

Affiliates of Indicted Contractor May Face Longer Suspension

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The United States Court of Appeals for the Eleventh Circuit recently confirmed that the Government has the ability to suspend “affiliates” of a suspended contractor, even though there is no allegation that the affiliates themselves had done anything wrong. The Circuit then went on to hold that affiliates of a government contractor facing indictment could be suspended longer than the 18-month limit contained in the Federal Acquisition Regulation (“FAR”), again even though the affiliates themselves were not accused of wrongdoing. The December 31, 2013 decision reversed the holding of an Alabama federal district court, which had held the affiliates’ suspension past 18 months impermissible.

Agility Defense & Government Services, Inc. v. United States Department of Defense, No. 13-10757, 2013 WL 6850891 (11th Cir. Dec. 31, 2013), involved two United States subsidiaries (collectively, “Agility”) of Public Warehousing Company, K.S.C. (“PWC”), a Kuwaiti corporation that was suspended in 2009 after it was indicted on fraud charges related to U.S. military food supply contracts. The Government also suspended Agility on the basis of affiliation, relying on the following FAR provision:

Suspension constitutes suspension of all divisions or other organizational elements of the contractor, unless the suspension decision is limited by its terms to specific divisions, organizational elements, or commodities. *The suspending official may extend the suspension decision to include any affiliates of the contractor if they are --*

(1) *Specifically named; and*

(2) *Given written notice of the suspension and an opportunity to respond (see 9.407-3(c)).*

FAR 9.407-1(c) (emphasis added). FAR 9.403 defines “affiliates” as follows: “Business concerns, organizations, or individuals are affiliates of each other if, directly or indirectly, (1) either one controls or

has the power to control the other, or (2) a third party controls or has the power to control both.” Agility’s affiliation with PWC was undisputed.

The Eleventh Circuit first stated that the FAR clearly establishes that the agency can suspend an affiliate without any showing of wrongdoing by the affiliate: “The whole text of the regulation provides that an affiliate can be suspended based solely on its affiliate status so long as the agency establishes that it is an affiliate, gives notice of the suspension, and provides an opportunity to respond to the suspension.” As the District Court reasoned below, “To require a finding, or even an allegation, of wrongdoing, would render the language of § 9.407-1(c) surplusage. That is, there would be no need for a provision specifically addressing the suspension of an affiliate if the government was required to apply the same procedures to affiliates as to principals.” *Agility Defense & Gov’t Servs., Inc. v. U.S. Dep’t of Defense*, No. CV-11-S-4111-NE, 2012 WL 2480484, at *7 (N.D. Ala. June 26, 2012).

The Eleventh Circuit then addressed the question of whether an affiliate could also be suspended beyond the FAR’s 18-month suspension limitation without the Government initiating legal action against it. The FAR states:

(b) If legal proceedings are not initiated within 12 months after the date of the suspension notice, the suspension shall be terminated unless an Assistant Attorney General requests its extension, in which case it may be extended for an additional 6 months. *In no event may a suspension extend beyond 18 months, unless legal proceedings have been initiated within that period.*

FAR 9.407-4 (emphasis added). The District Court had held that, because the government had not initiated legal proceedings against the affiliates within 18 months of their suspension, the suspensions were contrary to law and had to be terminated. The District Court also noted that “to allow the government to suspend a contractor indefinitely, without suspicion, raises due process concerns.”

In reversing, the Eleventh Circuit held that the “legal proceedings” referred to in FAR 9.407-4 need not be against suspended affiliates themselves and that the indictment against PWC was sufficient to toll the 18-month suspension limitation as applied to Agility. As the panel stated: “The agency argues that we must interpret ‘legal proceedings’ as legal proceedings against the indicted government contractor. The affiliates argue that we must interpret ‘legal proceedings’ as legal proceedings against the suspended affiliate of the indicted government contractor. We agree with the agency.” The Eleventh Circuit reasoned first that FAR 9.407, as a whole, “clearly establishes that the agency can suspend an affiliate without any showing of wrongdoing.” Second, an agency “may also debar an affiliate of that contractor based solely on its affiliate status” and, because suspension is the precursor to debarment, it would be “nonsensical to require the agency either to terminate the suspensions of the affiliates or to initiate separate legal proceedings against the affiliates, only to debar them if the legal proceedings against [PWC] end in a conviction.” The court also found that Agility’s suspension did not raise Constitutional due process concerns because the relevant FAR provisions provide adequate notice procedures and afford suspended affiliates an opportunity to respond to their suspensions.

The Eleventh Circuit’s *Agility* holding – that a government contractor might be suspended essentially indefinitely without even being accused of any wrongdoing, based merely on its affiliation with another entity – also raises potentially important questions on the scope of the term “affiliates,” which, according to the FAR, covers parents, subsidiaries, and sister corporations.

This decision serves as a reminder for government contractors of the need to establish strong internal controls, including superior compliance programs – front-end investments that will minimize the risk of

suspensions or “legal proceedings” relating thereto. Perhaps more importantly, in a climate of frequent mergers and acquisitions among government contractors, the case highlights the critical importance of investing in extensive and careful due diligence review of potential acquisition targets or merger partners, lest one bad apple spoil the bunch.

If you have any questions about the content of this client alert, please contact the Pillsbury attorney with whom you regularly work, or the authors below.

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