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# PRATT'S GOVERNMENT CONTRACTING LAW REPORT



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# Virginia Supreme Court Puts Contractor Teaming Agreements on Life Support

*By Paul R. Hurst, Kendall R. Enyard, and Thomas P. Barletta\**

*Teaming agreements typically used by contractors may well be on life support after a recent Virginia Supreme Court decision holding that the post-award provisions of a teaming agreement relating to the award of a subcontract were unenforceable. The authors of this article discuss the decision and its implications.*

Although teaming is not officially dead under Virginia law, teaming agreements typically used by contractors may well be on life support after a recent Virginia Supreme Court decision holding that the post-award provisions of a teaming agreement relating to the award of a subcontract were unenforceable.

In *CGI Fed. Inc., v FCI Fed., Inc.*,<sup>1</sup> the Virginia Supreme Court affirmed a lower court's decision to set aside a jury verdict for \$12 million in damages arising out of breach of contract and fraudulent inducement claims. The court determined that the teaming agreement at issue did not create an enforceable obligation to enter into a subcontract with specific terms, but rather included language that expressly conditioned the formation of a subcontract on future events and negotiations and included other terms indicating that the relationship might terminate without the formation of a subcontract. Further, the court found that CGI Federal, Inc. ("CGI") could not recover damages on its fraudulent inducement claim because CGI was not entitled to lost profits under a subcontract in which the final terms were uncertain and unenforceable. The court also affirmed the lower court's ruling granting summary judgment in favor of FCI Federal, Inc. ("FCI") on CGI's alternative claim of unjust enrichment.

## BACKGROUND

In 2012, CGI and FCI entered into a teaming agreement to prepare a proposal for a U.S. State Department contract for visa processing that was set

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<sup>1</sup> Record No. 170617 (Va. S. Ct. June 7, 2018), *available at* <https://law.justia.com/cases/virginia/supreme-court/2018/170617.html>.

aside for small businesses. The decision to form a team arrangement provided benefits to each party—CGI, as a large business, was not eligible to bid on the contract and FCi, although it was small, did not have the capabilities to perform the contract alone. The teaming agreement provided that FCi would submit the proposal as the prime contractor and CGI would be included in the proposal as a subcontractor.

Under the teaming agreement, CGI agreed: (a) that it would not team with or assist any other contractor competing for the visa contract; (b) to furnish personnel, materials, and information necessary to assist FCi in preparing the proposal; and (c) to reasonably cooperate with FCi to ensure the success of the proposal. CGI's and FCi's teaming agreement also included provisions relating to a subcontract for CGI if FCi won the prime contract. Those provisions included:

- A Statement of Work which provided that CGI would receive a workshare of 45 percent the total contract value, but which also made CGI's workshare "subject to the final solicitation requirements" for the visa processing contract;
- An agreement to engage in good faith negotiations to enter into a subcontract subject to applicable laws, regulations, terms of the prime contract and CGI's best and final proposal to FCi;
- A provision subjecting the subcontract to various additional conditions, including the "[m]utual agreement of the parties to the statement of work, financial terms and reasonable subcontract provisions;" and
- A clause providing for the expiration of the teaming agreement if the parties could not agree on terms and conditions for a subcontract within 90 days of the contract award to FCi.

The teaming agreement also provided that each party would bear its own costs, expenses, risks and liabilities arising out of the performance of the teaming agreement, and precluded the recovery of lost profits for a breach of the teaming agreement.

FCi submitted the jointly prepared bid to the State Department on December 6, 2012; however, FCi did not share the proposal with CGI and failed to inform CGI that the proposal allocated only 38 percent of the workshare to CGI. The State Department identified certain deficiencies in FCi's proposal and directed FCi to submit a revised proposal. In response, FCi informed CGI additional subcontractors were needed and that CGI's workshare therefore could not exceed 41 percent. In exchange for accepting a 41 percent workshare, CGI requested and FCi agreed to allocate 10 management positions for CGI employees for work on the contract. The parties executed an amended

teaming agreement that reflected the agreed upon changes to the workshare percentage and the allocation of 10 management positions to CGI, but did not amend or alter any of the other provisions of the original teaming agreement. However, the day after the parties executed the amended teaming agreement, FCI submitted a revised proposal to the State Department that reflected only a 35 percent workshare for CGI and reserved all management positions for FCI employees.

On August 2, 2013, the State Department awarded FCI the visa processing contract, but the performance of the contract was delayed due to multiple protests related to FCI's small business status. To resolve the protests, FCI agreed to give the protester work under the contract which, in turn, reduced CGI's workshare even more. After FCI's settlement with the protester, the State Department requested a revised proposal. In its second revised proposal, FCI increased its workshare to 75 percent and it lowered CGI's workshare to 18 percent without CGI's knowledge.

On March 31, 2014, the State Department finalized FCI's contract award for a base year contract with four annual renewal options for a total value of \$145 million, and FCI and CGI then began negotiations of a subcontract. Initially, FCI offered CGI 18 percent workshare and subsequently increased the offer to 22 percent workshare. The parties agreed to a temporary agreement that allowed CGI to perform work on the visa contract under which CGI was paid \$2 million. On November 10, 2014, FCI terminated CGI for cause related to a staffing dispute.

### **THE TRIAL COURT'S DECISION**

On March 25, 2015, CGI initiated a lawsuit against FCI for breach of contract for FCI's failure to extend a subcontract to CGI with a 41 percent workshare and 10 management positions for CGI employees, unjust enrichment (which was plead in the alternative to the breach of contract claim) and fraudulent inducement relating to the amended teaming agreement under which CGI sought to recover the lost profits it expected to earn under the subcontract. At the close of evidence, FCI moved to strike on the basis that the post-award provisions of the teaming agreement were unenforceable and that CGI failed to prove its damages on the fraudulent inducement claim. The trial court found that the provision in the teaming agreement that required the parties to enter into a subcontract within 90 days of contract award, limited damages. The court also took FCI's motion to strike under advisement, but submitted the case to a jury. The jury awarded CGI \$11,998,000 for the breach of contract and fraudulent inducement claims.

After holding a hearing on FCI's motion to strike, the court vacated the jury verdict on CGI's breach of contract claim and the \$12 million award to CGI.



On the breach of contract claim, the court found that the teaming agreement was unenforceable because the post-award terms were “aspirational only” as neither party agreed to be bound by the teaming agreement’s post-award provisions related to workshare and management positions until a formal subcontract was negotiated and executed.

The court upheld the jury’s finding that FCi fraudulently induced CGI to enter into the amended teaming agreement. However, it vacated the jury’s award of lost profits because the parties had not agreed to a subcontract within 90 days of contract award to FCi; it went on to hold that CGI therefore was precluded from recovering lost profits beyond the 90 day period and that CGI had failed to prove lost profits during that limited period. The court also granted FCi’s motion for summary judgment on the unjust enrichment claim and entered final judgment for FCi on all claims.

### **VIRGINIA SUPREME COURT’S ANALYSIS**

On appeal, the Virginia Supreme Court affirmed the trial court’s ruling vacating the jury’s verdict on the breach of contract claim. The court found that the “amended teaming agreement did not create any enforceable obligation for FCi to extend a subcontract with a 41% workshare and 10 management positions to CGI.” Relying on *Navar, Inc. v. Fed. Bus. Couns.*,<sup>2</sup> the court found that the amended teaming agreement, read as a whole, did not create any enforceable post-award obligations for FCi to extend work to CGI as a subcontractor and that, at most, the amended teaming agreement imposed a framework for good faith negotiations of a final subcontract.<sup>3</sup>

Specifically, the court determined that the amended teaming agreement contained several provisions that expressly conditioned the formation of a subcontract on future events and negotiations which, the court concluded “make clear the parties never agreed to the final terms of a subcontract.” For example, the court found that the Statement of Work’s provision regarding CGI’s post-award workshare was subject to the final solicitation requirements of the visa processing contract. Similarly, it pointed to the amended teaming agreement’s requirement that parties enter into “good faith negotiations for a subcontract . . . subject to applicable laws, regulations, terms of the prime contract and . . . [CGI’s] best and final proposal to FCi;” and the provision for termination of the teaming agreement if the parties could not reach an

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<sup>2</sup> 291 Va. 338, 347 (2016).

<sup>3</sup> The court’s opinion (at n.1) suggests that CGI might have been able to bring an action for breach of contract under the teaming agreement for failure to conduct good faith negotiations for a subcontractor after FCi was awarded the prime contract, but that CGI had not done so here.

agreement on the terms and conditions of a subcontract within 90 days of award of a prime contract as evidence that the parties' "contemplated [that] a subcontract may not materialize after the prime contract award to FCi and [had] created a mechanism for ending their relationship." Finally, the court also stated that just as CGI could not rely on the teaming agreement to get a subcontract from FCi, "FCi could not have relied on the agreement to require CGI to perform work as a subcontractor."

The court also found that the trial court correctly vacated the jury's damages award, but the court did not concur with the lower court's ruling that CGI's fraud damages were limited by the 90-day termination provision in the amended teaming agreement. Instead, the court held that "lost profits are not recoverable for a fraudulent inducement claim when they are premised on the unenforceable provisions of a contract;" here, the unenforceable post-award provisions of the amended teaming agreement. The court also noted that CGI proved the existence of its lost profits based on the amounts it would have earned under the subcontract. The court, however, concluded that because the final terms of the subcontract, including CGI's workshare, were uncertain (subject to negotiations and contingencies), any damages based on lost profits under the prospective subcontract were therefore also uncertain and not recoverable.

Finally, the court affirmed the lower court's entry of summary judgment in favor of FCi on CGI's unjust enrichment claim under which CGI sought to recover the expenses it incurred in helping FCi prepare the proposal and any profits that FCi realized from performing the work it had promised to CGI. The court rejected CGI's claim on the basis that the amended teaming agreement created an enforceable express contract that governed the parties' relationship in preparing the proposal for the State Department contract. For example, the amended teaming agreement set forth reciprocal obligations related to proposal preparation and negotiation of a subcontract and included provisions that required the parties to bear their own costs of performance and precluded them from recovering lost profits for a breach of the amended teaming agreement. As a result, the court determined that CGI, as a victim of fraudulent inducement, was entitled to either rescind the contract or affirm the contract and sue for damages. Here, the court held that CGI was not entitled to recover on its quasi-contract claim because CGI sued for contract and tort damages and therefore, it affirmed the amended teaming agreement and agreed to be bound by its provisions, which expressly barred the recovery of lost profits or expenses incurred to prepare the proposals.

## TAKEAWAYS AND CONCLUSION

CGI involved a fairly typical contractor teaming agreement—*e.g.*, one that did not expressly provide for the award of a subcontract upon the award of a prime contract, made the award of a subcontract contingent on various future events, and provided for good faith negotiations of a subcontract and for termination of the teaming agreement if the parties failed to successfully negotiate a subcontract.

The court's decision essentially holds that such an agreement is unenforceable under Virginia law insofar as a prospective subcontractor seeks breach of contract damages for failure to award a subcontract pursuant to the teaming agreement. Likewise, the prime contractor under a teaming agreement cannot rely on that agreement to compel its teammate to perform as a subcontractor. The court's opinion also appears to foreclose recovery of lost profits under a fraudulent inducement claim insofar that claim is based on an unenforceable contract.

On the other hand, the court's opinion recognizes that the typical contractor teaming agreement can create an enforceable express contract relating to the preparation a proposal and negotiation of a subcontract. The opinion also leaves open the possibility of a breach of contract action for failure to conduct good faith negotiations for a subcontract. However, the damages potentially recoverable in such an action are uncertain, although B&P costs could be one potential measure. Moreover, assertion of a contract (or tort) claim might preclude recovery under an unjust enrichment theory for failure to engage in good faith negotiations for the award of a subcontract.

CGI was not well served by the teaming agreement with FCi: A jury found that CGI was fraudulently induced to execute the amended teaming agreement; and although CGI continued to assist FCi in proposal preparation, it was then "left at the altar" without a subcontract or a remedy. However, government contractors will continue to use teaming agreements because joining complementary capabilities improves the ability of the team members to obtain contract awards and because many procurements are now "team versus team."

A typical teaming agreement may be entered into well before the RFP has been issued and at the time of formation issues such as whether the teammate improves the ability to win the award and whether the teammates can work together will predominate over considerations of enforceability. However, the court's decisions in *CGI* and *Navar* demonstrate that enforceability can be a significant issue if one party seeks to require its teammate to meet certain of its obligations under the teaming agreement or to recover damages for its failure to do so. Given this uncertainty, the companies entering teaming agreements

should consider exploring alternative choice of law provisions that are more hospitable to the enforcement of teaming agreements.

They should also consider drafting teaming agreements that are as specific as possible regarding the terms of the anticipated subcontract and that limit or avoid provisions that condition the formation of a subcontract on future events and negotiations. However, accomplishing this can be difficult if the program's requirements are not known or finalized at the time the parties negotiate the teaming agreement so that it may be difficult to negotiating a teaming agreement early in the pursuit of a contract opportunity that will be fully enforceable in Virginia.

That said, the decision of the U.S. District Court for Eastern District of Virginia in *Cyberlock Consulting, Inc. v. Info. Experts, Inc.*,<sup>4</sup> may provide some guidance for developing a potentially enforceable teaming agreement. There, the district court, applying Virginia law, struck down a teaming agreement as an unenforceable agreement to agree where, looking at the agreement as a whole, the court concluded that the parties did not manifest an intent to be bound by the agreement. In reaching that result the court cited the several elements of the teaming agreement (similar to those in the FCI/CGI teaming agreement) as evidence that the parties contemplated that a formal subcontract would have to be negotiated and executed and that the future transaction "might not ever come to fruition."<sup>5</sup> In that regard, the district court's interpretation of Virginia law as applied to the teaming agreement at issue was consistent with the Virginia Supreme Court's decision in *CGI*. However, in setting out the facts of the case, the district court noted the teaming agreement at issue was the second of two teaming agreements between the parties relating to contract opportunities with the Office of Personnel Management.

Although the first teaming agreement was *not* at issue in the case and the court did *not* otherwise discuss its enforceability, its discussion of that agreement provides an interesting contrast with the second, unenforceable, agreement. In particular, the court observed that the first teaming agreement:

- Had several attachments, including (i) a Statement of Work, which "specifically covered provisions including the period of performance, place of performance, the requirement for key personnel, the format of the contract [IDIQ], and project management requirements for the work that Cyberlock would be performing for [the prime contractor]," and (ii) "the specific subcontract" that parties intended to enter

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<sup>4</sup> 939 F. Supp. 2d 572, 578 (E.D. Va. 2013), *aff'd*, 549 Fed. Appx. 211 (4th Cir. 2014).

<sup>5</sup> See 939 F. Supp. 2d at 575-75, 581-82.

following award of a prime contract;<sup>6</sup>

- Provided that the prime contractor “will . . . enter into the subcontract attached to this Agreement as Exhibit D” within five business days of award of the task order to the prime contractor;<sup>7</sup> and
- Identified a number of events that would result in its termination, but “none of [them] was the failure of the parties to successfully negotiate a subcontract.”<sup>8</sup>

While provisions such as these do not ensure enforceability, they do address some of the shortcomings in teaming agreements like those in *CGI*, *Navar*, and *Cyberlock* that have been found to be unenforceable under Virginia law.

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<sup>6</sup> *Id.* at 574–75.

<sup>7</sup> *Id.*

<sup>8</sup> *Id.* The court also noted that the parties executed the subcontract attached to the teaming agreement on the same day as the prime contract award and that Cyberlock subsequently completed performance.