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PRACTICAL TIGHT-KNIT BRIEFINGS INCLUDING ACTION GUIDELINES ON GOVERNMENT CONTRACT TOPICS

The Intersection Of Bankruptcy And Government Contracting And Impact Of Bankruptcy On Government Contractors And The Acquisition Of Government Contract Assets

*By Michael D. McGill, Thomas A. Pettit, and Rosa Evergreen**

Companies that contract with the U.S. government are often considered to be more resilient to national and international business cycles due to the relative reliability of federal customers, with long-term contracts and steady funding levels. But most government contractors are not immune from the impact of macroeconomic conditions both in the United States and globally. This is especially true of commercial companies that devote only a minor portion of their business to government contracting. And all companies, including those that contract with the government, are subject to a variety of business, economic, and legal risks that can lead to financial distress. Inevitably, some government contractors will face financial distress so severe that it threatens their solvency.

Government contractors facing such hardship may consider various options to maintain sufficient liquidity to remain solvent, including selling additional equity, selling a portion of existing assets, or issuing debt-equity swaps. In some cases, these options may not be viable or may not align with the company's objectives—leaving a bankruptcy, a more comprehensive sale, or a combination of the two as the only realistic options. Companies may find relief through restructuring or reorganizing under the protections of the Bankruptcy Code, which appears in Title 11 of the U.S. Code (the "Bankruptcy Code"). While a company can use bankruptcy to liquidate and dissolve, the Bankruptcy Code also allows companies to stabilize, restructure, and repay debts without liquidating and dissolving. Filing for bankruptcy protection can provide significant benefits, including allowing debtors to reject unprofitable contracts and discharge certain pre-petition liabilities and protecting debtors from judicial and administrative proceedings that were or could have been commenced prior to the bankruptcy petition. However, bankruptcy will not necessarily discharge all liabilities, and it may cause business disruption, be costly to pursue, and create uncertainty.

Government contractors face unique challenges when navigating bankruptcy due to the special rights and powers of the government. These challenges are relevant

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not only to government contractors but also to companies and financial sponsors considering acquiring assets from distressed government contractors. For any company—government contractor or otherwise—filing for bankruptcy often involves conceding some level of control, and a company in bankruptcy may find that creditors hold more sway than anticipated over its future. This dynamic can be especially challenging when the government is both a critical customer and creditor. As compared to the standard non-contractor, a government contractor seeking to reorganize may find bankruptcy more complicated and less effective at discharging key liabilities. Government involvement often is unavoidable when a debtor plans to transfer government contracts and related assets to a third party. Companies and financial sponsors interested in acquiring assets from a government contractor need to understand the incremental processes, approvals, time, and cost associated with attempting to transfer government contracts from a debtor.

This Briefing Paper examines the intersection of federal bankruptcy law and federal procurement law. It covers, among other issues, how standard provisions of the Federal Acquisition Regulation (FAR) affect rights at issue in bankruptcy proceedings; how government contracts are affected by the automatic stay in bankruptcy proceedings and the application of the non-discrimination rule to government contractors; how 41 U.S.C.A. § 6305 (the "Anti-Assignment Act") affects a contractor's ability to retain or transfer government contracts following bankruptcy; how bankruptcy may (or may not) restrict the government's ability to terminate contracts for default or convenience; how bankruptcy may limit a government contractor's ability to seek contractual relief; and how False Claims Act (FCA) liability could extend to contractors that emerge from bankruptcy or acquirers that purchase assets from a debtor in bankruptcy. This Briefing Paper is not intended to, and does not, cover all of the myriad issues relevant to government contracting and bankruptcy law and therefore does not address a variety of topics, including the rights of the government vis-à-vis a contractor's other creditors.

This Briefing Paper is organized as follows:

Section A provides a brief summary of the bankruptcy process as context for the balance of the Briefing Paper.

Section B covers the impact of a bankruptcy filing on a government contractor and its government contracts, including the FAR notice requirements, ongoing government enforcement rights, the potential for the government to terminate contracts, the effect on government and contractor requests for relief and claims, and the potential for the government to account for a government contractor's bankruptcy in evaluations.

Section C covers issues related to the ability of the contractor to retain or transfer its government contracts through the bankruptcy process.

Section D covers issues pertinent to companies and financial sponsors considering acquiring government contracts and other assets from distressed government contractors.

Sections E and F provide some concluding thoughts and practical guidelines.

This Briefing Paper focuses on federal government contracts, but many of the concepts apply equally to state and local contracts and to foreign government contracts.

A. Introduction To Bankruptcy Processes

Corporations and other business entities can use bankruptcy to liquidate or reorganize. There are three main chapters of the Bankruptcy Code most applicable to a government contracting company that might file for bankruptcy: Chapter 7, Chapter 11, or Subchapter V (a Subchapter within Chapter 11).

Chapter 7 of the Code allows for liquidation and Chapter 11 allows for reorganization or liquidation. Under Chapter 7, the debtor's assets are placed into an estate managed by a court-approved trustee, who is in charge of liquidating those assets. The trustee, subject to court approval, then sells the debtor's

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assets. In Chapter 11 proceedings, the debtor's management typically remains in place and it retains possession of and control over its assets and is allowed to continue operating while the bankruptcy process is pending. The debtor under those circumstances is known as a "debtor-in-possession" (DIP). While a company can use Chapter 11 to liquidate and shut down the company,[1] Chapter 11 can also be used to reorganize or restructure the company ultimately allowing the company to emerge from bankruptcy. The resolution of pre-petition contractual debts is one of the primary benefits to reorganizing. If, during the bankruptcy proceeding, the debtor decides that filing under the other chapter would be more advantageous, subject to certain limitations, it can move to dismiss and refile or move to convert.[2]

The Small Business Reorganization Act (SBRA), effective in early 2020, created within Chapter 11 a new subchapter (Subchapter V) to streamline bankruptcy procedures for and expand the rights of small businesses,[3] which play a significant role in many aspects of federal government contracting. These companies are frequently targets for acquisition by both private equity and strategic buyers. While the case law analyzing Subchapter V is still developing, Subchapter V generally allows small business owners to retain an ownership interest in the company,[4] generally eliminates creditors' committees,[5] typically removes disclosure statement requirements,[6] and permits small business debtors to amortize administrative expense claims across the term of the reorganization plan.[7] Recent data show that Subchapter V filings increased 82% year-over-year from 2022 to 2023, indicating small businesses are availing themselves of the benefits under that subchapter.[8]

Many bankruptcy proceedings—whether under Chapter 11 or Chapter 7—involve selling some portion or all of the debtor's assets. Bankruptcy Code § 363 is the default mechanism for asset sales in bankruptcy proceedings.[9] Debtors may not sell assets without court approval, except for sales in the ordinary course of business.[10] This limitation requires the debtor to notify creditors and other interested parties of the impending sale and the court to hold a hearing to approve the sale.[11] When debtors sell assets under § 363, those assets may be sold "free and clear of any interest in such property of an entity other than the estate" if the statutory conditions are satisfied.[12] When selling assets in connection with a reorganization plan, sales are effected under Bankruptcy Code § 1123.[13]

The bankruptcy process provides a variety of protections for the debtor while the process is pending. The automatic stay, a central tenet of the bankruptcy process, subject to some exceptions, automatically enjoins creditors from taking unilateral action against the estate or DIP immediately upon the filing of the bankruptcy petition.[14] The stay, if no exception exists, applies to all creditors, including federal, state, and local governments, and continues until an event triggers its termination, such as resolution of the bankruptcy case or a court decision granting a creditor relief from the stay.[15] Importantly, however, there are exceptions to the stay. One exception that is particularly relevant to government contracting allows the government to take actions against a debtor when exercising its "police and regulatory power."[16] Further, although the stay applies to most government contract claims and certain administrative actions, courts are generally more likely to grant stay relief to the government than to a private creditor. The non-discrimination rule, codified in § 525 of the Bankruptcy Code, generally prohibits the government from discriminating in many contexts against debtors "solely" because they filed for bankruptcy, including when issuing licenses, permits, and grants.[17] However, as discussed below, the automatic stay and non-discrimination rules may not protect government contractors as effectively as they protect companies that do not perform government work.

The bankruptcy process also can involve the debtor "assuming" or "assuming and assigning" contracts that existed prior to the bankruptcy filing. The Bankruptcy Code generally allows debtors to retain or transfer executory contracts and unexpired leases. This is the case even if a contract provision prohibits or restricts assignment.[18] However, like the application of the automatic stay and non-discrimination rules, the assumption of contracts tends to be less straightforward, and sometimes less debtor friendly, when government contracts are involved. As discussed below, the Anti-Assignment Act and other laws governing the assignment of government contracts can impede the ability of debtors to retain government contracts in bankruptcy or to transfer contracts before, during, or after a bankruptcy proceeding.

B. Effect Of Bankruptcy On Government Contractors

The filing of a bankruptcy petition has a range of implications for the debtor. In some respects, those implications are the same for government contractors as they are for any other company, but in other respects, there are key differences. More notably, protections afforded by the bankruptcy process can be limited in several key ways when it comes to the debtor's relationship to the government. The following section summarizes the impacts of bankruptcy on a government contractor and its government contracts.

1. Notification Requirements

Every contract subject to the FAR that exceeds the simpli-

fied acquisition threshold[19] must incorporate FAR 52.242-13, Bankruptcy.[20] This clause does not regulate bankruptcy proceedings. Rather, it requires contractors that have entered bankruptcy, voluntarily or involuntarily, to notify "the contracting officer responsible for administering the contract" of the bankruptcy no later than five days after the bankruptcy proceedings have been initiated.[21] The notification must be in writing and sent "by certified mail or electronic commerce method authorized by the contract."[22] The contracting officer responsible for administering the contract depends on the procuring agency. In some agencies, the contracting officer responsible for administering the contract may be the procuring contracting officer (PCO), while in other agencies it may be a separate administrative contracting officer (ACO), such as an ACO within the Defense Contract Management Agency (DCMA). All affected contracting officers may seek assurances that the contractor will be able to meet its performance obligations under the relevant contracts.

Once a contractor provides notice of the bankruptcy proceedings, the government must "take prompt action to determine the potential impact of a contractor bankruptcy on the Government in order to protect the interests of the Government."[23] Such actions include notifying "legal counsel and other appropriate agency offices," identifying any potential claims the government may have against the contractor (e.g., contract disputes and terminations for default), and taking "actions necessary to protect the Government's financial interests and safeguard Government property."[24] The interests of the government will vary depending on the circumstances. The government's interests in the bankruptcy may be most acute when the contractor possesses government property, is a sole-source supplier or service provider, or performs contracts that are rated orders under the Defense Production Act (DPA).[25] The government also could have unique interests when the contract is classified or involves access to classified information.

2. Government Recovery Of Property

Government contracts frequently require access to and use of government property. In addition, the government regularly holds rights to property that a contractor acquires or develops during contract performance, including certain intellectual property. As a result, the government often has title in tangible and intangible property held by debtors. Several courts have granted the government relief from automatic stays to recover property if title to that property is vested in the government. This may include government-furnished property, contractor-acquired property, and other property where title has vested in the government.[26] For instance, in *In re American Pouch Foods, Inc.*, the U.S. Court of Appeals for the Seventh Circuit allowed the government to recover property to which it "held absolute title (and right to possession) to certain goods in the [debtor's] possession."[27] The court based its conclusion on a contract clause that vested title in the government "to all parts, materials, inventories, work in process and various other categories."[28] Similarly, in *In re Reynolds Mfg. Co.*, a district court in the Third Circuit held that courts should interpret government contract vesting clauses literally and concluded that title to all supplies that the debtor acquired in performance of a government contract vested in the government.[29]

3. Government Enforcement Through "Police And Regulatory Power"

Under the Bankruptcy Code, federal, state, and local governments are exempt from the automatic stay when exercising their "police and regulatory power."[30] The application of the police and regulatory power exception in the government contracting context tends to raise complicated issues because contractors are subject to compliance requirements not imposed on non-government contractors. The exception is generally limited to instances in which the government is enforcing laws and regulations relating to public health and safety.[31] Notably, courts have recognized that this exception does not apply when the government is seeking to enforce financial or economic rights arising solely by contract because such actions tend to advance the government's pecuniary interests in the debtor's property or could provide the government with an advantage over other creditors.[32]

Government contractors should expect the government to attempt to rely upon the police and regulatory power exception when seeking to enforce statutes and regulations that impose compliance obligations on government contractors through contract clauses or by operation of law. This would include, among many other requirements, the Service Contract Labor Standards statute (formerly known as the McNamara-O'Hara Service Contract Act (SCA)),[33] which requires contractors to, among other things, comply with prescribed wage standards and provide employees with certain minimum fringe benefits. At least one court has held the government can bring an action against a debtor to enforce SCA requirements notwithstanding the automatic stay.[34] While the case law in this area is limited, contractors should not assume that a bankruptcy court would preclude a government agency from enforcing requirements related to protecting sensitive government information, avoiding the use of technologies sourced from certain countries, and paying prevailing wages to personnel, to cite just a few examples. Even assuming the government needs stay relief to enforce such requirements, contractors should expect the government to be able to secure such relief.

Further, FCA actions[35] are also generally considered exempt

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from the automatic stay under this police and regulatory power exception, at least where the action is brought by the government and not a *qui tam* relator.[36] Debtors therefore may be forced to defend against FCA allegations and face exposure to the draconian financial and administrative sanctions that can follow from serious FCA violations. Moreover, companies emerging from bankruptcy may continue to face FCA liability for pre-petition conduct, as discussed below.

4. Potential Termination Of Existing Contracts

Government customers may be interested in terminating contracts after a contractor petitions for bankruptcy for a variety of reasons, including concern that the contractor may not have sufficient resources to perform or that resources used in performing the contract could be used to pay the contractor's creditors with more senior interests. Outside the bankruptcy context, the government generally has the right to terminate contracts for convenience or default.[37] The standard FAR clauses allow the government to terminate a contract if it is in its interest to do so.[38] The government may terminate a contract for default if the contractor fails to perform the contract and to cure an identified breach.[39]

Bankruptcy or insolvency is not, in itself, a basis on which the government may terminate a contract under the FAR default termination clause.[40] The FAR termination clauses (and other comparable non-FAR termination provisions) are not *ipso facto* provisions, i.e., provisions that declare a default upon filing for bankruptcy. Consequently, the contractor/debtor cannot exercise its right to invalidate *ipso facto* provisions to circumvent termination for convenience and default provisions. However, termination proceedings of pre-petition contracts are generally considered to be subject to the automatic stay, meaning the government cannot initiate termination proceedings after the contractor files a bankruptcy petition, absent court-ordered relief.[41]

Bankruptcy courts have been reluctant to provide the government with special treatment and relief from the automatic stay to terminate a contract immediately upon a bankruptcy filing, subject to some exceptions discussed below. Indeed, some courts have held that a provision allowing a party to terminate a contract for convenience is not in itself sufficient cause to grant relief from automatic stays, and a counterparty must still show "cause" to grant relief in accordance with 11 U.S.C.A. § 362(d)(1).[42] The Armed Services Board of Contract Appeals (ASBCA), a tribunal with jurisdiction over disputes between the government and contractors, has supported this view, holding that the automatic stay generally prevents termination actions.[43] On the other hand, it is conceivable that a bankruptcy court may provide stay relief to allow the government to proceed with a termination action, especially where the contract includes a termination for convenience provision.[44] Contractors should expect a bankruptcy court to provide the government with considerable discretion to terminate for convenience where national security or other mission concerns are implicated. Plus, the automatic stay does not protect against termination of contracts entered into after the bankruptcy petition is filed.[45]

As discussed below in Section C, a debtor in some jurisdictions may need the government's consent to assume or retain a government contract through the bankruptcy process. In those jurisdictions where such consent is required (i.e., the hypothetical test jurisdictions), contractors may find that bankruptcy courts are more inclined to grant a government request for relief from an automatic stay to pursue a termination based on the principle that the Anti-Assignment Act prohibits the debtor contractor from assuming the contract without the government's consent.[46] In contrast, debtors in jurisdictions where government consent is not required (i.e., the actual test jurisdictions) may be able to preclude a counterparty from exercising a termination for convenience provision on the basis that the counterparty's real reason for termination was the debtor's bankruptcy filing, which runs afoul of § 365(e)(1) of the Bankruptcy Code.[47] For this reason, it may be worthwhile for a contractor to attempt to draw the government out to explain why it is exercising a termination clause, in the hope that the government reveals that its real motivation is the bankruptcy filing or the debtor's financial condition generally, in violation of § 365(e)(1).

Lastly, a contractor planning to reorganize and exit bankruptcy should be mindful of the government's ever-present right to terminate contracts for convenience. Once a contractor is no longer in bankruptcy, there is no automatic stay to impede government customers from terminating the contractor's contracts for its own convenience. Thus, a reorganization plan should account for input from government customers and anticipate the need for novation agreements or similar mechanisms to memorialize government consent. For the same reason, contactors should be wary of declaring bankruptcy for the purpose of fending off anticipated government terminations. In addition, a contractor that is capable of paying its debts and seeks only to use bankruptcy as a means to frustrate a government action could find itself in a position where its bankruptcy case is dismissed as filed in bad faith or the government is the only impaired creditor and has extensive, undue control over whether a reorganization plan is confirmed.

5. Government Claims Against The Contractor/Debtor

Government contract claims (e.g., demands for money dam-

ages for breach of contract) in bankruptcy are generally treated in the same manner as private party claims. This equal treatment is grounded in the sovereign acts doctrine, which provides that when the government acts as a contracting party, it "stands in the same shoes as any private party would in dealing with another private party."[48] Not surprisingly, however, unique issues arise when resolving government contract claims during bankruptcy proceedings, including the forum for resolving those disputes and contractual notice requirements that are necessary to discharge government claims.

The litigation of disputes between contractors and the government is governed by federal common law and a complex web of statutes, regulations, and judicial doctrines, including the Contract Disputes Act (CDA)[49] and implementing rules in the FAR and agency-specific FAR supplements. Due to the complex, specialized nature of government contracts litigation, bankruptcy courts often defer to tribunals with expertise in adjudicating those disputes. Those tribunals include the U.S. Court of Federal Claims (COFC), the ASBCA, the Civilian Board of Contract Appeals (CBCA), and, on appeal, the U.S. Court of Appeals for the Federal Circuit.[50] In certain circuits, bankruptcy courts are required to stay proceedings and defer to those tribunals absent good cause for doing otherwise.[51] This can often result in delays as the bankruptcy court awaits adjudication of those claims.

6. Potential Limits On Contractor Requests For Relief And Contract Claims

Contractors that declare bankruptcy may face hurdles in pursuing equitable adjustments and contract claims against the government under the CDA. For example, in *Doninger Metal Products, Corp. v. United States*, the COFC held that the contractor, which was a debtor in bankruptcy, did not have standing to seek an equitable adjustment.[52] This decision was based on the specific circumstances of that bankruptcy and the fact that the debtor's property had been placed in an estate and controlled by a trustee. The outcome may have been different if the contractor had been a DIP and thus continued to control its property.[53] Nevertheless, this case illustrates pitfalls contractors may face after petitioning for bankruptcy and highlights the importance of careful planning to evaluate and balance all of the attendant risks and benefits when deciding whether and when to file for bankruptcy and whether and when to pursue contractual relief and contract claims against the government.

7. Government Evaluations Of The Contractor And Its Proposals During The Bankruptcy Process

Historically, it was thought that filing for bankruptcy would damage a company's reputation with customers, suppliers, and employees. Today, the same stigma usually does not attach to bankruptcy at least within financial markets. Despite this evolution in the perception of bankruptcy, contractors may still find that government customers look unfavorably upon a company that avails itself of bankruptcy.

As noted above, the Bankruptcy Code prohibits the government from discriminating in many contexts against debtors "solely" because they filed for bankruptcy, including when issuing licenses, permits, and grants.[54] The U.S Supreme Court, in *F.C.C. v. NextWave Personal Communications Inc.*, interpreted the word "solely" in 11 U.S.C.A. § 525(a) broadly as applying to government actions regardless of the government's motive.[55] Although the Bankruptcy Code does not expressly preclude the government from declining to award a contract to a debtor that otherwise would receive the contract, certain courts have interpreted the Bankruptcy Code's prohibition on discrimination to extend to contract awards. For instance, the Fifth Circuit in *In re Exquisito Services, Inc.* held that an agency's refusal to exercise an option period was based solely on the contractor's bankruptcy declaration and, therefore, violated § 525(a).[56] However, there is potential tension between this prohibition on discrimination and the concept of "responsibility" in federal government contracts. The government is required to determine whether a prospective contractor is "responsible" prior to awarding a contract to that entity.[57] When making responsibility determinations, agencies must consider, among other things, whether an offeror has (or has the ability to obtain) the technical and financial resources necessary to successfully perform the contract.[58] Notwithstanding this tension, the COFC and the Government Accountability Office (GAO), both tribunals with certain jurisdiction over bid protests, have denied bid protests challenging agency non-responsibility determinations based on an offeror's bankruptcy.[59] The Federal Circuit has also upheld a contracting officer's affirmative responsibility determination notwithstanding a contractor's bankruptcy declaration, indicating that bankruptcy is not an absolute bar to doing business with the government where the contracting officer is willing to conclude a company is otherwise responsible.[60] This case law shows that a bankruptcy filing is something that a contracting officer can cite as a basis to decline to award a contract, but it should not be disqualifying in most cases.

8. Effect Of Bankruptcy On Defense Production Act Rated Orders

The DPA,[61] which rose to new prominence with the COVID-19 pandemic, authorizes the Defense Priorities and Allocations System (DPAS), which is implemented through Department of Commerce regulations.[62] President Trump invoked the DPA through a March 18, 2020 Executive Order.[63] DPAS allows certain "delegate agencies" to place "rated

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orders" and "allocation orders" to require companies holding rated contracts, and in some cases industry more broadly, to prioritize U.S. government orders and allocate resources as necessary to support the national defense and emergency preparedness.[64] It is conceivable, if not likely, that the U.S. government could require a debtor to satisfy federal needs pursuant to DPAS notwithstanding any pending bankruptcy proceeding.[65]

C. Retention Of Government Contracts Through The Bankruptcy Process

A central consideration for a government contractor planning to reorganize through bankruptcy is whether the contractor will be able to retain its government contracts if and when it emerges from bankruptcy. As discussed below, the contractor may have the right to retain its contracts in bankruptcy, in certain jurisdictions, without the government's formal approval. Importantly, under applicable non-bankruptcy law, the government must recognize any third party that would seek to assume rights and responsibilities under an existing government contract and the government can terminate a contract as soon as the bankruptcy process is complete, if not sooner. For these reasons, it is advisable to consult with the government and attempt to secure government consent if a contractor intends to retain or transfer government contracts.

The jurisdiction in which the bankruptcy is pending may affect the debtor's ability to assume (or to assume and assign) its government contracts. Section 365(f) of the Bankruptcy Code, which applies to § 363 asset sales[66] and Chapter 11 reorganizations,[67] sets forth the general rule that a debtor may "assume" and/or "assume and assign" an executory contract[68] or unexpired lease, notwithstanding a contractual provision that prohibits, restricts, or conditions assignment.[69] "Assumption" is a term of art in bankruptcy law and defined under the Bankruptcy Code. It does not refer to a debtor's mere continuation of performance under an agreement subsequent to a bankruptcy filing. Rather, assumption is the mechanism by which a debtor, upon notice to creditors, seeks authorization from the bankruptcy court to reaffirm its obligations under an executory contract. It requires the debtor to cure monetary and other defaults and to prove that it has the capability going forward to meet its contractual obligations. The normal rule for commercial, non-government contracts (codified in § 365(f) of the Bankruptcy Code) is that, as part of a debtor assuming and assigning a contract, it can generally override anti-assignment provisions and assign that contract to a third party.[70] Notwithstanding this broad authority of debtors (as DIPs or through trustees) to assume and assign contracts, § 365(c) of the Bankruptcy Code provides that a counterparty may enforce a prohibition or restriction on assignment where "applicable law" (i.e., non-bankruptcy law) would excuse the counterparty from accepting performance from, or rendering performance to, an entity other than the debtor, and the counterparty does not consent to such assumption or assignment.[71]

By way of background, the Anti-Assignment Act, codified at 41 U.S.C.A. § 6305, generally prohibits contractors from assigning government contracts to third parties, stating that "[t]he 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."[72] There are exceptions to this prohibition, including government consent (usually accomplished through a novation), transfer by operation of law, and waiver. If a contractor violates the Anti-Assignment Act, the contract is annulled, although the government retains the right to bring a breach of contract claim against the contractor.[73] The purpose of the law is to help ensure that the government knows and approves of the parties with which it is contracting.[74]

Nearly all jurisdictions consider the Anti-Assignment Act to be an "applicable law" for purposes of the Bankruptcy Code that prohibits or restricts a debtor from its generally broad discretion to "assume and assign" (or transfer) contracts.[75] Importantly, in the context of bankruptcy proceedings, the Anti-Assignment Act has potential legal ramifications beyond just limiting assignments. Some courts have held that, due to the Anti-Assignment Act, a debtor cannot even assume (or retain) a government contract without the government's consent. Courts applying the actual test hold that the Anti-Assignment Act applies only where the contractor seeks to assign a contract to a third party, but not to the debtor's assumption of the contract (through which the debtor essentially assigns the contract to itself). In hypothetical test jurisdictions, however, the contractor can neither assume nor assign a contract, including to itself as a DIP, without government approval. While it may seem that reorganizations should fall under the "operation of law" exception to the Anti-Assignment Act, this is not the case in hypothetical test jurisdictions, which view the pre- and post-petition company as distinct entities. Thus, the pre- and post-petition companies are not considered to be "essentially the same entity." Indeed, at least one court has held that 11 U.S.C.A. § 365(c) is a "general non-transferability statute" that "precludes any assumption of the contract, *even where such an assumption might otherwise occur by operation of law*."[76] Where the government refuses to consent to an assumption, the contractor transferring the contract to a DIP will be deemed to have breached the contract, which could result in the government pursuing a termination for default.

The upshot is that the contractor's ability to retain its contracts in bankruptcy may depend on the judicial circuit in

which the bankruptcy case is filed. In those circuits that follow the hypothetical test, a government contractor may be precluded from assuming and retaining its government contracts by virtue of the Anti-Assignment Act. Jurisdictions that follow the hypothetical test include the Third Circuit,[77] the Fourth Circuit,[78] the Ninth Circuit,[79] and the Eleventh Circuit.[80] Jurisdictions that follow the actual test include the First Circuit[81] and most bankruptcy courts in circuits that have not decided this issue.[82] A distressed contractor should consider these issues when selecting the venue in which to file its bankruptcy petition. Federal law allows debtors to file petitions in the U.S. district court for the district where the company had its principal place of business or maintained its principal assets for 180 days preceding filing the petition or, if they have not been limited to a single district for 180 days, the district in which the company had its principal place of business or held its principal assets "for a longer portion of such [180-] day period."[83] When this analysis may result in multiple potential venues, distressed government contractors should consider the implications of venue on the contractor's ability to retain its government contracts.

As noted above, it is critical to not focus solely on the bankruptcy jurisdiction but to also remain mindful of the important role the government plays in the ability of a contractor to retain or transfer contracts. The government may show greater deference to a debtor if the bankruptcy proceeding is in an actual test jurisdiction, but that is not always the case. The government typically holds some degree of leverage due to its right to terminate contracts for convenience, which it can exercise as soon as a company emerges from bankruptcy, if not sooner. Thus, regardless of jurisdiction, it is prudent for a contractor to consult with government customers about the bankruptcy and any plans to retain or transfer government contracts. A government customer will inevitably have concerns when an important contractor has entered bankruptcy. The contractor should be prepared to address any such concerns and explain why the contractor's plan for the performance of existing contracts—whether that involves retention, transfer, or a combination of the two—is in the government's best interest.

D. Special Considerations For Acquiring Government Contract Assets Through Bankruptcy

When a government contractor is financial distressed, it may seek to sell some or all of its assets, including its interests in government contracts, in an attempt to avoid bankruptcy, or in bankruptcy, as part of a plan to divest assets, reorganize, or through liquidation. Strategic or financial acquirers assessing potential value in a distressed government contractor's assets must consider unique regulatory requirements and other considerations applicable to federal government contracts, including restrictions on assignment of contracts, successor liability standards that vary from those in the purely commercial context, preservation of positive past performance and experience, and when applicable, national security concerns, including those stemming from foreign ownership, control, and influence (FOCI). If the target is in bankruptcy, acquirers may face additional difficulties in transferring government contracts, discharging liabilities, and navigating national security concerns. Prospective acquirers must consider these issues in concert with all the standard considerations when structuring a potential transaction and planning for how to address the regulatory and government-unique processes both before and after closing. This section discusses various considerations relevant to acquiring government contract assets through the bankruptcy process.

1. Transfer Of Government Contracts During Or Following Bankruptcy

A primary concern of any prospective acquirer of a government contractor or its assets is preservation of existing government contracts and their associated revenue stream. As discussed above, transferring and assigning government contracts is generally more complicated than transferring and assigning commercial contracts, and such transfers are even more complicated during a pending bankruptcy. As explained above, the Anti-Assignment Act is critical to the bankruptcy court's assessment of whether the debtor can assume (or retain) the preexisting government contracts. If the debtor during bankruptcy, or the contractor after emerging from bankruptcy, is interested in transferring its government contracts, the Anti-Assignment Act will be directly implicated. This makes sales of government contracts in a bankruptcy more complicated than the typical Bankruptcy Code § 363 sales in other contexts.

Transferring government contracts between companies necessitates advanced planning and planning is even more important and complicated in the bankruptcy context, especially if the seller is liquidating due to insolvency and will be pursuing dissolution after the bankruptcy case closes. Where novations are required, this planning should include consideration of how best to bridge the period between closing and the effective date of the novation. Buyers and sellers, following notice to the contracting officer, may need to execute a transition agreement, typically some form of agency or subcontracting arrangement, pending approval of the novation. These arrangements often present their own challenges, which are compounded in the bankruptcy process, and their viability may depend on the terms of the underlying prime contract, including any consent-to-subcontract requirements.

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● *Novation Process*—To obtain the government's consent to a transfer, the parties must comply with the novation process detailed in FAR 42.1204. This process requires the parties to submit a proposed tri-party novation agreement and certain supporting documentation to the cognizant contracting officer, which, in many cases, is an ACO acting on behalf of all of the contractor's agency customers.[84] A complete novation package cannot be submitted to the government until a transaction has closed, due in part to the documentation requirements.

There is no guarantee that an agency will consent to a transfer of a government contract, and the decision to accept or reject a novation falls within the broad discretion of the contracting officer. Indeed, the Federal Circuit held in *Ordnance Devices, Inc. v. United States* that a buyer "ha[s] no right to have the contracts novated" and explained that the buyer "took a business risk when it purchased" the seller's assets because it "had no guarantee that the contracts would be novated."[85] For an acquisition that will require the novation of one or more contracts, this creates risk for both the seller and the purchaser. Additionally, there is no prescribed timeline for the government to decide whether to accept or reject a novation request, which can delay the transfer for weeks or months.

This delay is why transition arrangements, as discussed below, are necessary. Notably, however, such arrangements may not provide sufficient protection if the government ultimately withholds any required consent, including consent required under FAR 52.244-2, Subcontracts. Acquirers should negotiate provisions in the purchase agreement for unwinding the transaction, or to reduce the purchase price or trigger other considerations, if the government fails to approve the novation of material contracts. Subcontracting arrangements may also be unattractive or infeasible when the prime contract is a small-business set-aside contract and the buyer is not a "similarly situated" business. Where applicable, FAR 52.219-14, Limitations on Subcontracting, requires the employees of the small business prime contractor to perform a specified portion of the work.[86]

● *Transition Agreements*—Subcontracts pending novation are commonly used to transfer certain performance obligations and financial benefits from a government contractor to its acquirer or an acquirer-controlled company, while a novation request is pending. When the transferor is a debtor planning to dissolve, this waiting period presents unique challenges. Once the debtor sells all or substantially all of its assets, the debtor will typically be little more than a shell company, winding up its business. Pending approval of the novation, however, the debtor must continue to serve as the prime contractor and perform, at a minimum, administrative tasks, including invoicing, maintaining a bank account to receive payments, and distributing payments to the subcontractor buyer to avoid termination for default. For this reason, it may not be feasible to novate contracts in connection with a liquidation. These ongoing obligations, and the buyer's interest in the debtor's continued existence to serve as the prime contractor, may conflict with the debtor's interest in dissolving and may not be feasible if the debtor lacks sufficient resources to survive long enough to facilitate the transition. To ensure the buyer's interests are adequately protected, a buyer must carefully draft the transaction documents (including any subcontracts) to provide that the seller contractor will continue to perform its prime contractor obligations until the contracting officer issues the final decision approving the novation. The parties involved in this type of acquisition should consider whether it is realistic for the debtor to continue to perform even minimal obligations given the recurring costs involved.

2. Limiting Exposure To Pre-Bankruptcy Liabilities

Diligence is critical to assessing liability risks, but even in the most facilitative conditions, diligence rarely, if ever, reveals all risks and never eliminate those risks. The bankruptcy process is not conducive to diligence. Thus, a central concern of any prospective acquirer is limiting exposure to the target's legacy liabilities—known and unknown—to the maximum extent practicable. This concern is often heightened in the context of distressed companies given the likelihood that they face substantial liabilities and lack the assets to satisfy those liabilities, meaning creditors will look elsewhere for relief.

The type and structure of a transaction can affect whether the acquirer inherits liabilities of the seller. Although the Bankruptcy Code provides unique rules for discharging liability in Chapter 11 reorganizations, those protections do not always extinguish all financial liability and other negative consequences for pre-petition actions of the debtor. That is a primary reason why prospective acquirers would not be interested in purchasing the debtor's business, including its government contracts, through an equity sale. Acquirers may attempt to exclude liabilities from an asset purchase and extinguish liabilities through the bankruptcy process, such as through a Bankruptcy Code § 363 sale.[87] With limited exceptions, the standard successor liability doctrines (i.e., implicit assumption, fraudulent transfer, continuity of enterprise, and de facto merger theories) generally do not apply to an acquirer that purchases assets through a § 363 sale. However, if an acquirer agrees to the novation of contracts from the contractor, the acquirer (or the company that serves as the transferee, i.e., the company that would be the government contractor following the novation) may be responsible for existing contractual liabilities through the express terms of a novation agreement.

● *False Claims Act Liability*—The question of whether FCA

liability was discharged through a prior reorganization is a fact-intensive inquiry that can vary across jurisdictions. Section 523 of the Bankruptcy Code provides that non-dischargeable debts include "any debt . . . for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by—(A) false pretenses, a false representation, or actual fraud"; or "(B) use of a statement in writing . . . that is materially false."[88] To satisfy this standard, a "[c]reditor must prove that the debtor obtained money through a material misrepresentation that at the time the debtor *knew was false* or made with *gross recklessness* as to its truth."[89] Prior to 2005, this section did not apply to corporate debtors, which could discharge all debts.[90] The Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA)[91] rendered non-dischargeable certain corporate debts owed to a domestic governmental unit, including i.e., debts arising from fraud.[92] It also excluded from discharge any debt "owed to a person as the result of an action filed under [the FCA] or any similar State statute."[93]

It is unclear whether FCA liability is *per se* non-dischargeable through 11 U.S.C.A. § 1141, which governs the confirmation of the plan. Under 11 U.S.C.A. § 523(a)(2)(A), which is the general fraud provision, a key question is whether the debtor's intent in committing fraud rose to the level contemplated by the Bankruptcy Code (i.e., actual knowledge or "gross recklessness as to its truth").[94] In light of recent Supreme Court precedent, there would appear to be significant, if not perfect, overlap between the Bankruptcy Code and the scienter necessary for liability under the FCA.[95] Section 523(a)(2)(B), which specifically references the FCA and similar state statutes, has rarely been interpreted by courts. At least one court has held that § 523(a)(2)(B) does not apply to the FCA because it refers to debts owed to a "person" and FCA claims belong to the government, which is not a person.[96]

The uncertainty surrounding the discharging FCA liability is another reason that prospective acquirers may favor acquiring government contracts and other assets from the debtor rather than attempt to purchase the contractor itself, even after it emerges from bankruptcy. At least one federal court has indicated that the standard for analyzing whether a successor is liable under the FCA is the same regardless of whether government contract assets are transferred to the successor through a § 363 asset sale or through a standard asset sale outside the bankruptcy context.[97] Thus, while there is some risk that successor FCA liability could apply through a § 363 asset sale, such a sale may still be more effective at extinguishing or avoiding FCA liability than a sale outside of bankruptcy.

In all situations involving the acquisition of government contract assets (in or outside of bankruptcy), it is prudent to attempt to perform some diligence focused on potential exposure to FCA liability. There are inherent limitations in assessing FCA risks in diligence. One of those limitations is that the target often does not know that it is subject to FCA scrutiny, as a *qui tam* action could be pending and the seller may not have knowledge of the suit. Plus, as noted above, diligence can be more difficult in the context of bankruptcy.

● *Contractual Liability*—In Chapter 11 reorganizations, once the bankruptcy court confirms the reorganization plan, all debts—including government claims—are discharged, unless the Bankruptcy Code or the plan deems them non-dischargeable.[98] Government contract claims against the contractor debtor are normally discharged through the bankruptcy. Although discharge precludes the debtor's liability for those debts, the debts are not typically extinguished against non-debtor parties, absent the confirmed plan including a third-party release or some other unique cases. Thus, notwithstanding the government's inability to collect on that discharged debt from the contractor, absent an injunction or other provisions in a confirmed plan or other bankruptcy court order to the contrary, the government "may recover on the claim from third parties possessing liability, such as guarantors, sureties, and insurers."[99]

The standard FAR novation agreement provisions can complicate a prospective acquirer's efforts to extinguish liability to the government through the bankruptcy process. FAR 42.1204 states that the novation agreement "shall ordinarily provide in part that . . . [t]he transferee assumes all the transferor's obligations under the contract."[100] The standard FAR novation agreement "may be adapted to fit specific cases and may be used as a guide in preparing similar agreements for other situations"[101] but includes that standard provision stating that "[t]he Transferee also assumes *all obligations and liabilities of, and all claims against, the Transferor*."[102] Bankruptcy cases may necessitate modifications to, or elimination of, this provision to avoid assuming liabilities extinguished through the bankruptcy process, though agencies may push back on attempts to remove this assumption of liabilities provision from the standard novation agreement. Unless the government agrees to modify the standard novation terms or to a special release or settlement, an acquirer of government contracts and related assets may find that it is liable for contractual liability that pre-dates the acquisition and bankruptcy petition.

● *Administrative Sanctions*—Bankruptcy discharge may be able to restrict more than just the government's ability to collect on a debt. At least one court has extended discharge protections to suspensions and debarment.[103] For example, in *In re*

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Pilgrim's Pride Corp., the bankruptcy court denied the Department of Labor's request that the debtor be excluded from conducting business with the government.[104] The court denied the request to the extent it arose from pre-confirmation conduct that itself was a discharged claim. Notwithstanding this decision, contractors should not expect that suspension and debarment officials will defer to bankruptcy courts.

• *Negative Performance Record*—Questions may arise concerning whether a procuring agency can downgrade a proposal based on negative past performance that occurred prior to a bankruptcy filing. These questions could apply where a contractor reorganizes and emerges from bankruptcy or where a contractor's assets are purchased such that its business is reconstituted in a new company. The ability of an offeror to claim credit for past performance and the discretion of an agency to consider past performance as relevant to a particular offeror tend to demand a fact-specific inquiry that considers, among other factors, the terms of the applicable solicitation, the relationship between the offeror and the potentially relevant past performance, and the passage of time. Companies and financial sponsors seeking to acquire government contract assets should consider whether past performance is likely to convey with the assets and whether that past performance is advantageous or not.

3. Other Government Contracting Considerations

There are various other considerations relevant to acquiring government contracts and related assets from a distressed government contractor before, during, or after bankruptcy. The following highlights some of the issues that take on increased or special importance in these situations.

• *Government Compliance Program and Controls*—As discussed above, it may be possible for an acquirer to extinguish or otherwise avoid responsibility for financial liability associated with instances of contractual non-compliance that occurred prior to the acquisition. However, unless the acquirer plans to consolidate the acquired assets with a strong existing government contracting compliance structure, it is usually important for the acquirer to perform diligence on the compliance posture of the contractor and the sufficiency of the compliance program and other controls that are included in the deal.

As with any acquisition of a government contractor or government contract assets, it is important to perform specialized due diligence to assess issues related to the contractual and regulatory obligations that apply to any government contracts included within the acquisition. Those include compliance with applicable cybersecurity requirements and continuing eligibility for small business-set-aside contracts or other preference programs. While that diligence will be similar in nature to the diligence performed on any government contractor, additional scrutiny is warranted if there is concern that financial challenges may have resulted in the allocation of inadequate resources to compliance efforts.

Strategic and financial buyers should consider whether the assets included in the detail are sufficient to satisfy any compliance obligations and, if they are not, account for the resources and costs associated with implementing an adequate compliance program and other internal controls. The nature and scope of the compliance measures required will depend in large part on the requirements of the contracts included in the deal. If an acquirer fails to account for the need to address compliance going forward, it may find that legacy non-compliance issues carry over under new ownership and create new liability.

• *Supply Chain Risks*—Prospective buyers of government contract assets must consider actual or potential supply chain risks. Such issues tend to be more common for distressed companies. Diligence should consider whether the prime contractor's financial challenges have resulted in breach of important first-tier subcontracts. It is important to assess whether the supply chain is healthy and able to deliver and perform on schedule. Prime contractors are responsible for their supply chains and can be liable to the government for a subcontractor's nonperformance or poor performance. This is true even when the prime contractor was not at fault for and had no control over the subcontractor's performance. The government will consider if the prime contractor could have obtained supplies or services from other sources or the contracting officer directed the contractor to purchase supplies or services from alternative sources and the contractor did not comply with that directive.[105] Even if it is possible to extinguish, settle, or otherwise resolve liability for pre-petition issues related to a contractor's supply chain, those issues can create additional problems and liability going forward.

• *Organizational Conflicts of Interest*—Government contractors generally must avoid organizational conflicts of interest (OCIs).[106] OCIs usually do not present insurmountable obstacles to doing business with the government. Some OCIs can be avoided or, if not avoidable, mitigated. Plus, agencies have broad discretion to waive OCIs, and the GAO has been reluctant to second-guess agency waivers absent procedural errors, such as when the waiver was not in writing.[107] It is still important, however, for prospective acquirers to assess whether the transaction would create actual or apparent OCIs that could affect either the acquired assets or the acquirer's existing business.

It is important to identify OCI issues in diligence involving a distressed company, as there can be a tension between OCI

principles and a debtor's obligation in bankruptcy to select the highest and best offer in § 363 asset sales and to act in the best interest of creditors when developing a reorganization plan. For example, a plan might not be in the best interest of creditors if the reorganization would jeopardize existing OCI mitigation plans, such as when the plan is already approved by the government, or raise new OCI concerns. These are issues the parties and the court will need to navigate as the bankruptcy proceeds, but they cannot be addressed unless they are identified through diligence.

● *Government Intellectual Property Rights*—The government generally obtains broad license rights in technical data and software developed with government funding and to subject inventions that arise from government-funded research. The government may hold rights to use software and detailed technical data in its possession (e.g., delivered by the contractor) based on FAR and agency data rights clauses included the debtor's government contracts.[108] In such instances, the government is a licensee—it does not have title to the software or technical data, but it has certain rights to use the software or technical data. It is questionable whether bankruptcy could discharge the government's rights in intellectual property (e.g., Bayh-Dole Act license rights in a subject invention[109]) that arise through its funding of development that occurs prior to bankruptcy, absent the government's express agreement. Even assuming a contractor could reject (breach) this type of government license right in bankruptcy, the government should be able to benefit from the protections reflected in 11 U.S.C.A. § 365(n), which allow a licensee to retain its rights under a license agreement even where the debtor rejects the license. Consequently, it is critical for diligence to consider the government's rights in the debtor's intellectual property and the potential for those rights to undermine the value of the intellectual property and perhaps the contractor's other assets. There may be instances in which the debtor's continued performance or the ability to rely on other debtor assets are critical to maintaining the practical value of the intellectual property (e.g., where the use of proprietary software is only feasible with the debtor's performance of maintenance or provision of recurring updates) and such considerations would need to be addressed.

● *National Security Concerns*—For contractors performing classified contracts, issues regarding FOCI must be addressed to ensure that the contractor can continue to perform and continuity or transfer of facility security clearances, export controls registrations and licenses, and requirements for review and approval by the Committee on Foreign Investment in the United States. FOCI determinations and associated mitigation requirements are different in some respects for each requirement, but each assessment is aimed at evaluating and limiting the ability of foreign interests to access classified or controlled information and to control, direct, or decide, directly or indirectly, issues related to a company's management and operations.

Although FOCI requirements apply equally to transactions involving solvent and insolvent companies, FOCI can inject challenges into bankruptcy proceedings. For instance, there may be tensions between FOCI review and mitigation and the "best interests of creditors" test that applies to Chapter 11 reorganizations or the requirement that a debtor accept the highest and best offer in § 363 asset sales. If a transaction could be unwound, or if the sale price could be reduced due to national security concerns, an offer that may be the highest-priced could nevertheless prove not to be in the best interests of creditors or the best offer.

E. Conclusion

U.S. government contractors are highly regulated. The same is true of the U.S. bankruptcy system. When a government contractor enters the bankruptcy process, these complex legal regimes overlap, creating a web of complicated legal and practical issues. It is critical for government contractors and those seeking to acquire or invest in government contractors or their assets to understand both the rules applicable to government contracts and the special rules that apply to such contracts in bankruptcy.

Companies holding even a single government contract face unique requirements and hurdles when seeking bankruptcy protection. These include notice requirements, loopholes that may jeopardize their right to an automatic stay, the potential termination for convenience of existing contracts, restrictions on assumption and assignment of those contracts, and limits on requests for equitable adjustment and contract claims. At the same time, contractors that think strategically may be able to use these features to their advantage. In some contexts, requests for equitable adjustments, followed by submission of a certified claim and appeal of a contracting officer's final decision, if necessary, could allow contractors to recover funds sufficient to help offset existing debts and provide working capital to facilitate a restructuring. As noted above, however, contractors that file bankruptcy petitions—particularly those that will not be DIPs—could find themselves unable to pursue equitable adjustment claims and contractual relief if they file bankruptcy petitions prematurely.

The assessment for prospective acquirers interested in government contract assets is often even more challenging. In addition to the contractual and compliance rights and obligations distinguishing government contractors from commercial acquisition targets, options presented to distressed contractors,

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including asset sales and reorganizations, both within and outside a bankruptcy process, need to be identified and coordinated between government contracts and bankruptcy counsel to ensure the best outcome for the parties. The parties must plan for and address an additional statutory overlay and court approval requirements. It is critical for government contractors and prospective buyers to understand the Anti-Assignment Act and how that law affects the acquisition of government contracts from distressed companies.

The bankruptcy process may offer attractive benefits to a distressed government contractor and prospective acquirers, but if they do not account for the government's rights and powers, they may find it much more difficult, if not impossible, to accomplish their objectives.

F. Guidelines

These *Guidelines* are intended to assist in understanding what government contractors and those seeking to acquire government contract assets need to know about bankruptcy and related concepts. They are not, however, a substitute for professional representation in any specific situation.

1. Wherever possible, a financially distressed government contractor should consider the potential implications of a bankruptcy petition on its government contracts before filing for bankruptcy, and spend significant time, in advance of any potential bankruptcy filing, analyzing and planning for these implications and scenarios.

2. A financially distressed government contractor should consider the implications of the bankruptcy jurisdiction on the ability of the contractor to retain its existing government contracts.

3. A government contractor that has entered bankruptcy or is contemplating entering bankruptcy should consider the need to follow the novation process to transfer contracts to another entity, including through a Bankruptcy Code § 363 asset sale. The contractor should consider the willingness of government customers to consent to novation, the practical implications associated with the normal delays in novation processing, including increased costs, and the implications of the novation agreement on the feasibility of discharging or avoiding debts and liabilities.

4. A government contractor that has entered bankruptcy should comply with its notice obligations under FAR 52.242-13, Bankruptcy. A contractor should be cautious about providing advance notice, unless contractually required, because the contractor cannot avail itself of the automatic stay and nondiscrimination rules prior to filing for bankruptcy.

5. A government contractor that has entered bankruptcy should confirm that it possesses an accurate accounting of the equipment and other property in its possession to which the government holds title and communicate with government customers about plans for such property.

6. A government contractor that has entered bankruptcy should be cognizant of the protections provided by the Bankruptcy Code, including the automatic stay and nondiscrimination rules, and assert those protections if and where appropriate, including in response to adverse actions from government customers, including terminations for default or convenience, contract claims for breach of contract, and negative performance evaluations and proposal evaluations.

7. A company or financial sponsor that is considering attempting to acquire assets from a distressed government contractor should understand the unique statutory, regulatory, and contractual requirements, restrictions, and limitations that apply to government contractors and their government contracts in the context of bankruptcy and the possibility for liability for pre-petition actions, including FCA liability, to survive.

ENDNOTES:

[1]11 U.S.C.A. § 1123(a)(5)(B), (D); see also CHS, Inc. v. Plaquemines Holdings, L.L.C., 735 F.3d 231, 238 (5th Cir. 2013) ("Chapter 11 of the Bankruptcy Code permits a debtor to reorganize or liquidate all or substantially all of its assets.").

[2]11 U.S.C.A. §§ 349(a), 706, 1112.

[3]A company qualifies as a "small business" under this subchapter if the company's debts, exclusive of debts owed to affiliates or insiders, do not exceed $7,500,000 and if at least 50% of those debts "arose from the commercial or business activities of the debtor." 11 U.S.C.A. § 1182(1)(A). Congress temporarily increased this threshold from $2,725,625 through the Coronavirus Aid, Relief, and Economic Security (CARES) Act, Pub. L. No. 116-136, § 1113(a)(1), (5) (2020), for one year, and subsequently in the Bankruptcy Threshold Adjustment and Technical Corrections Act, Pub. L. No. 117-151, § 2(d), (i)(1)(B) (2022), until June 21, 2024.

[4]11 U.S.C.A. § 1191(b).

[5]11 U.S.C.A. § 1102(a)(3).

[6]11 U.S.C.A. § 1181(b) (making 11 U.S.C.A. § 1125 inapplicable except for good cause).

[7]11 U.S.C.A. § 1191(e).

[8]Subchapter V Bankruptcy Filings Increase 81% Y/Y in April, Total Chapter 11s Up 32%, MonitorDaily (May 3, 2023), https://www.monitordaily.com/news-posts/subchapter-v-bankruptcy-filings-increase-81-y-y-in-april-total-chapter-11s-up-32/.

[9] 11 U.S.C.A. § 103(a) ("Except as provided in section 1161 of this title, chapters 1, 3, and 5 of this title apply in a case under chapter 7, 11, 12, or 13. . . .").

[10]11 U.S.C.A. § 363(b)(1).

[11] 11 U.S.C.A. § 363(b)(1).

[12] 11 U.S.C.A. § 363(f). This section applies if "(1) applicable nonbankruptcy law permits sale of such property free and clear of such interest"; (2) the entity other than the estate consents to the sale; "(3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property; (4) such interest is in a bona fide dispute; or (5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest." 11 U.S.C.A. § 363(f)(1)–(5).

[13] 11 U.S.C.A. § 1123. See generally In re Ditech Holding Corp., 606 B.R. 544 (Bankr. S.D.N.Y. 2019).

[14] 11 U.S.C.A. § 362(a).

[15] 11 U.S.C.A. § 362(c)(2), (d).

[16] 11 U.S.C.A. § 362(b)(4).

[17] 11 U.S.C.A. § 525(a).

[18] 11 U.S.C.A. § 365(f).

[19] The simplified acquisition threshold is currently $250,000, with certain exceptions. See FAR 2.101, Definitions.

[20] FAR 42.903.

[21] FAR 52.242-13. Contractors should be careful about notifying the government about an actual or potential bankruptcy before filing the bankruptcy petition because the protections afforded through the bankruptcy process do not apply until the petition is filed.

[22] FAR 52.242-13. Contractors should timely notify the cognizant contracting officer for each contract of pending bankruptcy petitions. A contractor that fails to provide the required notice could be liable to the government for injuries caused by the contractor's failure to provide the required notice. Although contractors should ensure that they comply with the FAR notice requirements, contractors may have various defenses when they fail to provide the required notice. For example, in In re Santos, the bankruptcy court held that constructive and actual notice were insufficient to satisfy notice requirements but held that the equitable defense of laches prevented the government from raising claims after the debtor's case was closed. The court found that the government had actual notice of the debtor's bankruptcy and could have raised its claims, while the bankruptcy case was pending. 589 B.R. 413 (Bankr. D. Col. 2018). If the government had not received actual notice and thus not knowingly failed to raise its claims, the government's claims could have survived the bankruptcy process. Contractors are well advised not to assume this risk.

[23] FAR 42.901.

[24] FAR 42.902(a).

[25] See 50 U.S.C.A. § 4511(a).

[26] See FAR 52.232-16(d), Progress Payments; FAR 52.232-12, Advance Payments (providing for liens and vesting of titles). "Government-furnished property" is tangible "property in the possession of, or directly acquired by, the Government and subsequently furnished to the Contractor for performance of a contract." FAR 52.245-1(a).

[27] In re Am. Pouch Foods, Inc., 769 F.2d 1190, 1191 (7th Cir. 1985) (affirming district court decision that, due to certain contract clauses, "the United States held absolute title (and right to possession) to certain goods in the possession of the Debtor").

[28] 769 F.2d at 1192.

[29] In re Reynolds Mfg. Co., 68 B.R. 219 (W.D. Pa. 1986).

[30] 11 U.S.C.A. § 362(b)(4).

[31] In re Royal, 137 F. App'x 537, 541 (4th Cir. 2005) (holding that government's use of eminent domain was not exempt from the stay because eminent domain was not used to enforce "pre-existing public health or safety regulations" and stating: "The statutory context therefore indicates that we should read [11 U.S.C.A. §] 362(b)(4) narrowly because the bankruptcy court can quickly and easily correct issues resulting from a problematic stay, but has no power to correct issues caused by a problematic exception to a stay."); In re Chapman, 264 B.R. 565, 569 (9th Cir. 2001) ("[T]he Ninth Circuit applies the "pecuniary purpose" and the "public policy" tests in determining whether § 362(b)(4) applies. The pecuniary purpose test reviews whether the government acted primarily to protect its pecuniary interest in the debtor's property or the public safety and welfare. If it is the former, the stay applies. The public policy test examines whether the government's actions are motivated to effectuate public policy or private rights. Satisfaction of either test will suffice." (citations omitted)).

[32] See, e.g., United States v. Nicolet, Inc., 857 F.2d 202, 207-209 (3d Cir. 1988); In re Corporacion de Servicios Medicos Hospitalarios de Fajardo, 805 F.2d 440, 445–47 (1st Cir. 1986).

[33] 41 U.S.C.A. §§ 6701–6707; FAR subpt. 22.10, Service Contract Labor Standards; FAR 52.222-41, Service Contract Labor Standards. Cf. Solis v. SCA Rest. Corp., 463 B.R. 248 (E.D.N.Y. 2011) (Department of Labor's action under the Fair Labor Standards Act exempt from automatic stay).

[34] See Eddleman v. U.S. Dep't of Labor, 923 F.2d 782, 783 (10th Cir. 1991).

[35] 31 U.S.C.A. §§ 3729–3733.

[36] See, e.g., In re Universal Life Church, Inc., 128 F.3d 1294, 1298 (9th Cir. 1997) ("[A] civil suit brought pursuant to the Federal False Claims Act is sufficient to satisfy the [11U.S.C.A.] 362(b)(4) exception."); In re Commonwealth Cos., 913 F.2d 518, 526 (8th Cir. 1990) ("[C]ivil actions by the government to enforce the FCA serve to inflict the "sting of punishment" on wrongdoers and, more importantly, deter fraud against the government, which Congress has recognized as a severe, pervasive, and expanding national problem. The police and regulatory interests furthered by enforcement of the FCA are undeniably legitimate and substantial. The fact that the statute's chief purpose is to make the government whole does not reduce the weight of these interests so as to make their vindication insufficient to qualify for the [11 U.S.C.A.] § 362(b)(4) exception from the automatic stay."); United States v. Vanguard Healthcare, LLC, 565 B.R. 627 (M.D. Tenn. 2017) (similar); United States ex rel. Fullington v. Parkway Hosp., Inc., 351 B.R. 280 (E.D.N.Y. 2006) (similar); United States ex rel. Doe v. X, Inc., 246 B.R. 817 (E.D. Va. 2000) (similar).

[37] See, e.g., FAR 52.249-2, Termination for Convenience of the Government (Fixed-Price); FAR 52.249-6, Termination (Cost-Reimbursement). Many commercial contracts also contain ipso facto clauses, which are contract clauses that terminate contracts when a party files for bankruptcy. The Bankruptcy Code generally allows debtors to override ipso facto provisions. 11 U.S.C.A. § 365(a). Termination for convenience and default provisions are not ipso facto clauses, and federal procurement contracts governed by the FAR do not contain ipso facto provisions, although such provisions may be

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included in other government contracts, though non-procurement contracts that are not subject to the FAR (e.g., other transaction agreements) can contain these clauses. Government subcontracts awarded under government prime contracts may include an ipso facto provision separate from a flow-down of the FAR Termination for Convenience clause.

[38]See, e.g., FAR 52.249-2(a); FAR 52.249-6(a)(1).

[39]See, e.g., FAR 52.249-6(a)(2).

[40]See, e.g., FAR 52.249-8, Default (Fixed-Price Supply and Service); see also 11 U.S.C.A. § 525(a) (prohibit discrimination by government entities against debtors).

[41]See, e.g., In re Enron Corp., 300 B.R. 201, 211–12 (Bankr. S.D.N.Y. 2003) (holding that a contract cannot be terminated without first seeking stay relief, regardless of the existence of a provision in the contract allowing for termination); In re Redpath Computer Servs., 181 B.R. 975, 978–79 (Bankr. D. Ariz. 1995) (finding that "the Bankruptcy Code neither enlarges the contract rights of a debtor, nor prevents termination of a contract by its own terms," but "[a]n executory contract that is property of the estate can only be terminated after a grant of relief from the stay"); Commc'ns Tech. Applications, Inc., ASBCA No. 41573, 92-3 BCA ¶ 25,211 (holding that termination for default was stayed by bankruptcy proceeding); Harris Prods., Inc., ASBCA No. 30426, 87-2 BCA ¶ 19,807 (holding that terminations for default based on facts that arose prior to the debtor filing the petition are stayed); In re Corporacion de Servicios Medicos Hospitalarios de Fajardo, 805 F.2d 440 (1st Cir. 1986) (same).

[42]See In re The Elder-Beerman Stores Corp., 195 B.R. 1012, 1018 (Bankr. S.D. Ohio 1996) ("The conditions under [11 U.S.C.A. §] 362(d) govern relief from the stay, and when those conditions are not met, courts have not hesitated to leave the stay intact, even in the presence of 'at will' termination clauses."); Coaldale Energy LP v. Lehigh Coal & Navigation Co. (In re Lehigh Coal & Navigation Co.), 2009 WL 1657096, at *3–4 (Bankr. M.D. Pa. June 12, 2009) (holding that the debtor's ability to terminate the agreement at will "may not be sufficient to constitute cause to grant relief," but finding that cause existed to grant stay relief on other grounds).

[43]See, e.g., U.S. Coating Specialty & Supplies, LLC, ASBCA No. 58245, 17-1 BCA ¶ 36,710 ("U.S. Coating's bankruptcy filing imposed an automatic stay pursuant to 11 U.S.C.A. § 362(a), prohibiting the CO from commencing administrative actions or proceedings against U.S. Coating. Martel Truck & Tractor Serv., Inc., ENG BCA No. 6191, 96-2 BCA ¶ 28,368 at 141,649. Therefore, the Corps could not terminate the contract for default absent permission from the Bankruptcy Court. Id. at 141,650.").

[44]See Valley Forge Plaza Assocs. v. Schwartz, 114 B.R. 60 (E.D. Pa. 1990) (holding that the Bankruptcy Code does not prevent termination of a contract by its own terms, and "the ability to terminate a contract on its terms survives bankruptcy").

[45]See In re New England Marine Servs., Inc., 174 B.R. 391, 397 (Bankr. E.D.N.Y. 1994).

[46]See also United States v. TechDyn Sys. Corp., (In re Tech Dyn Sys. Corp.), 235 B.R. 857 (Bankr. E.D. Va. 1999) (distinguishing between debtor and DIP and granting agency relief from automatic stay to terminate contract because, under the Anti-Assignment Act, contractor debtor could not assume or assign government contract without agency's consent).

[47]11 U.S.C.A. § 365(e)(1); see In re Nat'l Hydro-Vac Indus. Servs., 262 B.R. 781, 786 (Bankr. E.D. Ark. 2001) (holding that a contract termination clause did not enable a bank to terminate on the basis of the debtor's Chapter 11 filing, and noting that "[i]n a commercial contractual relationship, terminable-at-will provisions must be exercised in good faith"); In re B. Siegel Co., 51 B.R. 159, 164 (Bankr. E.D. Mich. 1985) (convenience termination clause does not confer an unrestricted right to cancel a contract, when the only reason for its invocation is the debtor's bankruptcy filing, because this would nullify the remedial policy of 11 U.S.C.A. § 365(e)(1)).

[48]Stockton East Water Dist. v. United States, 583 F.3d 1344, 1366 (Fed. Cir. 2009); see also Yankee Atomic Elec. Co. v. United States, 112 F.3d 1569, 1575 (Fed. Cir. 1997) ("When the Government enters into a contract, 'its rights and duties therein are governed generally by the law applicable to contracts between private individuals.' " (quoting United States v. Winstar Corp., 518 U.S. 839, 895 (1996)).

[49]41 U.S.C.A. §§ 7101–7109.

[50]See, e.g., In re Reynolds Mfg. Co., 68 B.R. 219 (W.D. Pa. 1986) (explaining that government contract vesting clauses should be interpreted literally and concluding that title to all supplies that the debtor acquired in performance of a government subcontract vested in the government); In re Am. Pouch Foods, Inc., 30 B.R. 1015 (Bankr. N.D. Ill. 1983) (ordering debtor "to reassert its claim before either the Board of Contract Appeals or the Court of Claims").

[51]See, e.g., In re Gary Aircraft Corp., 698 F.2d 775 (5th Cir. 1983) ("We hold that a bankruptcy court should defer liquidation of a government contracting dispute to the Board of Contract Appeals" or COFC unless there is undue delay in deferring to those tribunals). But see In re MacLeod Co., 935 F.2d 270 (Table), 1991 WL 96718 (6th Cir. 1991) (explaining that "the apparent lack of discretion possessed by district court judges in such contract disputes is not as inviolable as it would seem at first glance" and "that such discretion should be balanced by countervailing considerations, perhaps most importantly, whether the deferral may cause undue delay").

[52]Doninger Metal Prods., Corp. v. United States, 50 Fed. Cl. 110 (2001). The ASBCA reached a similar conclusion in connection with a contractor that had been "liquidated under Chapter 7." Traction Sys., Inc., ASBCA No. 53081, 03-1 BCA ¶ 32,169 (holding that contractor that had liquidated under Chapter 7 did not have standing to appeal a contracting officer's final decision under the CDA because, although the company continued to exist for some period of time after the liquidation pending dissolution in accordance with state law, "the corporation's existence outside the confines of the bankruptcy estate is wholly extinguished" (citations omitted)).

[53]See 11 U.S.C.A. §§ 363(c), 1107.

[54]11 U.S.C.A. § 525(a).

[55]F.C.C. v. NextWave Personal Commc'ns Inc., 537 U.S. 293 (2003).

[56]In re Exquisito Servs., Inc., 823 F.2d 151 (5th Cir. 1987); see also Marine Elec. Ry. Prods. Div., Inc., 17 B.R. 845 (Bankr. E.D.N.Y. 1982).

[57]FAR 9.103(a) ("Purchases shall be made from, and contracts shall be awarded to, responsible prospective contractors only.").

[58]41 U.S.C.A. § 113(1); FAR 9.104-1(a) ("To be determined

responsible, a prospective contractor must—(a) Have adequate resources to perform the contract, or the ability to obtain them. . . .").

[59]See, e.g., Global Crossing Telecomms., Inc., B-288413.6 et al., June 17, 2002, 2002 CPD ¶ 102 ("While the mere fact that a bidder files a petition in bankruptcy under Chapter 11 of the Bankruptcy Act does not require a finding of nonresponsibility, bankruptcy may nevertheless be considered as a factor in determining that a particular bidder is nonresponsible.").

[60]See, e.g., Bender Shipbuilding & Repair Co. v. United States, 297 F.3d 1358 (Fed. Cir. 2002) (upholding contracting officer's affirmative responsibility determination where contractor would have access to sufficient working capital to perform contract).

[61]50 U.S.C.A. § 4501 et seq.

[62]15 C.F.R. pt. 700.

[63]Exec. Order No. 13909 (Mar. 18, 2020), published at 85 Fed. Reg. 16227 (Mar. 23, 2020) (delegating to the Secretary of Health and Human Services authority to determine priorities and allocate "all health and medical resources" in the civilian market to respond to COVID-19).

[64]FAR 11.602.

[65]Implications of DPAS rated orders should be of particular interest to companies purchasing debtors or their assets. They could be purchasing assets for certain intended purposes only to find that the government forces them to use those assets to satisfy government orders.

[66]11 U.S.C.A. § 363.

[67]11 U.S.C.A. § 1123(b)(2).

[68]The Bankruptcy Code does not define "executory contract." However, the Supreme Court clarified that an executory contract is "a contract that neither party has finished performing." Mission Prod. Holdings, Inc. v. Tempnology, LLC, 139 S. Ct. 1652, 1657 (2019).

[69]11 U.S.C.A. § 365(f).

[70]11 U.S.C.A. § 365(f); see also Haggen Holdings, LLC v. Antone Corp., 739 F. App'x 153 (3d Cir. 2018) (holding anti-assignment provision unenforceable pursuant to 11 U.S.C.A. § 365); In re Crow Winthrop Operating P'ship, 241 F.3d 1121 (9th Cir. 2001) ("Section 365(f) permits the assignment of contracts by debtors notwithstanding a contractual 'provision . . . that prohibits, restricts, or conditions the assignment.' " (quoting 11 U.S.C.A. § 365(f)(1)).

[71]11 U.S.C.A. § 365(c)(1)(A).

[72]41 U.S.C.A. § 6305(a) ("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.").

[73]41 U.S.C.A. § 6305(a).

[74]See United Int'l Investigative Servs. v. United States, 26 Cl. Ct. 892, 899 (1992).

[75]But see Bonneville Power Admin. v. Mirant Corp. (In re Mirant Corp.), 440 F.3d 238, 253 (5th Cir. 2006), in which the court adopted the "actual test" (see discussion infra) but noted in dicta that the federal Anti-Assignment Act might not be considered an "applicable law" prohibiting assignment until an actual assignment was proposed that did not fall within the statutory exceptions to the Anti-Assignment Act's general prohibition on the assignment of federal contracts (e.g., the exception for assignment to a financing institution). The Fifth Circuit, however, did not consider whether the Anti-Assignment Act might constitute an applicable law restricting assignment. Although the Anti-Assignment Act might not constitute an applicable law prohibiting assignment, given the exceptions to the general prohibition found within the statute and in the case law, the better interpretation of the Anti-Assignment Act is that it is an applicable law restricting assignment.

[76]In re Pa. Peer Review Org. Inc., 50 B.R. 640, 645–46 (Bankr. M.D. Pa. 1985) (emphasis added).

[77]See, e.g., In re West Elecs., Inc., 852 F.2d 79 (3d Cir. 1988); In re Trump Ent. Resorts, Inc., 526 B.R. 116 (Bankr. Del. 2015).

[78]In re Sunterra Corp., 361 F.3d 257 (4th Cir. 2004).

[79]In re Catapult Ent., Inc., 165 F.3d 747, 750 (9th Cir.1999)

[80]See, e.g., In re James Cable Partners. L.P., 27 F.3d 534, 537 (11th Cir.1994).

[81]Institut Pasteur v. Cambridge Biotech Corp., 104 F.3d 489 (1st Cir.1997).

[82]See In re Sunterra Corp., 361 F.3d 257 (4th Cir. 2004) (cataloging actual v. hypothetical test jurisdictions).

[83]28 U.S.C.A. § 1408(1).

[84]FAR 42.1204(e).

[85]Ordnance Devices, Inc. v. United States, 50 F.3d 22 (Table), 1995 WL 131498, at *4 (Fed. Cir. 1995) (holding that an acquirer "ha[s] no right to have the contracts novated" and explaining that the acquirer "took a business risk when it purchased" the seller's assets because it "had no guarantee that the contracts would be novated").

[86]FAR 52.219-14, Limitations on Subcontracting, generally requires the employees of the small business prime contractor to perform portions of the work. For example, in non-service construction contracts, employees of the small business prime contractor, or a similarly situated subcontractor, must account for at least 50% of labor costs. A subcontractor is similarly situated if it "has the same small business program status as the prime contractor" (e.g., if the prime contractor is a service-disabled, veteran-owned small business (SDVOSB), the subcontractor must also be a SDVOSB) and the subcontractor is certified as small for the North American Industry Classification System Code. 13 C.F.R. § 125.1.

[87]11 U.S.C.A. § 363.

[88]11 U.S.C.A. § 523(a)(2)(A)–(B).

[89]In re Ward, 857 F.2d 1082, 1083 (6th Cir. 1988) (emphasis added); see also Mayer v. Spanel Int'l, 51 F.3d 670 (7th Cir. 1995); In re Kirsh, 973 F.2d 1454 (9th Cir. 1992).

[90]11 U.S.C.A. § 523(a).

[91]Pub. L. No. 109-8, 119 Stat. 23 (2005).

[92]11 U.S.C.A. § 1141(d)(6)(A).

[93]11 U.S.C.A. § 1141(d)(6)(A).

[94]In re Ward, 857 F.2d at 1083.

[95]See United States ex rel. Schutte v. SuperValu Inc., 143

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S. Ct. 1391, 1399–1400 (2023) ("Here, the FCA defines the term 'knowingly' as encompassing three mental states: First, that the person 'has actual knowledge of the information,' [31 U.S.C.A.] § 3729(b)(1)(A)(i). Second, that the person 'acts in deliberate ignorance of the truth or falsity of the information,' [31 U.S.C.A.] § 3729(b)(1)(A)(ii). And, third, that the person 'acts in reckless disregard of the truth or falsity of the information,' [31 U.S.C.A.] § 3729(b)(1)(A)(iii). In short, either actual knowledge, deliberate ignorance, or recklessness will suffice.").

[96]In re Hawker Beechcraft, Inc., 493 B.R. 696 (Bankr. S.D.N.Y. 2013), rev'd on other grounds, 515 B.R. 416 (S.D.N.Y. 2014). But see United States ex rel. Ceas v. Chrysler Grp. LLC, 78 F. Supp. 3d 869, 877 (N.D. Ill. 2015) (explaining in dicta that 11 U.S.C.A. § 1141(d)(6)(A) means "FCA claims are not dischargeable in bankruptcy").

[97]United States ex rel. Ceas v. Chrysler Grp. LLC, 78 F. Supp. 3d 869, 877 (N.D. Ill. 2015).

[98]11 U.S.C.A. § 1141(d)(1)(A); see also Rabo Agrifinance, Inc. v. Veifel Farm Partners, 328 F. App'x 942 (5th Cir. 2009) (recognizing that, except debts preserved under § 1141(d), pre-confirmation debts are discharged upon plan confirmation); Sw. Marine, Inc., ASBCA No. 47621, 96-2 BCA ¶ 28,601 ("Confirmation of a reorganization plan 'discharges' a debtor from debts arising prior to confirmation. . . . In short, a debtor's 'discharge' operates principally as an injunction against post-confirmation action to collect pre-confirmation debts." (citations omitted)).

[99]Sw. Marine, Inc., ASBCA No. 47621, 96-2 BCA ¶ 28,601.

[100]FAR 42.1204(h)(1).

[101]FAR 42.1204(i).

[102]FAR 42.1204(i), Standard Novation Agreement § (b)(2) (emphasis added).

[103]See FAR subpt. 9.4.

[104]In re Pilgrim's Pride Corp., 564 B.R. 534 (Bankr. N.D. Tx. 2017).

[105]FAR 52.249-14(b).

[106]See FAR subpt. 9.5.

[107]See, e.g., ARES Tech. Servs. Corp., B-415081.2 et al., May 8, 2018, 2018 CPD ¶ 153.

[108]See, e.g., FAR 52.227-14, Rights in Data—General.

[109]See 35 U.S.C.A. §§ 200 et seq.

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