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GAO Creates Catch-22 For Contractors In M&A Transactions

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Government contracts can have a way of complicating corporate transactions. A number of these complications arise out the fact that the Anti-Assignment Act,[1] in no uncertain terms, prohibits the assignment of contracts with the U.S. government from one entity to another. If this prohibition were followed to the letter, it would foil countless mergers, acquisitions and other corporate transactions. Instead, the formal novation process has emerged as the practical work-around within the contract administration process. By following a set of procedures outlined in Part 42 of the Federal Acquisition Regulation,[2] contractors are usually able to novate their existing government contracts to a successor in interest — notwithstanding the fact that this process can be time-consuming and document-intensive, and is entirely at the government's discretion.

The question of what to do about pending bids during corporate transactions, by contrast, has remained an untamed frontier. If a contractor has a pending bid and is in the midst of merging with another company, for example, what is the contractor supposed to tell the agency — and when and how should it do so? The FAR is silent on this question. In recent years, the Government Accountability Office has weighed in and, as a result, has created a Catch-22 for contractors.

In a pair of decisions — Wyle Laboratories Inc. (Dec. 27, 2013)[3] and FCi Federal Inc. (Aug. 5, 2015)[4] — the GAO sustained bid protests of awards to contractors undergoing corporate transactions, on the grounds that the agency failed to consider how the contractors' performance would change as a result of the transactions. The upshot of these decisions is that awards to newly reorganized contractors are particularly vulnerable to protest, and contractors' hands are tied when it comes to fully protecting against that risk.

In Wyle, the GAO sustained an unsuccessful bidder's protest of a $1.76 billion cost-plus-award-fee indefinite-delivery, indefinite-quantity contract with NASA, which was based on the fact that the awardee had been spun off from a larger company during the pendency of its bid. The GAO found that NASA failed to evaluate what effects, if any, the spin-off would have on the awardee's proposed technical approach, resources and costs under the contract. According to the GAO, even though the awardee had addressed the fact of the impending spin-off and the need for an eventual novation with NASA in its proposal and during discussions, that was not sufficient; the agency also had to evaluate how the spin-off would impact the awardee's proposal, performance and cost experience.

Last month, in FCi Federal, the GAO extended Wyle even further to sustain the protest of an award to a contractor that had been acquired by another company after the initial award was made and during the agency's limited corrective action on a specific responsibility question. Like in Wyle, the GAO functionally presumed that the acquisition would have material and significant effects on the awardee's technical approach, past performance experience, financial resources, and ability to meet contract requirements. The GAO also found that it was unreasonable for the agency to limit its corrective action to the specific responsibility question underlying the corrective action; rather, by virtue of the corporate sale, the agency was obligated to entirely reopen its evaluation of the awardee.

The GAO's decisions in Wyle and FCi Federal are grounded in a seemingly uncontroversial principal — that award cannot be made to a contractor based on a proposal materially different than how the contractor actually intends to perform. The problem is that contractors often lack the ability or appropriate mechanism to convey to the agency the type of information that the GAO envisions as necessary.

As an initial matter, due to deal dynamics, contractors may not be permitted to even disclose the possibility of a corporate transaction at the time of their original proposals — or may be limited to offering high-level predictive statements about what the transaction, if consummated, would entail. Unless the agency opens discussions or invites proposal revisions, contractors are then prohibited from volunteering any further information to the agency for fear of violating procurement regulations or generating protest grounds. This predicament may begin to arise more frequently as procurement cycles become drawn out due to funding crunches and contractors are asked to extend the period during which their proposals remain valid. In short, the GAO has created a duty to update proposals, but no mechanism by which contractors are authorized to do so.

In addition, it appears that this duty to update does not end at the time of award, as the protestors in Wyle and FCi Federal prevailed in protesting awards to contractors whose corporate transactions did not close until after the award decision was made. In Wyle, the spin-off closed over a month after award — and over three weeks after the unsuccessful bidder filed its initial protest. And in FCi Federal, the sale occurred months after the original award decision and while the agency was engaged in limited corrective action. It is unclear how contractors are supposed to fulfill this duty to update after award, particularly as the GAO has indicated that post-award novations do not remedy the underlying error in the evaluation process and award decision.

What is more, even if contractors did have a mechanism by which to convey it to the agency, the information that the GAO envisions as required in this situation often would be highly burdensome, if not impossible, for contractors to actually provide. As the GAO would have it, at the first whiff of a potential deal, contractors must provide a two-pronged proposal in all future bids: one proposal that addresses performance pre-transaction (or if the transaction falls through), and one proposal that addresses performance post-transaction. This is an unrealistic expectation given the timing, confidentiality and uncertainty of corporate deals.

The GAO's decisions in Wyle and FCi Federal are likely to accomplish little more than fueling protests of awards to contractors undergoing corporate transactions. In the meantime, both contractors and agencies are left without practical means by which to meet the GAO's expectations, as the GAO delves into what was formerly considered to be a question of contract administration.

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[1] 41 U.S.C. § 6305.

[2] 48 C.F.R. Subpart 42.12.

[3] Wyle Labs., Inc., B-408112.2, 2014 CPD ¶ 16 (Comp. Gen. Dec. 27, 2013), recons. denied sub nom. NASA—Recons., B-408112.3, 2014 CPD ¶ 155 (Comp. Gen. May 14, 2014).

[4] FCi Fed., Inc., B-408558.7, 2015 CPD ¶ 245 (Comp. Gen. Aug. 5, 2015).