THE NASH & CIBINIC REPORT

government contract analysis and advice monthly from professors ralph c. nash and john cibinic

Author: Ralph C. Nash, Professor Emeritus of Law, The George Washington University
Contributing Authors: Vernon J. Edwards and Nathaniel E. Castellano

NOVEMBER 2025 | VOLUME 39 | ISSUE 11

¶ 69 GOVERNMENT CONTRACT NOVATION: Overlooked Candidate For "Revolutionary Overhaul"

*Nathaniel E. Castellano**

**Nathan is Counsel at Freshfields US LLP specializing in government contracts and grants; the ideas presented here, particularly those that may prove to be in error, are the author's own and should not be attributed to others.*

The Federal Acquisition Regulation provisions governing novation of Government contracts are in desperate need of overhaul. The current novation rules, last reformed nearly 30 years ago, flout commercial practice, creating unnecessary barriers to private capital investment, mergers and acquisitions, and corporate restructuring in the Government contracting industry. Alas, the "Revolutionary FAR Overhaul" would leave the novation rules largely untouched, save minor stylistic adjustments. See https://www.acquisition.gov/far-overhaul/far-part-deviation-guide/far-overhaul-part-42. That is a shame: it signals complacency with an embarrassing *status quo* and ignores readily available proposals for reform. In 2017 comments, the American Bar Association Public Contract Law Section articulated the need for change:

> [T]he current novation requirements are outdated, inconsistent with commercial practices, and often incongruent with market realities.
>
> In the context of commercial mergers and acquisitions ("M&A"), for example, parties can "assign" contracts from the seller to the buyer in the time that it takes for the seller and buyer to negotiate the transfer. Often this effort involves contracts that contain provisions that prohibit the other contracting parties from "unreasonably" denying assignment requests. In contrast, under government novation requirements, contractors sometimes need years to finalize novation agreements, with agencies often requiring additional or different terms or simply refusing to accept the novation.
>
> This dichotomy creates needless uncertainty for parties to corporate transactions, as well as inefficiencies for agency customers. For example, because the novation process can continue after a corporate transaction closes, the parties must arrange for temporary pass-through subcontracts to allow performance to continue pending completion and acceptance of the novation. These structures may be complex and confusing for all sides and do not serve anyone's best interests.

Comments to Section 809 Panel; Improving Novations (Nov. 20, 2017), available at https://www.americanbar.org/content/dam/aba/administrative/public_contract_law/comments/comments-section-809-improving-novations.pdf.

The "Novation" Issue

The FAR novation provisions describe circumstances when a procurement contract may be transferred from one contractor to another. When a novation is executed, the Government recognizes the transferee as the lawful contract holder but continues to hold the transferor liable in the event of non-performance. The terminology alone departs with commercial parlance, where the term "novation" is not so stiff:

> In a novation, the Government, the transferring organization (the "transferor") and the recipient organization, (the "transferee") execute an agreement which permits the transferee to take the place of the transferor but continues to hold the transferor liable to the government for non-performance. This special Government contract use of the term "novation" may differ from that encountered in private law. There, "novation" can mean anything from a simple change of name agreement to one involving the substitution of parties with or without continued liability for the substituted party.

Novation Agreements: Is You Or Is You Ain't My Baby?, 4 N&CR. ¶ 56.

The unique rules addressing transfer of Government contracts derive from an antiquated statutory prohibition. Taken at face value, the statute arguably prohibits any transfer of a Government contract, at penalty of voiding the contract at issue:

> 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 USCA § 6305.

The statute has long been interpreted with a grain of salt, leading to two important judicial exceptions. The first exception is waiver: the Government can waive the statutory prohibition and recognize the transfer. The formal process for such a waiver is the novation procedure set forth in the FAR. Implicit waiver without novation is possible, but the judicial decisions are fact specific and unpredictable. *Tuftco Corp. v. U.S.*, 614 F.2d 740 (1980).

The second exception applies to transfers that occur "by operation of law." *Seaboard Air Line Railway v. U.S.*, 256 U.S. 655 (1921). If a contract is transferred by operation of law, then the statutory prohibition does not apply, and novation is not necessary. FAR 42.1204(b) gives partial recognition to the "operation of law" exception, confirming novation is "unnecessary when there is a change in the ownership of a contractor as a result of a stock purchase, with no legal change in the contracting party, and when that contracting party remains in control of the assets and is the party performing the contract." Yet, the precise contours of the judicial doctrine are notoriously ill-defined, creating inherent uncertainty regarding the need for novation in transactions that do not fall within the specific stock purchase scenario described in the FAR. Roberts & Tatum, *The Novation of Government Contracts and the Unreliable and Unpredictable "Operation of Law" Exception*, 50-Fall Procurement Law. 1 (2014).

While obtaining a novation can provide certainty as to the Government's position, there are significant substantive and procedural hurdles associated with novation. Substantively, the novation terms prescribed by the FAR can be dissatisfying for both transferor and transferee. Manos, *Novation Agreements in Corporate Restructuring: The Government's Contractual Stealth Weapon*, 26 Pub. Cont. L.J. 339 (Fall 2014). Procedurally, the FAR requires burdensome document submission as part of the novation process, and many of the required documents are not available until after the transaction is complete. That means the parties must close the transaction without knowing whether the Government will actually consent to the transfer. And the Government's decision may not come for months. Between the time that the deal closes and the novation is approved, the parties typically rely on awkward subcontract-pending-novation arrangements to manage performance, invoicing, and payment.

To avoid the difficulties of novation, parties often attempt to structure a transaction to avoid novation. As the ABA Public Contract Law Section explained:

> The burden, delay, and uncertainty created by this process drives government contractors to avoid novation whenever possible, including by structuring many M&A deals as stock transactions.
>
> * * *
>
> Because novation can be requested only after a transaction has closed, parties must complete their transaction before they can formally ask the Government for permission to complete a transaction that was just completed. This back-loaded permission creates a gap between the transfer of personnel/assets (which occurs at closing to give a buyer the benefit of its bargain) and the contracts that those personnel/assets are performing (which cannot actually transfer until novation is approved). Parties bridge this awkward gap by implementing temporary subcontracts under which the buyer performs the seller's contractual obligations with buyer's newly acquired personnel and assets. In some instances, the seller exists only as a corporate shell entity for invoicing and payment until novation is granted. This arrangement is necessary because the current novation requirements elevate form over substance.

This "subcontract pending novation" arrangement causes both parties to incur additional costs and strips the Government of privity with the entity that performs the contractual requirements. The arrangement also puts the transactional parties at a disadvantage because they cannot discern whether the Government will, at some undisclosed time, object to the request to recognize the successor-in-interest. This necessary, but unfortunate, structure also creates a cumbersome payment process under which the prime contractor (seller) receives payment and the subcontractor (buyer) performs the work with seller's former employees. Even more challenging is the process by which the parties determine how the buyer of multiple-awardee contract can submit task-and delivery-order proposals under the contract it has purchased while the contract remains in the seller's name.

Proposed Reforms

Concerns with the status *quo are* well documented, and so are practical proposals for reform. The most significant proposals involve the timing and process for novation. The ABA Public Contract Law Section proposed (1) a pre-transaction novation process similar to the processes currently in place for national security and antitrust review, along with (2) incentives encouraging contracting agencies to complete review in a timely manner.

The Section recommends two primary changes in the novation process and timing to increase certainty for contractors and to minimize disruption for the Government.

First, novation should occur before transaction closing. This change could be accomplished by allowing the review to occur before closing, just like the reviews offered under Hart-Scott-Rodino Act and by the Committee on Foreign Investment in the United States ("CFIUS"). Such a change would allow parties to close with certainty, avoid unwinding transactions, and make pass-through subcontracts a relic of the past.

Second, the Government should have incentives to timely process novations. The Government should be required to approve or disapprove novation applications within 90 days of the application's submission. This timeline is similar to the deadlines established in the Hart-Scott-Rodino review and the review conducted by CFIUS. Both of those reviews apply to transactions involving government contractors, and both require the Government to act on an approval request within a prescribed time period, seek more time, or waive any objection to the approval request. In addition, this novation time period should include not just approving the novation, but also issuing all required modifications to the contract affected by the transaction.

These changes in the processing of novation applications would alleviate several burdens. For one, the Government would remain in privity with the entity that has the assets performing the prime contracts. In addition, the transactional parties could close the proposed deal with much more certainty. These changes would not increase risk for the Government: the novation agreement still requires the seller to continue to guarantee contractual performance after the Government agrees to recognize the successor-in-interest.

Another proposed reform is to clarify that novation is not needed to recognize contract transfers caused by internal corporate reorganizations and transfer of assets between affiliates of the same corporate family.

Contractors are increasingly changing corporate form, whether to achieve tax advantages or obtain increased flexibility for outside investment. The Government has taken conflicting positions on whether novation is required for these conversions in form. In the Section's experience, some officials have created specialized "conversion forms" that differ from the standard novation forms in the FAR. The Section recommends improving consistency in treatment of these conversions.

Novation agreements, together with the associated documentation, do not appear to apply to corporate conversions because no third party acquires any assets. The only parties to a corporate conversion are the entity undergoing the conversion and the Government. Further, a change in corporate form does not implicate any of the risks to be mitigated by novation—the assets of the contractor have not been transferred to a third party. Instead, they continue to exist, but in a different corporate form. As a result, novation is not needed for a corporate conversion in which a contractor simply changes its corporate form or state of incorporation.

The novation process, by its nature, must involve three parties to the agreement, and the package requires documents from the buyer (the successor-in-interest) seeking recognition from the Government. Accordingly, the Section recommends clarifying that the name-change requirements of FAR 42.1204(b) (not the novation requirements) apply to a corporate conversion.

Finally, a number of reform recommendations focus on practical adjustments that would streamline the documentation requirements required to seek and obtain novation.

The Section proposes a simplified novation package that includes the following: (i) a cover letter certifying that the novation packet is authentic and accurate; (ii) a novation agreement; (iii) a list of affected contracts; (iv) a statement of transferee's capability to perform; (v) the purchase agreement; (vi) the opinion of legal counsel; (vii) evidence that classified security requirements have been met; and (viii) the consent of any sureties.

Other documents are superfluous and appear often times to not be reviewed by government personnel. For example, if an authorized person from the company has executed the purchase agreement and cover letter, and the agreement has been declared to be legal by counsel, other documents, such as board minutes approving the transaction, are unnecessary to protect the Government's interests.

* * *

The Section also recommends eliminating the requirement for audited financials from before and after an M&A transaction. Although submission of audited financials is intended to address the risk of default or non-performance, the submission is cumbersome, outdated, and often waived. In almost all instances, the parties have only annual audited financials. If audited financials for shorter periods do exist, they are almost always outdated because the periods do not coincide with the transaction. Obtaining timely audited financials under the required timing may take weeks or months to perform and cost hundreds of thousands of dollars. Perhaps in recognition of this burden, the Government, in the Section's experience, often waives the requirement to submit audited financials and agrees to the novation request without receiving audited financials from either the buyer or the seller.

This requirement can be replaced, without any risk to the Government, with a requirement to provide financial evidence of the buyer's ability to perform in its capability statement. This is the risk at the heart of requiring audited financial statements. The parties should be able to provide the seller's most recently audited financials or other financial information that is part of the financial support required by bidders for government contracts generally. If the rule changes allow providing this information, the information should meet the Government's needs while avoiding unnecessary and costly novation-specific audited financials. In addition, the seller's (transferee's) continued guarantee of performance, which is a requirement in the novation agreement, provides a further security for the Government's interests in the event of a default.

Concluding Thoughts

The "Revolutionary FAR Overhaul" is meant to "remov[e] undue barriers" to the procurement system, while "allowing for the expansion of the national and defense industrial bases." To meet that end: "the FAR should contain only provisions required by statute or essential to sound procurement, and any FAR provisions that do not advance these objectives should be removed." Executive Order No. 14275, *Restoring Common Sense to Federal Procurement* (Apr. 15, 2025), 90 Fed. Reg. 16447 (Apr. 18, 2025).

It is hard to understand how the FAR novation provisions could pass review under that standard without requiring significant transformation. None of the document submission requirements are required by statute, and the novation provisions are hardly essential to sound procurement. Rather, the current novation rules are undue barriers to the procurement system that obstruct private investment in our national and defense industrial bases.

Thankfully, the acquisition community—through the ABA Public Contract Law Section and others—have already chronicled the defects in the current FAR provisions and proposed detailed solutions. Yet, based on the current proposals, the Revolutionary FAR Overhaul will leave the defunct novation rules largely untouched. That is an unfortunate and unforced error, and it should be rectified. *NEC*