

10 Novation Do's and Don'ts

1. *Do remember that the government is not obligated to novate a contract*
2. *Don't expect to move quickly; novation can take anywhere from 3 to 6 months*
3. *Do get to know the DCMA "One Book" as a novation resource*
4. *Don't forget FAR 42.12; while not black and white, it is a good study guide*
5. *Do alert the CO as early in the process as possible*
6. *Don't underestimate the importance of a compelling novation package narrative*
7. *Do work with the CO to prepare documentation and promptly respond to questions*
8. *Don't pester the CO; that will not make it move faster or garner any support*
9. *Do solicit expert legal advice, not generalist attorneys*
10. *Don't forget that novation is only the beginning; market the contract and compete for task orders*

Contract Novation Consternation

- Shifting federal spending priorities and procurement proclivities necessitate maintenance of a robust contract vehicle portfolio
- Small business graduation, divestitures, and mergers wreak havoc on portfolios, leaving companies without critical customer access
- Similarly, contractor graduation and consolidation can leave federal buyers with less than the desired level of competition on contracts
- The need to structure transfers as equity sales or asset sales with equity-like terms hinders many would-be buyers and sellers
- Successful contract novation requires early, frequent, and transparent communication with contracting officers (COs)
- Emerging thresholds (OASIS) and ambiguous treatment of graduated small businesses further complicate the contract aftermarket

Market Disequilibrium

In a competitive market where contract vehicles are critical to maintaining customer access, it is no surprise that there is widespread interest in buying and selling contracts. Those that fail to win contracts are looking to buy their way in after award. Those that have won a contract but failed to secure any work under it, and those that find themselves with duplicate contracts as a result of M&A activity, seek to monetize potentially valuable assets. This causes a conundrum: federal customers want to approve these transactions in order to preserve competition, but do not want (and 41 U.S.C. § 15 prohibits) aftermarket purchases that might circumvent the FAR. This ambiguity results in more market interest than completed transactions.

Gray Market

While it is a common refrain from procurement officials that they "do not want contractors trading contracts like baseball cards," there is a burgeoning parallel market. The easiest way to effect the transfer is via an equity purchase, which in many cases does not necessitate novation. Some sellers artfully bleed off all other assets, leaving a shell legal entity holding only the contract, in order to facilitate this approach. Buyers and sellers are getting increasingly creative at making asset purchases look like equity deals. To do so, buyers purchase all the assets involved in performing a contract (PM, task orders, websites, laptops, etc.) and assume all related contract liabilities.

White Market

None of these structuring gymnastics matter if the government does not ultimately accept the transfer, and novations are at the government's sole discretion. Given this dynamic, it behooves aspiring contract buyers and sellers to begin working with their government procurement officials as early as possible and to communicate transparently throughout the process. It is also helpful to remember that the government will want the seller to waive all rights under the contract and the buyer to assume all obligations of the seller. Lastly, novation packages must be tailored with the procurement officials' perspectives in mind, which are rarely germane to the buyer's financial and strategic rationale, however well-conceived.

Caveat Emptor

While the last generation of contracts (GSA Alliant, IRS TIPSS, CDC

CIMS, CMS ESD, DHS EAGLE) have fairly well-defined transfer mechanics and precedent transactions, the current crop of contracts is much more nuanced. For example, the first OASIS transfer was just completed, and in order to novate, the buyer had to show that it would have scored well enough in each task area to win the contract on its own. This applies a previously unprecedented past performance test to novation, which has given pause to many would-be buyers. Similarly, the widely rumored "other" category, created by CIO-SP3 small business graduations and by on-ramping, is another twist that has buyers scratching their heads.

GWAC and MA/IDIQ Bid Volumes



While the number of task orders released on GWACs and MA/IDIQs has recovered from 2012-2013 levels, the average number of bids per task order has declined over the same period and has returned to 2011 levels.

Source: Wolf Den Associates, fpds.gov