AFFILIATE: FRIEND OR FOE?

How the Acquisition of an Affiliate Can Lead to Denial or Revocation of FDOT Certification

Introduction

Most contractors are aware that they can be disqualified from bidding on and performing work for the Florida Department of Transportation if they have been convicted of certain crimes related to public contracts. However, many contractors may not appreciate that the bad acts of a related entity or its employees can also result in denial or revocation of qualification to bid on FDOT work.

To illustrate this, consider the following scenarios:

Scenario No. 1: Contractor A is a reputable contractor that regularly bids on and performs work for FDOT — it has a spotless record and has never been convicted of a crime. In an effort to expand its business, Contractor A acquires Contractor B, unaware that one of Contractor B's employees has been charged with submitting false certificates on a small county project in California. Years after the acquisition, the employee, who still disputes the charges, agrees to plead no contest to a reduced charge of obstructing an investigation.

Scenario No. 2: Contractor A learns that an employee of an affiliate has engaged in illegal conduct on a public project. It immediately fires the employee and reports him to the proper authorities. With the assistance of Contractor A and its affiliates, the employee is convicted of the illegal conduct.

In both scenarios, although Contractor A has done nothing wrong, it may still be subject to having its FDOT certification revoked or denied because of the acts of the affiliate and its employees. To make matters worse, disqualification or debarment by one agency often must be reported to other public owners, and may result in further automatic debarments.

While denial or revocation of Contractor A's certificate of qualification under these facts seems harsh or unjust, and may come as a surprise, such action is contemplated by Section 337.165 of the Florida Statutes. Contractors should be aware of this pitfall and thoroughly investigate business entities it may acquire, merge or partner with so as to avoid denial or revocation of its certificate of qualification, and take care to mitigate any unwitting violations that may occur.

FDOT's Ability to Revoke or Deny Contractor's Certification

Subsection 337.165(2)(a) of the Florida Statutes provides:

> **No contractor or his or her affiliate shall be qualified to bid on work let by the department** when it is determined that he or she has, **subsequent to January**

> **1, 1978**, **been convicted of a contract crime** within the jurisdiction of any state or federal court.

(emphasis added). A contractor or affiliate whose certificate is denied or revoked pursuant to this section may not act as a prime contractor, a material supplier, a subcontractor or a consultant on any Department project during the period of denial or revocation.[1] The statute provides for a *per se* ban on doing business with FDOT altogether if a contractor **or any of its affiliates** have been convicted of a "contract crime" after January 1, 1978. Worse yet, the statute provides that the Department may revoke or deny qualification for a period of time up to 36 months.[2] Denial or revocation applies only to future projects, not to existing projects.

The statute requires a conviction, not merely an investigation of alleged illegal conduct or the filing of charges.[3] While not all criminal conduct will disqualify a contractor from doing business with FDOT but the term "contract crime" is defined extremely broadly:

> Any violation of state or federal antitrust laws with respect to a public contract or a **violation of any state or federal law involving fraud, bribery, collusion, conspiracy, or material misrepresentation** with respect to a public contract.

(emphasis added). Examples of contract crimes include not only obvious crimes such as bid rigging or fraud in relation to a public project but arguably less recognized ones such as perjury, obstruction of an investigation or submitting false test reports.[4]

Who is an Affiliate?

When determining whether a Contractor is qualified to work with the Department, Section 337.165 makes clear that not only will the contractor's history be considered but also that of any "affiliate." Subsection (1)(c) broadly defines "affiliate" as:

> **a predecessor or successor of a contractor** under the same, or substantially the same control . . . so that one entity controls or has the power to control each of the other business entities […and] the **officers, directors, executives,** shareholders active in management, **employees and agents** of the affiliate. […]

(emphasis added). Under this definition, an affiliate includes not only related business entities (e.g. a newly acquired business or a business with the same parent company), but also employees of those related business entities. In the above scenarios, Contractor A could be subject to disqualification regardless of whether it was the affiliated company or one its officers or employees that was convicted of a contract crime, and even if the persons convicted of the illegal conduct are no longer employed by the affiliate. The statute goes further to provide that:

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[1] See 337.165(3), Fla. Stat.
[2] See 337.165((2)(b)1, Fla. Stat.
[3] §337.165(2)(a), Fla. Stat.
[4] Because the elements necessary to prove particular crimes can vary greatly from state to state, it may not always be obvious whether a conviction in another state constitutes a "contract crime" for purposes of Section 337.165.

> [t]he **ownership by one business entity of a controlling interest in another entity** or **a pooling of equipment or income among business entities** shall be **prima facie evidence** that one business entity **is an affiliate** of another.

(emphasis added). Although perhaps not the intent of the statute, this provision and especially the language regarding "pooling of equipment or income among business entities" should be a reminder to contractors to be careful when looking to partner with another contractor.

Self-Reporting Requirement

The application for qualification with the Department requires contractors to disclose whether it or any of its affiliates (as defined by statute) have been convicted of a contract crime. In addition, subsection 337.165(5) requires:

> Any contractor or the contractor's affiliate who is currently qualified or seeking to be qualified by the department **shall notify the department within 30 days after conviction of a contract crime applicable to him or her or to any of his or her affiliates**, or to any of the contractor's or the contractor's affiliate's officers, directors, executives, shareholders active in management, **employees** or agents.

(emphasis added). Arguably, this self-reporting provision applies to only prospective contract crimes and not to previous ones. It also is not clear whether a contractor must report past convictions of new affiliates or whether a contractor is required to disclose any conviction for a contract crime after 1978, even if it is not discovered by the applicant until much later, or even if the person convicted was not an affiliate at the time of conviction.

Options if Facing Suspension or Revocation

Section 337.165 provides two points of entry for contractors to challenge the denial or revocation of its certificate of qualification, or to apply for reinstatement or reapplication.

The first opportunity arises once the Department notifies a Contractor of a violation of section 337.165.[5] The contractor may request a hearing within 10 days after receiving the Department intent to deny or revoke the certificate. If it is determined at the hearing that the contractor or one of its affiliates was convicted of a contract crime within the applicable period, the statute calls for the Department to deny or revoke the contractor's certificate for 36 months, although in lieu of this administrative remedy, the Department has in the past agreed to a reduced suspension period, depending on mitigating factors.

The second opportunity for a hearing arises after the Department revokes or denies the certificate. Any time after revocation or denial, a contractor may "petition for and be granted a hearing to determine his or her eligibility for reapplication or reinstatement" upon a finding that it is in the "public interest" to do so.[6] When determining whether reapplication or reinstatement

[5] See §337.165(2)(b)1, Fla. Stat.
[6] §337.165(2)(d).

would be in the public interest, the Department or administrative law judge may consider any "relevant mitigating circumstances," which include the following:

i. The degree of culpability;

ii. Prompt and voluntary payment of damages to the state as a result of the contractor's violation of state or federal antitrust laws;

iii. Cooperation with any state or federal prosecution or investigation of a contract crime;

iv. Disassociation with those involved in a contract crime;

v. Reinstatement in other state and federal jurisdictions; and

vi. The needs of the department in completing its programs in a timely, cost-effective manner.[7]

In addition to these factors which "may" be considered, the Department or administrative law judge "must" consider[8] whether the applicant complied with the self-reporting requirement.[9] If the contractor's petition for reapplication or reinstatement is denied, it must wait 9 months to file another petition.

Conclusion

In light of the significant implications of section 337.165, a contractor must be diligent in preventing contract crimes both within its own company and within its affiliates, and in reporting convictions if they occur. Contractors should inquire closely into the past of any business entity it acquires to determine whether there are convictions that may cause it concern.[10]

It is important that contractors know their rights. The Department is required to afford notice and an opportunity to be heard prior to revocation or denial, as well as an opportunity to apply for reinstatement and reapplication. Care should be taken to document any mitigating factors, such as self-reporting, cooperation in the prosecution, and disassociation with the offending party and these may be used to reduce or eliminate penalties or to seek a quick resolution with the Department.

[7] §337.165(2)(4), Fla. Stat.
[8] Id.
[9] These same factors may also come into play when negotiating a settlement with the Department as discussed above.
[10] This creates a powerful incentive to conduct acquisitions through asset purchases, as opposed to mergers or acquisitions of shares in the target entities themselves, and to do employee background checks to avoid hiring a convicted person.