including wage and fringe benefit payments and record-keeping
- Contractor Minimum Wage
  - Covered contractors must pay minimum wages ($10.60 for 2019) to workers directly performing covered contracts (mostly services and construction) and to workers who indirectly support covered contracts for at least 20% of their time. FAR 52.222-55
- Gender Identity/Sexual Orientation Non-Discrimination
  - Non-discrimination requirements for contractors and subs. FAR 52.222-26 (Equal Opportunity)
- Employment-Data Collection; Pay Transparency
  - Non-discrimination against employees/applicants who inquire about or disclose compensation information. FAR 52.222-26
Export Controls and Restrictions

- U.S. government contractors are subject to regulations on the transfer of U.S. goods, technologies, or services to foreign countries, entities and end-users
  - International Traffic in Arms Regulations (ITAR)
    - Section 38 of Arms Export Control Act (22 U.S.C. 22778)
    - Administered by State Department’s Directorate of Defense Trade Controls (DDTC)
  - Export Administration Regulations (EAR)
    - 15 CFR Chapter VII, Subchapter C
    - Administered by Commerce Department’s Bureau of Industry and Security (BIS)
  - Sanctions - Multiple sanction laws
    - E.g., Cuban Assets Control Regulations, 31 CFR Part 515
    - Administered by Treasury Department’s Office of Foreign Assets Control (OFAC)
- Jurisdiction can extend to U.S. persons and U.S.-origin goods, services, and technology, wherever located
- Covers certain transfers to foreign persons of technology, services, and technical assistance, regardless of where the transfer takes place
Export Controls Due Diligence Issues

- Assess whether Seller manufactures or trades in covered goods, furnishes restricted services, or develops restricted technologies, *e.g.*:
  - Defense Articles (U.S. Munitions List, 22 CFR Part 121)
  - Defense Services involving assistance or data related to design, engineering, development, testing, operation, etc. of Defense Articles
  - Other technology or technical data subject to EAR

- Review international operations (sales, supply, product development, brokering, etc.) to identify relevant country/product issues

- Verify Seller’s ITAR & EAR registrations, licenses, and other agreements permitting foreign sales and transfers
  - Annual recordkeeping and registration requirements

- Assess scope of Seller’s internal export control expertise, compliance procedures and training
  - Procedures in place to prevent foreign nationals access to controlled items and technology
  - IT/network access restrictions
Investigations & Litigation

- Due to the heavily regulated nature of the government contracting industry, contractors are subject to potential audit or investigation by multiple different entities, e.g.:
  - Contracting Officer and government audit agencies (i.e., DCAA and DCMA)
  - Agency Inspectors General (IG) and Suspension and Debarment officials
  - Department of Justice, Congress, and GAO
  - Department of Labor, Small Business Administration, and other agencies

- Subpoenas, investigations, and document production may relate to:
  - Contract performance or general compliance issues
  - Potential civil liability or criminal charges
  - Private False Claims Act litigation involving *qui tam* relators

- Investigations could include potential violations of any of the compliance issues addressed in previous slides

- Active investigations and subpoenas represent significant business risk and must be thoroughly vetted during due diligence
  - Buyer may require escrow for potential fines, penalties and legal/litigation costs related to ongoing or pending investigations
Investigation Risks

- In addition to potential contract claims by the Government, investigations can signal more severe/significant liabilities

- **Suspension/debarment:** Under FAR Subpart 9.4, an agency has authority to suspend or debar a contractor in public interest
  - Precludes Government from awarding new contracts or extending performance of existing contracts and applies government-wide
  - Contractors proposed for suspension/debarment may need to enter into resource-consuming and business-limiting “Administrative Agreements” with the agency as a condition of avoiding suspension/debarment

- **False Claims Act:** The Government or an individual *qui tam* relator (suing on behalf of the Government) can pursue treble damages and penalties for a contractor’s knowing submission of false claims for payment
  - False claims liability has become a broad enforcement tool for Government in connection with any false or fraudulent contract submissions that can be tied to contract payments
  - Failures to comply with contract requirements, false certifications, and violations of other compliance obligations have been construed by DOJ as false claims
  - Carries both criminal and civil liability
  - In addition to severe financial penalties, False Claims Act conviction or civil judgment may be additional basis for debarment

- Standard R&Ws should address suspension, debarment and False Claims Act risks
Acquisition of Businesses and Technology Developed With Federal Funding

William C. Bergman
Federal Government Is Largest Funder of Basic Research

• The federal government is the largest funder of basic research ($36.9 billion), and is the primary driver of both innovative research and the training of the science, technology, engineering and mathematics (STEM) workforce.

• The business sector accounted for $22.7 billion.
Federal Government Encourages Businesses to Monetize Its R&D

• E.g., Small Business Innovation Research (SBIR) and Small Business Technology Transfer (STTR) programs involve three phases of funding that are designed to develop and commercialize technology

• "R&D -- basic, experimental and applied -- is the fuel that drives American business. Our ability to turn basic and experimental research results into practical applications is the stuff of legends."
  – Vinton Cerf, National Science Board member and Vice President and Chief Internet Evangelist at Google
Issues Arising in Acquisition of Tech Developed With Government Funding

• Unique due diligence issues arise, including:
  – Government Contracting Issues.
  – Security Restrictions on Access to Technology.
  – Export Controls on Technology.
  – Cybersecurity.
  – CFIUS (Committee on Foreign Investment in the U.S.).
  – Antitrust.
Due Diligence Issues Relating to Intellectual Property - Overview

- Has target complied with relevant government requirements as they relate to intellectual property?
  - Effect of failure to comply with statutes and regulations
  - Failure to comply can potentially have harsh consequences

- Ownership of IP rights relating to technology developed with federal funding
  - Patent rights, copyrights and trade secrets (data rights)
  - Identification of rights and effect of government interests in IP
Why the Government Is Different

• Contracting
  • Based on FAR and its supplements.
  • Limited negotiation.
  • Government policy is to typically let contractor retain ownership of IP but takes a license in it.

• Enforcement of IP Claims against the Government
  • Government has sovereign immunity unless waived.
  • Most IP Claims against the Government must be brought in the Court of Federal Claims.
Sample Government Contract Regulations Relating to IP

- FAR Parts 27 and 52-227 Govern IP Rights Under Civilian Agency Contracts.
- DFARS Parts 227 and 252.227 Provide Supplemental Terms Applicable to IP Under DOD Contracts.
- Other Agencies – NASA, GSA, DHHS, DOE, DOT, DHS, among others, provide additional supplemental conditions.
- Bayh-Dole Act, 18 U S C. §§ 200-212 (invention rights), 37 CFR 401 et seq. and related Executive Orders.
Patent Rights - Subject Inventions

• Subject Inventions
  • any invention of the Contractor made in the performance of work under the contract (FAR 52.227-11).

• “[W]ith respect to any subject invention in which the Contractor retains title, the Federal Government shall have a nonexclusive, nontransferable, irrevocable, paid-up license to practice or have practiced for or on behalf of the United States the subject invention throughout the world.”
  • FAR 52.227-11(b); 35 USC § 202(c)(4)
Potential Loss of Patent Rights If Subject Invention Not Disclosed

• Contractor must timely disclose subject inventions to government
  • Loss of ownership if not disclosed or not timely disclosed, *Campbell Plastics Engineering & Mfg., Inc. v. Army*, 389 F.3d 1243; 73 USPQ2d 1357 (Fed. Cir. 2004) (Must use DD Form 882)

• Contractor must elect to claim ownership
  • If elected, must incur cost of patents and maintenance

• Contractor must commercialize invention (35 U.S.C. § 203), submit commercialization reports (FAR 52.227-13) and manufacture invention in the United States (35 § U.S.C. § 204)
Patent Rights-Background Inventions

- Background Inventions
  - Invention that is made before contract award, developed at contractor expense

- Oftentimes the government may require a contractor to identify background inventions as part of the contract award process

- Failure to identify background inventions may give rise to claim by government that it has rights in the invention
Data Rights-Definitions

• “Data” is defined as “recorded information, regardless of form or the media on which it may be recorded”; includes technical data and computer software FAR 27.401, FAR 52.227-14

• “Technical Data” is recorded information of a scientific or technical nature, but does not include computer software FAR 2.101, 52.227-14; DFARS 252.227-7013 (similar)

• “Computer Software” is defined as computer programs that allow a computer to perform a specific operation, source code listings, algorithms—does not include computer databases or computer software documentation FAR 2.101, 52.227-14; DFARS 252.227-7013 (similar)
Government’s Rights in Data

• “Unlimited rights” (FAR/DFARS) – government has unrestricted use (can share with anyone)
  – Data/software first produced/developed exclusively with government funds
  – Form, fit and function data

• “Limited rights” – For data other than software—generally cannot disclose outside of government
  – Data developed at private expense
  – Data embodies proprietary information
  – Data must be properly marked
Government’s Rights in Data

• “Restricted rights” (FAR/DFARS) – For software, government gets one active copy, one backup, access by support contractors.
  – Software developed at private expense must be trade secret or copyrighted and properly marked.

• “Government Purpose Rights” (DFARS) – For tech data and software, data can be used within government and outside government if for government purposes.
  – Data developed with mixed funding; government gets unlimited rights after five years or other period.

• SBIR rights are yet another flavor and apply to data developed under SBIR contracts.
Due Diligence Regarding the Government’s Rights in Data

- It is important to understand what types of data rights may apply to any technology being acquired in an acquisition and evaluate the effects.
- In order to do this, the relevant government contracts under which the data/software was developed must be reviewed.
- Unlimited rights effectively allow the government to give the data/software away to the public, including your competitors.
  - The determination is made at the lowest segregable component level.
  - Failure to appropriately mark data may also cause a contractor to lose data rights.
Government Push to Use Open Source IP and Retain Greater IP Rights

In evaluating the data rights and patent rights, the Government will use information in the proposal to assess the extent to which the rights in technical data (TD), computer software (CS), computer software documentation (CSD), and inventions/patents offered to the government ensure unimpeded, innovative, and cost-effective production, operation, maintenance, and upgrade of the [SYSTEM NAME] throughout its life cycle; allow for open and competitive procurement of [SYSTEM NAME] enhancements; and permit the transfer of the [SYSTEM NAME] non-proprietary object code and source code to other contractors for use on other systems or platforms.

- OSA Contract Guidebook v.1.1, p. 71-72
Open Source Software and Data

- Government contractors may use open source software and may even be encouraged to do so.

**Pros**
- Free, low cost
- Encourages others to build upon past work

**Cons**
- Open source licenses can be complicated, and an unwitting contractor can lose valuable IP rights by intermingling open source code with its own.
- Critical part of due diligence is to confirm that rights of target are not lost due to sloppy implementation of open source software.
IP Claims Against the Government

• If the technology being acquired was developed for the government, purchasers often want to know what happens if the government infringes on IP rights that the government did not legitimately acquire pursuant to contract.

• Patent and copyright infringement.
  – 28 U.S.C. § 1498(a) and (b) authorize private parties to sue the United States for patent and copyright infringement
  – Suit must be brought in Court of Federal Claims (the “People’s Court”)

• Trademark infringement.

• Misappropriation of trade secrets.
  – Breach of Contract, 5th Amendment Takings (Fed Claims)
  – Tort (District Court)
Court of Federal Claims
“The People’s Court”

- Article I Court located in Washington, D.C.
- Established in 1855 to hear monetary claims against the U.S. government.
- Bench trials in which the government is always a defendant.
- Hears patent, copyright, bid protest, breach of contract, tax refund, 5th amendment takings, Indian claims, vaccine claims, etc.
Government Assumes Liability for Contractor Infringement

• 28 U.S.C. § 1498 states that work performed by government contractors and subcontractors during the course of the contract is considered as “use or manufacture” by the government itself.

• The government effectively assumes liability for any infringing acts committed by its contractors or subcontractors occurring during the performance of government contract work.


• Effect of this is that only the government can be sued for infringing IP, and competitors can only be enjoined for commercial sales of infringing products.
Potential Security Restrictions on Access to Technology

• Many different levels of security restrictions.

• National Security Information ("Classified").
  – Confidential, Secret, Top Secret
    • NATIONAL SECURITY INFORMATION, Executive Order 12356, April 2, 1982

• FOUO, Agency and Government Contractor Only, ITAR, etc.

• DOE has its own security restrictions.
Due Diligence Issues Relating to Classified Technology

- Has target been adhering to security guidelines?
- Performing due diligence on classified aspects of deal may be difficult.
  - It is a crime to make an unauthorized disclosure of classified information
  - In some instances contracts themselves may be classified
  - Only individuals with requisite security clearance and a “need to know” can be granted access
- Target may need to maintain a facility clearance.
  - Cannot simply relocate target assets
- Key employees of target with security clearances may need to be retained after deal closes.
  - Cannot simply substitute new employees
- CFIUS issues more likely.
- May need to spinoff classified aspects of target.
Due Diligence Issues Relating to Restricted Technology

- Even though information is not “classified” by the government, it may be subject to other security restrictions.
- For Official Use Only (FOUO), Agency and Government Contractor Only, ITAR, etc.
- Due diligence issues similar to classified subject matter may arise.
  - Has target been following appropriate security guidelines?
  - Limited access to key documents possessed by target
  - Target assets may not be so easily transferred or integrated with purchaser assets, including computer networks and data
  - Key personnel may need to be retained after deal closes
- Effect of restrictions on sales of acquired technology?
Due Diligence Issues Relating to Export Controlled Technology

• International Trafficking in Arms Regulations (ITAR).
  – Limits export of defense and military-related technologies and enforced by Department of State
  – Cannot export any goods or information subject to ITAR restrictions
  – In general, access to ITAR-restricted information is limited to U.S. citizens unless permission is obtained from DoS
  – Placing information on a computer network that can be accessed by non-U.S. citizens is considered an “export” and would be a violation of ITAR if the information was ITAR restricted
  – Has target been complying with ITAR?
• Effect of ITAR on sales of acquired technology?
Due Diligence Issues Relating to Export Controlled Technology

• Export Administration Regulations (EAR)
  – Found at 15 C.F.R. § 730 et seq. and administered by the U.S. Commerce Department.
  – Additional regulations governing whether something may be exported from the U.S.; the EAR apply to commodities as well as technology and software
  – Has target been complying with EAR?

• Effect of EAR on sales of acquired technology?
Evaluating the Effects of Government Security Restrictions on Acquisitions

• In general, sales of technology to U.S. government market should not pose a problem.
• Government security restrictions are often limited to the government’s particular application of a technology.
  – E.g, it is only the military’s particular use of artificial intelligence software that has restrictions on it
• Contracts and technical documents will often specify what aspects of the technology are restricted.
  – Some portions of the work may be restricted while others are not
• It will often be possible to separate out the unrestricted aspects of technology developed with government funding and commercialize it.
Due Diligence Issues Relating to Cybersecurity

• Government focus on requiring its contractors to maintain appropriate cybersecurity measures has been increasing

• The Federal Acquisition Regulation (FAR) includes a basic safeguarding clause, FAR 52.204-21
  – DoD contractors may be subject to DFAR 252.204-7012, which requires higher NIST pub. 800-171 standards

• Has target been following appropriate cybersecurity guidelines?

• Cannot simply assume that computer networks and data of target can be merged with or connected to purchaser networks