

CAN YOU SELL A GOVERNMENT CONTRACT: ASSIGNMENT, NOVATION, CHANGE OF NAME AND ASSIGNMENT OF CLAIMS, A PRIMER

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Contractors frequently ask if they can sell or transfer (assign) their government contract to another company. The sale or assignment of a purely commercial contract is very common and well recognized at law. But for a Government contract, there are special rules. Although a transfer can be made through a process known as “novation,” the contract can be annulled if the rules are not carefully followed.

Commercial Contracts May Generally Be Sold: Generally, commercial contracts can be sold or transferred to a third party. Indeed, Article 2-210 of the Uniform Commercial Code (“UCC”) explicitly permits this, by stating:

§ 2-210. DELEGATION OF PERFORMANCE; ASSIGNMENT OF RIGHTS.

- (1) A party may perform his duty through a delegate unless otherwise agreed [].
- (2) Unless otherwise agreed all rights of either seller or buyer can be assigned except where the assignment would materially change the duty of the other party, or increase materially the burden or risk imposed on him by his contract[].
- (4) An assignment of “the contract” or of “all my rights under the contract” or an assignment in similar general terms is an assignment of rights and unless the language or the circumstances (as in an assignment for security) indicate the contrary, it is a delegation of performance of the duties of the assignor and its acceptance by the assignee constitutes a promise by him to perform those duties. [].

UCC Article 2 has been adopted by 49 states and the District of Columbia. Only Louisiana, which has a civil law (not an English Common Law) system, has declined to adopt it.

Government Contracts May Not Be Sold Or Assigned, Except through Novation: The simple answer to the question of the assignment or sale of a government contract, is “NO.” U.S. law prohibits it, and states that any attempted transfer or assignment will annul the contract:

General Prohibition on Transfer of Contracts. The party to whom the Federal Government gives a contract or order may not transfer the contract or order, or any interest in the contract or order, to another party. A purported transfer in violation of this subsection annuls the contract or order so far as the Federal Government is concerned, except that all rights of action for breach of contract are reserved to the Federal Government.

41 U.S.C. § 6305, known as the “Contracts Act.” This prohibition, which is repeated in FAR 42.1204, protects the government from secret assignments, prevents possible multiple claims and makes unnecessary the investigation of assignments. See *American Gov’t Properties and*

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Houma SSA v. United States, Fed. Cl. No. 09-153 (Aug. 28, 2014). There are only two exceptions: (1) where the Government waives the prohibition by giving clear assent to the assignment; and (2) where the assignment occurs by operation of law (e.g., where there was corporate success through merger or consolidation). In *American Gov't Properties*, the Court held that an assignment of the contract violated the Contracts Act since there was no exception, that the contract had been annulled (voided), and that therefore, the Court had no jurisdiction because there was no contract and the Contract Disputes Act did not apply.

Furthermore, as readers know, only responsible contractors may receive contract awards, and when a contractor sells or transfer a contract, unless special provision are made for government review, the Government will have no assurance that the buyer is responsible.

Novation-the proper way to transfer a Government contract: The FAR does provide for transfer of a contract to a third party through a process called “novation” (substitution of a new contract for an existing one, between different parties). The government has the *option* (but is not required) to recognize a third party as a “successor in interest” to a Government contract only when there is a transfer of: (1) all the contractor’s assets; or (2) the entire portion of the contractor’s assets involved in performing the contract. FAR 42.1204(a).

In order to effect a novation, the contractor must carefully following the procedure in FAR 42.1204, by submitting copies of a *proposed* novation agreement, along with detailed information on all affected contracts, evidence of the transferee’s capability to perform, and any other relevant information requested by the contracting officer. Certain specific documents must also be submitted (bill or sale or merger; minutes of boards of directors authorizing the transfer, copies of corporate articles, opinion of legal counsel, balance sheets, evidence of security clearances, if required, consent of sureties). Even more important, the novation agreement must provide that:

- (1) the transferee assumes all the transferor’s obligations under the contract, and is receiving all the assets devoted to the contract
- (2) the transferor guarantees performance of the contract by the transferee (a bond may be used)
- (3) the transferor waives all rights under the government contract
- (4) Both transferor and transferee must comply with all Federal laws.

A sample novation agreement is included in the FAR, and should be used for all novations. FAR 42.1204. *REMEMBER: The novation will not take effect until approved by the Contracting Officer and the Contract is modified, in writing, to acknowledge and accept the novation. Until that happens, the transferor must continue to perform, and all payments will be made to the contractor whose name appears on the contract.*

Change of Name Only: If only a change of the contractor’s name is involved and the Government’s and contractor’s rights and obligations remain unaffected, the contractor may simply forward to the contracting officer copies of the Change of Name Agreement, a list of contracts, the State document effecting the name change, and the opinion of legal counsel. FAR 42.1205. Once again, this section of the FAR includes a simple “Change of Name Agreement” which can be used. Again, this should be memorialized in a modification to the contract.

You Cannot Sell Your Government Contract Invoices: In the commercial world, invoices can be sold or “factored” to get immediate cash flow. A financial factor may buy your invoiced receivables at a discount. Collecting from the customer then becomes the factor's responsibility. You cannot “sell” or factor your government contract invoices to a third party, because the Contracts Act states “ [the contractor] may not transfer the contract or order, or any interest in the contract or order, to another party” 41 U.S.C. § 6305(a). But there is another lawful method, outlined in the Contracts Act, and 31 U.S.C. § 3727, the Assignment of Claims Act of 1940, that permits something similar, but not identical.

Under the Assignment of Claims Act, a Government contractor may obtain financing for its contract by borrowing money from a bank or financial institution and then assigning moneys due or to become due under a contract if the assignment is made to a that bank or financial institution, the contract does not prohibit the assignment, and generally, the assignment covers all unpaid amounts payable, is made to only one party, and is not subject to any further assignment. There is a specific procedure in FAR 32.805, which requires formal submission of the Notice of Assignment to the Contracting Officer, and an acknowledgement of that instrument of assignment by the Contracting Officer. Once acknowledged, the assignment takes effect.

The contract must then be modified, and all future payments of invoices must be made *only* to the assignee. If the Government erroneously pays the contractor, the bank or financing institution may bring a suit against the government to recover any contract payment made to the contractor. *Produce Factors Corp. v. United States*, 467 F.2d 1343, 1349 (Ct.Cl.1972). An erroneous payment made by the Government is no bar to the rightful claimant, the assignee bank. *Central Nat'l Bank v. United States*, 91 F.Supp. 738, 741 (Ct.Cl.1950) (citation omitted).

Summary: While commercial contracts may be sold or assigned to a third party, Government Contracts may not be. However, government contracts may be transferred through novation, where the government gives its formal written approval after submission of specific information and assurances. A simple change of the contractor’s name does not require a novation. Finally, although government contractors may not “sell” their invoices, they may obtain loans from financial institutions and assign the proceeds of the contract to the financial institution granting the loan.