

Unclassified

DAF/COMP/GF/WD(2010)32



Organisation de Coopération et de Développement Économiques  
Organisation for Economic Co-operation and Development

28-Jan-2010

English - Or. English

**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS  
COMPETITION COMMITTEE**

DAF/COMP/GF/WD(2010)32  
Unclassified

## **Global Forum on Competition**

### **COLLUSION AND CORRUPTION IN PUBLIC PROCUREMENT**

#### **Contribution from Israel**

-- Session V --

*This contribution is submitted by Israel under session V of the Global Forum on Competition to be held on 18 and 19 February 2010.*

Contact: H el ene CHADZYNSKA, Programme Manager of the Global Forum on Competition  
Tel: +33 1 45 24 91 05; email: helene.chadzynska@oecd.org

**JT03277621**

Document complet disponible sur OLIS dans son format d'origine  
Complete document available on OLIS in its original format

English - Or. English

## COLLUSION AND CORRUPTION IN PUBLIC PROCUREMENT

-- Israel --

### 1. Introduction

1. Cases of collusion and corruption in public procurement are particularly sensitive as conspiracies like these take away resources from the purchasers and the taxpayers, diminish public confidence in the competition process and undermine the benefits of a competitive market. Some markets and industries rely heavily on public procurement and hence maintaining competition in those markets is of great importance to governments and competition agencies in particular. Defence products, energy and infrastructure markets usually involve a significant role for public procurement.

2. For several years now the Israel Antitrust Authority (hereinafter – IAA) has focused on the promotion and the protection of competition in public procurement: the former is done through targeted advocacy efforts whereas the latter through rigorous enforcement.

3. This report illustrates the experience of the IAA in protecting and promoting competition in public procurement. Issues pertaining to corruption are being handled by the National Fraud Investigation Unit of the Israeli Police and as such, the IAA does not have the power to investigate such offences, unless they constitute a violation of the Restrictive Trade Practices Act (herein – RTPA). However, in recent years the IAA has come across cases where an antitrust offence covered up fraud. In these cases, the IAA investigators can apply to the Minister of Public Security for a special permit to investigate fraud. The Attorney General can issue a special permit to the IAA legal department so that the fraud offence can be prosecuted by the IAA.

### 2. Public Procurement in a Small Island Economy

4. Due to Israel's relatively small size and unique characteristics, its economy is generally referred to as a small island economy. The smallness of the market is both in terms of population and land. With just over seven million inhabitants, the local market features limited demand and insufficient capacity to accommodate a large number of competitors in various sectors of the economy, particularly with respect to nationwide infrastructures. The island factor stems from a combination of elements, including geographic remoteness from main trading partners, limited degree of trade with close neighbours, language barriers, cultural and historic differences, and substantial reliance on foreign trade. Subsequently, and despite the higher openness to trade in recent years, there are still challenges to competition. Israel's small size and relative high entry barriers often make it less attractive to entry by foreign competitors. Subsequently, the shortage of immediate potential competition from neighbouring markets alleviates competitive constraints on local incumbents.

### 3. Enforcement Activity

5. Enforcement efforts break down to two main elements, namely enforcement against collusion and bid-rigging and enforcement through the IAA review process of mergers and applications to approve

restrictive arrangement. This section offers some examples for enforcement activity that relates to the protection of competition in public procurement.

#### **4. Merger Control**

6. The IAA has recently opposed a merger between two companies, Ackerstein Ind. and Netivey Noy Ltd., in the business of designing and installing curb stones and edge stones used for public streets. These products are typically procured by public bodies such as government offices and municipalities.

7. Ackerstein asked to merge with its competitor Netivey Noy by buying off all of its technical equipment which would have resulted in decreasing the number of competitors in the market from four to three. Upon examination, the IAA found that the market in question has oligopolistic features and that the level of prices did not match up with the relatively low costs of production and instalment. The merger was blocked after the IAA concluded that it would significantly harm competition which would result in public procurement bodies paying supra competitive prices.<sup>1</sup>

#### **5. The Envelope Manufacturers Cartel<sup>2</sup>**

8. The “Envelope Manufacturers Cartel” is a key example of a public procurement process falling victim to cartel activity that included price fixing, market allocation and abuse of taxpayer's money through governmental bids and tenders.

9. Three envelope manufacturers were indicted and convicted of bid rigging offences between the years of 1995-2002. The market share of the three defendants was estimated at 80-90% during the cartel activity. The government purchased and then distributed the envelopes among the various ministries and governmental agencies.

10. A former employee of one of the three manufacturers contacted the IAA and revealed substantial information that kick-started the cartel investigation. During the investigation, a major source of information and documentation was the government which provided the IAA with data relating to the different bids and details of the rigged offers submitted by the defendants.

11. The information provided evidence about the structure and conduct of the cartel: for example, a large number of bidders were disqualified for alleged technical flaws where in fact the bidders used this method to divide the market. This, however, could not be proven in court and thus the defendants could not be indicted on these charges.

12. Testimonies taken by IAA investigators showed that some government officials suspected that a collusion or bid-rigging might be taking place due to suspicious rotation patterns among the leading manufacturers of winning the public tenders and due to identical tenders submitted to the government. No government official, however, disclosed his or her suspicions due to insufficient experience in recognising cartel activity and due to lack of empirical evidence.

13. The District Court convicted the three envelope manufacturers and their executives in July 2007 of violations of the RTPA because of their participation in a cartel during the years of 1995-2002. The Court ruled that the cartel activity led to a division of market amongst the manufacturers, the coordination of tender submissions and the bribery of an envelope importer in order to protect the market from other imports. In December 2007, the defendants were sentenced to periods of compulsory public work ranging

---

<sup>1</sup> Ackerstein Ind. Ltd. - Netivey Noy Ltd. (Objection to Merger); Publication Number 5001526.

<sup>2</sup> Criminal case 377/04 (District court Jerusalem) State of Israel v. Gvaram *et al.*

from 6 months to 60 days; the companies were fined between 180,000 NIS to 250,000 NIS while the executives paid tens of thousands of NIS in fines.

14. In March 2008 the IAA appealed to the Supreme Court against the District Court's ruling. The IAA appealed the light sentence for the defendants as well as their acquittals with respect to the charges that they had violated the RTPA under aggravated circumstances.

15. The IAA argued that in light of the manufacturers' share and position in the envelopes market, which as mentioned above constituted 80-90% of the market and the seven year long period of continuous cartel activity, the envelope cartel was able to cause substantial damage and harm to competition. Therefore, the District Court should have convicted the defendants of having committed the offenses under aggravated circumstances.

16. The IAA further argued in its appeal to the Supreme Court that the penalties and fines imposed on the cartel are significantly more lenient than those that should have been imposed. The sentence deviated from the clear policy established in the Supreme Court's case law according to which antitrust offenders face imprisonment and substantially larger fines. The IAA asked the Supreme Court to impose actual prison sentences and substantially larger fines.

17. The Supreme Court only partially accepted the IAA's appeal: the fines were raised to 375,000 NIS and compulsory community service time was prolonged. The Supreme Court's main argument against imprisonment of the defendants was that too much time, namely seven years, had passed between the discovery and cessation of the cartel (2002), and the Supreme Court's verdict (2009). Other reasons as to why imprisonment was not an appropriate punishment, according to the Supreme Court, were due to more personal objections with regards to the main defendant. The private reasons were not disclosed to the public and thus the IAA has no detailed knowledge of the defendant's argumentation.

18. During the proceedings the IAA and the Civil Division of the State Attorney's office considered the possibility to sue the cartel members for damages on behalf of the State. This would have been an unprecedented action in Israel. However, the amount of quantitative and numerical evidence of the State's loss due to the cartel's activity did not suffice to support such a claim before court.

## **6. The Traffic Lights Cartel<sup>3</sup>**

19. The following example demonstrates a highly complex and problematic relationship between the public procurers and the bidding parties from a competition policy standpoint. The case is known as the "Traffic Lights Cartel".

20. In 1992 the Haifa municipality, the third largest city in Israel, issued a bid for the instalment and maintenance of traffic lights across the entire city. Before the municipality published the bid, they attempted to apply for an exemption from publishing a public bid. In Court the representatives of Haifa municipality claimed that for safety reasons only one company, namely "Menorah", can install and maintain the traffic lights. The municipality argued that only Menorah has the technical know-how to connect the traffic lights to the newly established control centre. Therefore, the exemption from publishing a public tender should be granted. "Ariel" is a major electricity and traffic light company and is also Menorah's main competitor. Ariel appealed to the court against the municipality with the claim that they can provide the same services with the same technical know-how as Menorah. Consequently, the Court ordered the municipality to publish a public bid for the tender.

---

<sup>3</sup> Criminal appeal (Supreme Court) 7829/03 State of Israel v. Ariel *et al.*

21. A few days before the deadline of the public tender, however, the CEOs of Menorah and Ariel reached an agreement in which Ariel committed to concede from the bid in return for 1 million NIS and the subcontractor rights for maintaining the traffic lights in Jerusalem. After the agreement, Menorah won the municipal tender which it priced at over 1 million NIS and thus exceeded the estimated cost of the Haifa municipality.

22. Both parties and their CEO's were charged for conspiring in bid-rigging offences. Menorah and its CEO paid 900,000 NIS after having signed a plea bargain; the CEO paid an additional 100,000 NIS in fines and was indicted to three months of community service. The District Court acquitted Ariel and its CEO with the reasons that competition is restricted in this industry due to technical barriers related to the traffic control centre. The IAA appealed the ruling of the District Court on the grounds that it was mistaken when considering the alleged technical barriers as reasons for restricting competition through bid-rigging as it is an offence under any circumstances. The Supreme Court accepted the IAA's appeal and convicted Ariel and its CEO. Additionally the ruling stated that the municipality's reluctance to publish a public tender was detrimental to competition and did not serve the public interest. The Supreme Court added that the agreement between the defendants harmed competition and did disservice to the public and the tax payers. The ruling of the Supreme Court emphasised the severity of the offences that were made in relation to a public tender published by a municipality. The bid-rigging offence, according to the Supreme Court's decision, deserves to be treated harshly through imprisonment sentences that reflect a clear and deterring message against those who try to extract "easy profits" on the expense of tax payers. The Supreme Court accepted the IAA's appeal over the sentences imposed by the District Court, and decided to impose harsher sanctions on the undertakings and individuals involved.

## **7. The Snowplough Cartel<sup>4</sup>**

23. Another case of bid-rigging, known as the "Snowploughs Cartel", saw the involvement of several firms colluding together between the years of 1997 and 1998 into a cartel when bidding for tenders published by the Ministry of Defence and the Jerusalem Municipality. The Government has no choice but to publish its tenders for the purpose of public procurement and therefore in 2001 the Court ruled that bid rigging offences in the public procurement process need to be treated with extra severity and punished with firm rulings.

## **8. The Defence Industry**

24. As stated above, certain industries are based on public procurement; one of such examples is the defence industry. This industry has a substantial degree of state involvement and its structural framework is a key factor for concerns for competition in public procurement. For these reasons, the IAA devotes a considerable amount of time and effort to advocate the importance of competition in the defence industry market through frequent discussions with officials in charge of public procurement.

25. The Ministry of Defence (hereinafter – MOD) is the single most substantial buyer of locally produced defence products. It is also in charge of regulating the procurement process of the industry. The MOD is the authority to grant the sales and export permits and regulates the security matters with regards to the industries' operations. In addition to all that, three out of the four major defence industries are state owned.

26. Although a considerable amount of revenue is collected from exports, the defence industry is nonetheless very dependent on the local market, especially when launching a new product. The MOD believes that local knowledge for development and production of the defence system is a fundamental

---

<sup>4</sup> Criminal case 1131/00 (District court Jerusalem) State of Israel v. Motorgrader *et al.*

requirement that cannot be compromised. As a result of this, defence products produced abroad by competitors are not regarded as substitutes for the locally produced products. The MOD claims that the local quality and the technical advantage are superior to products from abroad and therefore procurement of the local defence industry is vital. Other arguments brought forward by the MOD are the minimisation of the dependence of foreign supplies and the greater investment in R&D among local companies.

27. In recent years the IAA was asked to approve joint ventures between major defence industries with the aim to develop high quality technology products. The MOD was in favour of joint ventures as a combination of expertise, skills and the knowledge of each party will yield optimal technological solutions in an even shorter time span. Recent cases included a joint venture in 2007 between "Elbit" and "Ness" in order to develop an information technology for the air force and a venture in 2009 between the Israel Aerospace Industries and "Refael" in order to develop an electro-optic system tracing ballistic missiles. The IAA however, expressed concerns that large scale ventures would undermine competition in the product market and would therefore decrease the overall intensity of competition. The IAA voiced a concern over a possible anti-competitive spill over effect due to convergence of economic interest among competitors. Sharing commercial information between the parties to a joint venture may have a detrimental effect on competition.

#### **9. Joint Venture between Elbit Ltd. and Israeli Aircraft Industries Ltd.**

28. In 2007 the IAA examined a joint venture between "Elbit Ltd." and the Israeli Aerospace Industries Ltd. who sought to develop an advanced military vehicle. The MOD issued an urgent demand for the product. The IAA understood the operational importance of allowing joint ventures to develop the product but insisted on a few important conditions. The IAA demanded that the joint development was limited to specific functions of the product and that all other functions were developed separately. In addition to that, limitations on information transferral between the parties had to be guaranteed as well as that ownership of information developed by the parties had to remain in their possession. The IAA approved the joint venture under the condition that each party would be entitled to use the knowledge developed during the joint venture in other fields of operation without the need for consent from the other party.

#### **10. Promoting Competition in Public Procurement through Advocacy**

29. In addition to the sensitivity of the public procurement process, often public procurers give a different priority to the notion of competition as understood by the competition agency itself. Certain circumstances, according to public procurers, may allow balancing competition with other considerations in the procurement process.

30. For instance, public procurers may be under time pressure that requires a fast paced decision making which does not include careful planning of the competitive aspects associated with the procurement process. In some cases, procurers may consider objectives which reflect other facets of the public interest. The relationship between the IAA and public procurers is one of the issues exemplified in this report. A few prominent examples are given that demonstrate the experience and involvement in promoting and protecting competition in public procurement through advocacy and enforcement activity.

#### **11. Awareness to Bid Rigging in Public Procurement**

31. In light of the exposure of the public procurement process to anti-competitive practices, the IAA has embarked on a targeted awareness and advocacy campaign. In the first stage of the campaign the IAA's Director General and the Government's General Accountant which oversees and supervises the public procurement process, jointly issued a letter to all government procurers sending a strong message to

enhance and strengthen competition. In addition to the letter, the OECD Anti-Bid-Rigging Guidelines were summarised in Hebrew and distributed to all the government procurers. The letter from the IAA's Director General and the Government's General Accountant underscored the importance of protecting competition in the public procurement process and emphasised the potential economic harm associated with bid rigging. It went on to say that from a legal perspective, bid rigging is an illicit restrictive arrangement prohibited by the antitrust law. The letter outlined that the IAA investigates bid rigging offences and handles criminal cases against undertakings and business people who are alleged offenders. According to the antitrust law the maximum penalty for bid rigging offences is a five year imprisonment. In addition to the government's efforts to fight bid rigging offences through enforcement, the government sees great importance in raising awareness about the topic especially to the public procurement officials. A greater awareness may help the procurement body to decrease the risk of bid rigging amongst suppliers, ex ante and increase the chances to detect illicit bid rigging activity, ex post. The letter stated that the OECD Anti-Bid Rigging Guidelines should be considered with relevant adjustments to the Israeli legal framework.

32. The second stage of the campaign aims to raise awareness about bid rigging and collusion. Currently the IAA is preparing the seminars and workshops which will be carried out in early 2010. The IAA organises workshops which are based on the aggregated experience of the IAA as well as other competition agencies and on the OECD Anti-Bid-Rigging Guidelines. The IAA workshops will be attended by public officials that deal with public procurement on different levels, from government offices to municipalities and other public institutions. The seminars are designed to inform those who are involved in the public procurement process of the potential risks involved with bid rigging and their legal implications. In addition, these seminars will provide the public officials with the necessary tools to detect bid rigging attempts and instruct them how to respond to these situations.

## **12. Conclusion**

33. The different examples demonstrated above permit to deduce a twofold conclusion. Firstly, in order to promote competition in the public procurement process, it is necessary to take a proactive approach which is based both on advocacy alongside a tough enforcement activity. The combined strategy, encompassing both approaches, will yield better results and will have a more effective impact on the promotion of competition. The second factor that needs to be taken into consideration is the strong impact on the level of competition in the public procurement process because of the specific market characteristics and the role of the procurer. The competition authority, therefore, must identify the areas that are structurally problematic and give a special attention to specific needs of public procurement entities.