

## Northrop Grumman to Sell TASC Consulting Business

Written by Administrator  
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On August 20, 2009 the Wall Street Journal reported that Northrop Grumman had announced it was seeking a buyer for its TASC consulting business. TASC is based in Herndon, Virginia, and employs roughly 5,000 people. Insiders say Northrop Grumman is hoping to sell the unit for \$1 billion, and has retained Goldman Sachs and Credit Suisse Group AG as advisers. The Wall Street Journal article says that a deal for TASC could emerge by the end of September, and "private-equity firms are among the interested parties."

Why sell now? There are clearly several meta-trends that could impact TASC's business model.

1. Conflict of interest rules. In May, Congress moved to close conflict-of-interest (COI) loopholes by tightening the standards to be applied to contractor employee who act as augmented staff to the Federal workforce. Cutbacks in Federal acquisition and program management staff over the past 15 years have resulted in a need to hire contractors to do what had formerly been "inherently governmental" functions such as designing specifications, determining technical needs, and developing solicitations. Clearly, companies (such as Northrop Grumman) that both supplied staff and submitted bids faced potential COI issues (which can be mitigated); but the tougher rules would tend to make it harder to keep from straying over the line. Significantly, TASC's competition includes Booz-Allen Hamilton, who does not offer military hardware. TASC is in the unenviable position of being denied advisory opportunities in order to protect Northrop Grumman's competitive position, while simultaneously denying Northrop Grumman bid opportunities because of TASC's existing advisory role. Splitting the entities is in the best interest of both.

2. Insourcing. Recognizing that the Pentagon may have relied too much on contractors to fill its staffing shortages, SecDef Gates recently announced an intention to beef-up his acquisition corps, in order to return thousands of jobs back to the Federal government. Thus, the need for TASC's services might diminish in the future.

3. The Obama administration's budget balancing act is just getting started. Recent reports indicate that the Pentagon has to trim [\\$60 billion](#), for starters. It is likely that future demand for TASC's services will flatten or decline in the near future.

Given the foregoing, it is no surprise that Northrop Grumman wants to divest TASC. The question is, given the cloudy [future](#) facing defense companies, will NGC get the premium it is hoping for?

When contemplating the acquisition of any business that sells goods and/or services to the Federal government, it is important to evaluate the probability of contingent liabilities, and factor them into the deal. Government contracts, by their very nature, have long tails. It can take literally years after completion of the work for "contract close-out" to take place. Even after contract close-out and receipt of final payment, contract clauses give the Government the right to assert claims for an additional three years. Thus, after an acquisition an allegation of wrongdoing can surface that relates to actions that took place literally years before. Records can be missing, personnel may have departed, but the acquiring company still has to deal with the issue(s). It is critical to structure the deal so as to protect the acquiring entity from such

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contingent liabilities. Typically this is done either through purchase price adjustment, establishment of an escrow fund, or both.

During the due diligence phase of the acquisition, it is critical to evaluate existing internal and operational controls, administrative attention to detail, and to try to assess the probability that a contingent liability will surface after acquisition. Some areas to evaluate include: compliance with Truth-in-Negotiation Act (TINA), accuracy of timekeeping, accuracy of invoicing preparation, and integrity of the accounting system and related controls. Note that these areas have limited overlap with Sarbanes-Oxley Section 404 internal controls, and require some degree of expertise in order to properly evaluate.

In addition to the foregoing, considerable thought must be given to the post-acquisition control environment--particularly even two Government contractors are merging. Many operational control systems (e.g., estimating, accounting, billing, EVMS) have existing system descriptions that will need to be revised and resubmitted to Government oversight officials. The post-acquisition entity will need to allocate indirect costs and to calculate indirect cost rates; the cost impact(s) of the new rates on existing contracts cannot be ignored. Moreover, should one or both of the entities be subject to Cost Accounting Standards (CAS), then any changes to cost accounting practice must be carefully coordinated with Government customers, and may require revision of CASB Disclosure Statements and calculation of contract cost impacts in accordance with complex and very detailed process rules. In sum, there is quite a bit to think about and the traditional business-to-business M&A due diligence does not really address the necessary issues.

Northrop Grumman is putting its TASC unit up for sale. They want to receive top-dollar (reportedly, \$1 billion) for the business. Interested suitors will need to carefully weigh a myriad of detailed issues, as well as the impact of several mega-trends, when creating an offer. It will be interesting to see whether a deal that satisfies--and protects--both parties will be struck.