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## Top Five (5) Concerns Selling or Acquiring an Entity with Government Contracts

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by Kelly F. O'Donnell

Contract review is one of the most onerous (and important) processes in any due diligence process when buying or selling a company. We all know that those contracts are the backbone of many businesses- they document the relationships and operations of the business and are often the value of what a buyer is purchasing. This review process can get complicated when the selling entity has government contracts that may be governed by special rules known as the Federal Acquisition Regulations System (“FAR”). FAR was established to set forth uniform policies and procedures for acquisition by all executive branch agencies.

Individual agency acquisition regulations may implement or supplement FAR, in addition to internal agency guidance. For example, the Department of Defense has certain certification requirements in order to establish security clearance for defense contracts. FAR reminds contractors that the government is acting on behalf of the American taxpayer in procuring goods and services for government agencies, and the individual contract officers act on behalf of the government to ensure that each contract benefits the government.

Buyers, sellers and their advisors should address government contracts as early in the diligence process as possible in order to expedite any required changes which might delay closing. In addition to a careful review of the contract terms and any specific agency regulations, below are just a few of the considerations:

1. **Address novation early.** In an asset purchase, all contracts being purchased need to be assigned to buyer. Government contracts subject to FAR cannot just be assigned, the government requires what is called a novation. A novation is a three-way amendment to the contract entered into by buyer,

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seller, and the government that replaces the original contract. In order to request a novation, seller must submit a written request to the government contracting officer. The government contracting officer must then go through an internal process (including a 30-day wait) to evaluate whether it is in the government's interest to recognize buyer as a successor in interest to seller. If approved, seller will prepare a novation agreement using the government's form which will require that buyer accept all of seller's liabilities under the contract and ratifies all actions taken by seller. Seller will be required to guarantee buyer's performance under the contract as it exists and as it may be amended. Parties should budget at least 45 days for the novation process, and more if there are additional requirements. It is important to remember that the government is under no obligation to consent to a novation, so addressing the process early and openly is paramount.

2. **Ensure buyer is qualified.** Government contractors must meet certain requirements to be eligible for government contracts. For example, contractors must generally be United States entities and cannot be owned by certain foreign persons. In many strategic acquisitions, buyer is already a government contractor qualified through the System for Award Management ("SAM") registry. If buyer is not already qualified in SAM, then buyer will need to take steps to become qualified with the government prior to the transaction. This will include diligence on buyer's ownership, parent company, and other relationships the government deems relevant to confirm that buyer can satisfactorily perform under the contracts. The government may also require evidence of financial ability to perform.
3. **Manage the timing of the transaction.** If seller does significant government work it may be in a constant cycle of bidding on and receiving government contracts. A sale could impact current contracts and contracts under bid. Any change in ownership must be investigated and approved prior to a bid being awarded, which could either delay closing or result in forfeiting the contract.
4. **Alert and involve the contracting officer.** If seller has multiple locations and multiple government contracts then it might be required to use a corporate administrative contracting officer ("CACO") to deal with corporate management and perform certain functions on a corporate-wide basis. This person will need to be involved in the novation process and should be a member of buyer's management team.
5. **Consider record retention policies.** Seller is required by FAR to maintain certain records for a lengthy period of time, usually three or four years from the conclusion and final payment of the contract. These records can be voluminous and any failure to maintain these records could subject buyer to liability. Buyer should take steps to ensure that all necessary records are transferred post-sale.

By addressing these issues early, the parties can minimize any potential delay and maximize the value of government contracts which are likely already factored into the purchase price.

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