

## **Public Contracting Institute**

### **Subcontracting Summit**

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#### **Case Studies**

#### **LOOK BEFORE YOU LEAP**

Chris Chow is a former Army contracting officer who has been doing quite well working as a consultant for Government contractors. He has been asked to meet with executives for a software company named Pipsqueak, Inc. that has run into problems performing as a subcontractor on a large Government contract. When he sits down with the team of seven Pipsqueak executives, the president of the company begins to tell Chris their story:

“We were formed ten years ago by three friends who had a passion for software and a desire to see if we could make the world a safer place to live. We soon realized that the danger of physical harm in this world was one thing but the danger of sustaining harm in cyberspace is another thing altogether. Realizing this, we have developed three separate software platforms that are at the cutting edge of cyber security. One is for the aerospace industry; one is for the automotive industry; and one is dedicated to maritime applications.

“Although our original intention was to limit our products to the commercial marketplace, where there is huge potential, people in the Federal Government approached us at one trade show after another and urged us to consider selling to the Government. They even started coming to our offices and asking us to become a Government contractor. After looking at it for quite a while, and talking it over with people whom we trust, we elected to try a “Government Light” approach, meaning that we would only perform as a subcontractor. Our executive team and our board believed that this approach was the best of both worlds because it opened the Government marketplace to us but provided us some protection by virtue of the fact that we would not be a prime contractor.

“The Government people we met were very friendly and were very enthusiastic about our software. They introduced us to a company called Leviathan, which is a top-50 defense contractor and is performing contracts for all of the DOD agencies. The Leviathan representatives we met with were also friendly, and they told us that they badly wanted to add us to their team but that there was not enough time to negotiate what they called a teaming agreement to guide our path forward; instead, they suggested we enter into a non-disclosure agreement to govern the parties’ dealings, allowing us to begin working together immediately. They explained that, with the protection of the NDA, we could then move forward in an effort to meet the demanding proposal schedule imposed by the customer.

“It was nearing the end of the month, and we had a lot of pressure on us to close the deal before the month ended, so we signed the NDA that Leviathan handed to us. We then sent three of our best technical personnel out to Leviathan’s offices to begin working on the proposal. In retrospect, it may have been a mistake on our part to send those three experts out there without fully briefing them on the terms of the NDA. We basically told them to get out there, roll their sleeves up, and do what it took to help Leviathan meet its deadline. We pride ourselves on being team players, and they did just what we told them.

“As we understand it, our three employees got along very well with the Leviathan employees and they were thrilled at the thought of our software becoming an important part of a critical DOD project. They literally held nothing back as they worked for two weeks with the Leviathan team. Three days from the proposal deadline, however, Leviathan sent us an email advising us that it had decided to “go a different way” for this procurement and that they were no longer going to use us on their team. They thanked us for our efforts and told us they hoped we could work together in the future.

“We invested about \$300,000 into working with Leviathan. We now are learning that Leviathan simply took what we shared with them and acted as if it was all their information in preparing the proposal. It took us \$4 million and three full years of blood, sweat and tears to

develop that software, and these guys have taken it. Before we bring lawyers into the picture, is there anything we should be doing to make sure something like this does not happen again”?

Chris takes a deep breath and asks, “Who is your contract administrator”?

“What’s that”? asks the president/

“Well,” Chris responds, “that is one person who acts as the nerve center for your subcontracts. He or she maintains all of the relevant contracting documents; all correspondence goes through him; and he is the chief point of contact with the customer.”

“We don’t have things set up that way,” responded the president. “Charlie Yourd handled our marketing for this project; Sarah Stoces handled all of the technical discussions with the customer; and Brad Rush was the team leader for the three people we sent out to Leviathan.”

Taking another deep breath, Chris asks, “Where is the contract file”?

“What’s that?” asks the president. “Well,” Chris explains, “that is one file, usually maintained by the contract administrator, that contains all of the relevant documents relating to the particular project.”

“Oh, I get it,” says the president. “Well, we don’t have a dedicated file like that. Charlie keeps all the marketing-related documents; Sarah keeps all of the technical documents; and Brad would have all of the documents relating to what happened at Leviathan.”

Showing no concern, but getting a sinking feeling, Chris then asks, “Does Charlie have the documentation relating to the execution of the NDA?” Charlie, sitting on the other side of the table, says that he does.

Chris asks, “What law governs the NDA?” Charlie says he doesn’t know.

Chris asks if the NDA has a “Disputes” section. Again, Charlie says he doesn’t know.

Chris tells the Pipsqueak executives that he needs to review the NDA before he can make any recommendations about what to do next, and they agree to adjourn for an hour while Chris reviews it. When they reconvene, Chris tells them, “I have read the NDA, and I have

some concerns. Basically, the NDA provides that whenever either party shares “covered” information with the other party, you have 24 hours to alert the other party to the fact that it is covered by the NDA. Did your three technical personnel make sure to do that”?

“No,” says the president, “they were not aware of the terms of the NDA. They were just told that an NDA was in place.”

Chris asks if anyone has complained to Leviathan’s leadership about what has happened. “We sure have,” says the president, “but all they say is that they are sorry if there was any misunderstanding and that they hope we will not take it personally.”

### **QUESTIONS**

1. If an experienced subcontract administrator had been on board at Pipsqueak, could she have made a difference? If so, how?
2. Where did Pipsqueak fail in its internal communications?
3. Where did Pipsqueak fail in its communications with Leviathan?
4. Did Pipsqueak make any tactical mistakes? If so, what were they?
5. What could Pipsqueak have done to protect itself from a predator like Leviathan?
6. Beyond the NDA, how else can Pipsqueak protect its intellectual property?

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### **The Devil Is In the Details**

After leaving Pipsqueak’s offices, Chris heads back to his office. When he gets there, he finds a FedEx package from a company in Iowa, Cedar Rapids Communications. When he opens it, he finds a letter from the company’s president, telling Chris that he has been strongly recommended by a close friend and he is hoping Chris can help them. The letter goes on:

We are a successful manufacturer of communications equipment, with 30 years in business, all of which have been involved in sales to the commercial marketplace. About six months ago, we were approached by another small company, Baiten Switch Corporation, that told us they wanted us to be on their team for a large and lucrative Government contract. According to them, our reputation for service and maintenance would be a huge factor in convincing the Air force that our team was the best in the business.

We were leery of this opportunity, but we did our due diligence on Baiten Switch, and they seemed to be a legitimate concern with about ten years in business. In addition, our sales numbers had been weak for the prior six months, and our board decided that this was probably worth a shot. As a result, we entered into a teaming agreement with Baiten Switch, and we proceeded to work together to win the contract. The teaming agreement made it very clear that each party would bear its own expenses, and we thought that was a risk worth taking because of the payback down the line if this five-year contract was awarded to Baiten Switch. We put about \$150,000 worth of effort into the proposal-preparation process.

We waited about eight months before learning from Baiten Switch that it had been awarded the contract. Unfortunately, one of the losers filed a bid protest, and that meant another four months of delay before we actually got underway. When we finally received the draft subcontract from Baiten Switch, our Business Development people were so anxious to close the deal before the end of our fiscal year that we probably did not review it as closely as we should have. We basically signed it and sent it back, and 25 of our best service employees began working full-time on the contract at a site that Baiten Switch had leased just for this contract. The Air Force has a lot of communications equipment that needs servicing!

The first month seemed to go well. We were receiving positive feedback from Baiten Switch, and their people seemed to be working well with our people. We sent them an invoice for \$800,000 at the end of the first month, with our standard 30-day language. When it was not paid within 30 days, our CFO called the president at Baiten Switch and asked if there was a problem. She was told that no payment would be made to us until the Air Force paid Baiten Switch, and even then they had another ten days in which to pay us. Our CFO was surprised to hear this—shocked is the real word—but when she took a look at the contract she discovered that the payment provision clearly stated that Baiten Switch had up to ten calendar days after receiving payment from the Air Force before it had to pay us. What we did not know at the time we submitted our first invoice was that Baiten Switch had not even submitted an invoice to the Air Force for the first month of work!

We were obviously unhappy when we realized the kind of deal we had gotten ourselves into, but we pride ourselves on our reputation and we continued to perform our part of the bargain. Late in the second

month of the contract, when we were almost another \$800,000 into the hole, we got the following letter from Baiten Switch:

Dear Mr. Johnson:

Pursuant to Paragraph 20.1 of our agreement, we are writing to advise you that our agreement is terminated immediately. We appreciate the excellent work that your company has performed on this project, and we look forward to working with you again in the future.

Sincerely,

Ima Jerk

Needless to say, we were stunned. Once again, we pulled out the subcontract and took a look at the paragraph that Baiten Switch had cited. It read in full as follows:

#### 20.0 Termination or Suspension

20.1 Termination by Prime Contractor. Prime Contractor may terminate this Subcontract in whole or in part, or any incorporated clause under this Subcontract, upon fifteen (15) business days written notice to Subcontractor for Prime Contractor's convenience, or immediately upon written notice to the extent:

- a. the Prime Contractor or the Customer exercised its right to terminate for convenience under the Prime Contract;
- b. the Customer declined to exercise an option under the Prime Contract, or prohibited Prime Contractor from supplying the Work through the use of a subcontractor;
- c. the Customer suspends work in whole or in part; or
- d. the Subcontractor materially breaches a provision of the contract and fails to cure such breach, or make progress satisfactory to the Prime Contractor within ten (10) business days of receipt of written notice from the Prime Contractor demanding such cure.

Mr. Chow, we need your help in sorting this situation out, making sure we get paid for the work we have performed, and telling us what rights we have, if any, against Baiten Switch. It is now crystal clear to us that they used us to bolster their qualifications for the proposal, and then, once the award was made, they spent the next two months learning as much as they could from our service personnel so that they could discard us. Can you let us know if you can assist us on this project and how soon we might be able to meet?

### **QUESTIONS**

1. Would the participation of a skilled subcontract administrator have helped Cedar Rapids Communications at all?
2. What might a skilled administrator have done to prevent this disaster?
3. Is it too late to do anything to help Cedar Rapids Communications?

4. If you were Chris Chow, what is the first thing you would do after reading this letter?
5. What tactical mistakes did Cedar Rapids Communications make when entering into the teaming agreement and subcontract?
6. How can it avoid these mistakes in the future?
7. Can Cedar Rapids Communications reach out to the Government agency for help? How effective would that be?