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Contribution from Mr W. Michael Kramer

-- Session I --

This contribution is submitted by Mr W. Michael Kramer (Attorney of law and co-founder of International Anticorruption Resource Centre, US) under Session I of the Global Forum on Competition to be held on 27-28 February 2014.

Ms Ania Thiemann, Head of Global Relations, OECD Competition Division, Tel: +33 1 45 24 98 87, Email: Ania.Thiemann@oecd.org

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COLLUSIVE BIDDING BY CONTRACTORS

-- Contribution from Mr W. Michael Kramer 1--

Introduction

- 1. This paper briefly describes:
 - How collusive bidding schemes operate in international projects
 - Their primary red flags
 - Actual case examples
 - The basic steps to detect and prove the schemes, and
 - The elements of proof of collusive prices
- 2. As used here, collusive bidding refers to agreements by contractors or suppliers in a particular trade or area to cooperate to defeat the competitive bidding process in order to inflate prices to artificially high levels. It can occur in large and small contracts. Where collusive bidding is well established prices can rise substantially, in some cases by as much as several hundred percent.
- 3. Collusion in international projects often involves corruption, in which government officials and procurement personnel under their direction sponsor or facilitate the collusion in exchange for bribes. All or part of the corrupt payments often end up in the coffers of local political parties where they are used to offset campaign and other expenses.
- 4. The most common methods to execute collusive bidding schemes are:

• Complementary Bidding

Under this scheme, cooperating bidders agree to submit higher priced or deliberately defective bids to ensure the selection of the designated winner at inflated prices. In exchange, the winner might pay a percentage of its profits to the losing bidders, hire them as subcontractors, or allow them to win other high priced contracts. Collusive bidders can submit complementary bids from shell companies or affiliates to give the appearance of competition.

• Bid Rotation

Participants in a bid rigging scheme often rotate winning bids by separate lots of a contract, geographic areas (e.g., one road contractor gets all the work in one county, another company all the work in the next), by the type of job or by time to give each member a chance to share in the spoils. As noted above, "losing" bidders might receive a percentage of the winning company's profits or be hired as sub-contractors to improve their cash flow as they await their turn to win.

This paper was prepared by Mr W. Michael Kramer, JD, CFE (wmkramer@msn.com, www.wmkramer.com) (draft 1/29/14).

Bid Suppression

For bid rigging schemes to succeed, group members must prevent outside companies from submitting legitimate bids. This can be accomplished by paying off an interloper or by more forceful measures, such as threats or violence. The collusive group also can submit fabricated bid protests or coerce local suppliers and subcontractors not to do business with the outsider in order to protect its monopoly.

Corrupt government and procurement officials can facilitate the bid suppression efforts (e.g., by disqualifying other legitimate bidders during the bidding process) in exchange for bribes from the conspirators.

Market Division

The cooperating companies may divide markets or product lines and agree not to compete in each other's territory, or to do only so through collusive measures, such as submitting complementary bids.

1. Conditions favorable to collusion

- 5. Collusion can occur in almost any industry, and has been observed in development projects in the following sectors, among others:
 - Road construction and repair and maintenance
 - Pharmaceutical supplies
 - Major building construction
 - Major IT projects
 - Office supplies
- 6. Collusion is more is more likely to occur if there are few qualified competitors in the area and where access to the market is difficult because of high entry costs, restrictive legislation or other reasons. Collusion also may occur when there are a number of qualified firms, but there is a smaller group of major companies that dominate the market.

1.1 Red flags of collusive bidding

7. Below are the most common indicators of collusive bidding, prioritized by category. Research by the World Bank's Integrity Vice Presidency identified physical similarities – e.g., common typefaces, fonts, formats and typographical errors - in bidding documents as the most common indicator of collusion in relatively small contracts. Unusual bidding patterns – line item bid prices that are too close, or too far apart, or which are an exact percentage apart – is the most common indicator in larger contracts, in the author's experience.

1.1.1 Pricing RED FLAGS:

- Persistently high or increasing bid prices compared to cost estimates, price lists, previous prices similar jobs or industry averages
- Wide variation in line item bid prices between bidders, without apparent justification
- Bid prices drop when a new or infrequent competitor enters

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1.1.2 Bidding RED FLAGS:

- Rotation of winning bidders by job, type of work or geographical area
- A significant number of bidders who buy bid packages do not submit bids
- The same companies always bid, the same companies always win and the same companies always lose
- Unusual bid patterns, e.g.,
 - Bids are identical or very close
 - Bids are too far apart
 - Bids are an exact percentage apart
 - Bids are round numbers, when that is unusual
 - Bidder submits a very high price on one line item in one bid (to support designated winner),
 and a low price on the same line item in another bid (to win a contract)
- Losing bidders are hired as subcontractors or suppliers
- Contractor includes subcontractors in its bid that are competing for the prime contract
- Qualified contractors fail to bid and become sub-contractors, or one bidder withdraws and becomes a subcontractor
- Joint venture bids by firms that usually bid alone
- Losing bids do not comply with bid specifications
- Losing bidders are unknown in the industry or cannot be located in business or telephone directories or on the internet

1.1.3 Documentary RED FLAGS:

- Physical similarities in bids or proposals submitted by different bidders (indicating that all of the bids might have been prepared by the same party)
- Identical stationery layout, type face, etc.
- Common addresses, personnel, phone numbers, etc.
- Same calculations, type face, handwriting, spelling errors or corrections appear in two or more bid packages
- Bids or proposals contain white-outs or corrections indicating last minute price changes
- Multiple errors in losing bids
- Only the winning bid is complete and the other bids are poorly prepared or defective
- Defective, forged or sequential bid securities; bid securities are purchased at the same bank on the same day

1.1.4 Other RED FLAGS:

- Correspondence or other indications that contractors exchange pricing information, divide territories or enter agreements, e.g.,
 - A bidder requests a bid package for itself and a competitor or submits both its and another's bids
 - A bidder that is incapable of successfully performing the contract submits a bid or proposal (likely a complementary bid)
- A bidder brings multiple bids to a bid opening and submits its bid only after determining who else is bidding
- A bidder makes:
 - Any reference to industry-wide or association price schedules.
 - Any statement indicating advance (non-public) knowledge of competitors' pricing
 - Statements to the effect that a particular customer or contract "belongs" to a certain vendor
 - Statements that a bid was a "courtesy," "complementary," "token," or "cover" bid
 - Any statement indicating that suppliers have discussed prices among themselves or have reached an understanding about prices

1.2 Actual case examples of collusive bidding by contractors

1.2.1 South Asia, Transportation Projects

- 8. From 2000 to 2003 small groups of local construction companies rigged contract awards in road rehabilitation projects in collusion with government and project officials. To execute the schemes, the project officials would, among other things, deliberately fail to announce or publicize requests for bids in a timely manner, refuse to sell bid documents to outside companies or find trivial or invented reasons to disqualify the outside companies that were able to bid.
- 9. Senior government officials would choose the winning bidder, or "champion," from among those allowed to compete after private negotiations with all of the companies. The designated losing bidders would submit deliberately higher priced or non-responsive bids to allow the winner to inflate its prices sufficiently to fund the necessary bribes and enjoy handsome profits.
- 10. The designated winner often was a shell company set up solely to bid on the project in which project or government officials held undisclosed interests. Such firms would subcontract all of work to smaller firms, often "losing bidders," at far lower prices.
- 11. The scheme was detected when investigators noted that all of the bid securities commitments by the bidders that they would perform the contract if selected submitted by the different bidders were purchased at the same bank on the same day, indicating they were all purchased by the same person. Other indicators included losing bids that were an exact percentage apart (because they were all generated by the winning bidder by multiplying its winning bid), and a pattern of the winning bids falling just under the threshold of acceptable bids, with the losers being over the thresholds.

1.2.2 South Asia, Pharmaceutical Supply Contracts

- 12. At the suggestion of the government, for several years four major international pharmaceutical companies, operating through local subsidiaries, had divided the market for medicines and medical supplies purchased by the government under projects financed by international donors. The conspirators met quarterly in the capital city to agree on which company would provide which items and set highly inflated prices.
- 13. A US pharmaceutical firm saw the very high prices that the government was paying and submitted a bid at a much lower price. The bid prompted concerted protests by the consortium members, who complained that the company was not qualified to supply the drugs because of local laws and regulations. Eventually, under pressure from the lead donor, the low bid was accepted.
- 14. Such unwanted interference was, of course, a cause for concern by the four consortium members, who responded by inviting the low bidder to their next quarterly meeting. There they invited the interloper to join the conspiracy, which it did, and thereafter five companies divided the spoils and claimed the big profits.

1.2.3 South East Asia, Transportation Project

- 15. A review of bids submitted by several local construction companies for six bid packages on a \$300 million roads improvement project revealed strong circumstantial evidence of collusion, including:
 - False and forged bid securities submitted by three of the bidders on four of the bid packages. False bid securities are a strong indicator of collusion. This is because the security will be called only from the winning bidder, meaning that companies that know they are going to lose can avoid the expense of purchasing a real security.
 - <u>Inconsistent disqualifications across bid packages</u>. Certain firms were disqualified from one package for deficiencies such as previous non-performance or inadequate experience, but were allowed to bid on other almost identical packages. Such actions, of course, indicate that the procurement officials were involved in the collusion scheme.
 - <u>Inflated engineers estimates</u>. The estimates were substantially higher than virtually all of the bids received and estimates provided by other experts during the investigation. Higher estimates provide a platform for the acceptance of artificially inflated bids and again indicate the involvement of procurement officials.
 - <u>Inconsistent unit prices across bid packages (submission of "ping-ponged" bids</u>). On numerous occasions the same bidder quoted significantly different unit prices for nearly identical line items across several bid packages, sometimes lower to enable them to win the award, sometimes much higher to enable a competitor to win. Such bids are a common and strong indicator of collusion.

1.2.4 South East Asia, Transportation Project

- 16. Bidders in two rounds of bidding on another transportation project in South East Asia agreed to submit non-competitive bids to ensure that a designated company, pre-selected by government officials, would win at an artificially high price. The winner compensated the designated losers for their cooperation. Non-cooperative companies were threatened with exclusion from future contracts, once again indicating the involvement of government procurement officials.
- 17. Two companies ignored the inducements and threats and attempted to submit real bids. The first was pressured to amend its legitimate bid and raise its price by 40%. An employee of the second company

was kidnapped en route to submitting a bid and detained at a local hotel until the bid opening session was completed. The winning bidder graciously paid the non-cooperative bidders, including the company of the kidnapped employee, a respectable sum in compensation.

- 18. Similar intimidation tactics, in which "muscle men" hired by the designated winning bidder have forcibly prevented other companies from submitting bids have been seen in cases in Bangladesh, India, Vietnam and Cambodia. Such tactics are often associated with local political parties.
- 1.2.5 Europe, Construction of International Agency Headquarters
- 19. An international agency conducted a special audit to determine if there was collusion in the award of a contract to construct a new 300 euro headquarters building for the agency. The construction was to occur in a region in which reputed wide-spread collusive bidding by contractors was believed to inflate construction costs by at least ten percent.
- 20. The audit found that only three firms submitted bids for the attractive project. Two of the bidders were large, well-known local companies; the third was a much smaller, privately held firm that appeared to be unqualified for the contract.
- 21. The two public firms submitted realistic bids that closely tracked the estimated costs. The third, privately held company submitted an incomplete bid at a much higher price. The higher price was almost entirely due to a grossly inflated quote for two line items to provide fire safety equipment. The private company was given an opportunity to "clarify" its bid, which appeared to be an error, but declined to do so.
- 22. The contract was awarded to the publicly-held low bidder. Almost immediately thereafter it subcontracted most to the work to the highest priced third bidder, the private company.
- 23. Further investigation revealed that the international agency had twice previously hired the private company to renovate other smaller properties occupied by the agency, and that the company had paid kickbacks to the agency management in exchange for both contracts.
- 24. The international agency re-wrote the special audit report to exclude the above findings and concluded that there was no evidence of collusion or misconduct in the construction of the new headquarters.

1.3 Collusive Bidding in Auctions

1.3.1 USA, Real Estate Auctions

- 25. According to US federal prosecutors, eight real estate investors agreed not to bid against each other at public real estate foreclosure auctions in Northern California.
- A designated member of the group would buy properties at the public auction at the lowest possible price. Thereafter, the investors would hold a secret, private auction at which each participant would bid the amount above the public auction price he was willing to pay. The secret auctions took place at or near the courthouse steps where the public auctions were held. The highest bidder at the private auction won the property. The difference between the price paid at the public auction and that at the private auction was the group's illicit profit, which was divided among the conspirators, often in cash.
- 27. The conspirators also paid other potential competitors not to bid competitively in the public auctions for the foreclosed properties.

1.3.2 Eastern Europe, Sale of Privatized Assets

- 28. An Eastern European government privatized a number of previously owned government owned assets, including valuable commercial real property worth billions of dollars located in the center of the capital city.
- 29. A group affiliated with local organized crime elements organized a scheme to bribe local privatization agency officials and commercial court personnel to approve the sale of the properties to them at very low prices. The privatization agency and court officials agreed to withhold public notice of the auctions and to appraise the properties at unreasonably low values. Other potential bidders were threatened or otherwise excluded. A member of the conspiracy who was arrested on other charges was killed while in prison, presumably to prevent his potential cooperation.
- 30. The conspirators promptly resold the properties to actual investors from Western Europe at much higher, fair market prices.

3. Basic steps to detect and prove collusive bidding

- 1. Interview all complainants or confidential sources to obtain further detail.
- 31. **General Initial Interview Questions.** Cover as many of the following points as possible and follow up with further questions as appropriate:
 - The full names, job titles and contact information for all persons and organizations allegedly involved
 - The details (who, what, when, where, why and how much) of the allegations
 - The dates or time period of the key events
 - How much money or losses are involved
 - Are there any records or documents that support the allegations? If so, what and who has them? Ask for electronic and paper copies
 - The names, location and contact information of other persons who might know of the wrongdoing and be willing to discuss it
 - Are there other similar transactions? If so, get the details, and find out who knows about them
 - How does the complainant know about the allegations? If from other persons, who and where are they?
- 32. **Other Potentially Useful Questions.** Other potentially useful questions to ask in the initial interview include, depending on the circumstances, include:
 - Is the scheme currently on-going? If so, do the subject(s) know of the complainant's report? (This helps to determine whether a covert investigation would be feasible.)
 - Will the complainant agree to testify or sign a statement?
 - What is the complainant's motive to report?
 - Try to determine if there is any reason to suspect the complainant's credibility, such as a personal interest in the transactions, a history of disputes between the parties, or a criminal record.

- 33. **Specific Collusive Bidding Questions.** Questions that might reveal collusive bidding include:
 - Do you know or suspect, or have you heard, that certain bidders have engaged in collusive bidding?
 - Do certain companies win contract awards on a rotating basis, or obtain the majority of work in a particular area?
 - Do losing bidders appear as sub-contractors to the winning bidder?
 - Are the winning and low bids on certain contracts unreasonably high?
 - Are certain line items in losing bids unreasonably high?
 - Are there physical similarities in bids submitted by different companies, such as identical formats or common spelling errors?
 - Are there unusual bidding patterns, such as winning and next lowest bids on several contracts differing by exact amounts, or bidders submitting the same price on different contracts?
 - Have different bidders on a contract submitted sequential bid securities, or securities purchased at the same time or the same bank?
 - Do some losing bids contain what appear to be deliberate errors, or appear to be deliberately incomplete?
 - Do the same bidders bid on every job?
 - Do qualified bidders who once bid no longer submit bids?
 - Are there qualified bidders who never submit a bid?
 - Do prices drop when a new bidder enters the competition?
 - Is there correspondence or other indications that contractors engage in pricing agreements, bidder's conferences, or other agreements?
 - Are controls and procedures to prevent collusive bidding in place and enforced?
- 2. Obtain the following bidding documents, including, if possible, bidding documents from similar prior projects (to identify bid rotation):
 - Prequalification applications and reports
 - Requests for bids
 - Minutes of pre-bid conferences
 - Winning and losing bids and supporting documents, including BoQ line items and bid securities
 - Bid evaluation reports
 - Contracts and subcontracts

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- 3. Examine the actual bidding documents for the red flags listed above, particularly:
 - Physical similarities in the bidding documents from different bidders, such as common formatting, typefaces and color schemes
 - Other apparent connections between bidders, such as common addresses, fax numbers or email addresses
 - Persistent, unexplained high bid prices
 - Unusual bidding patterns, e.g., line item or final bids are an exact percentage apart
 - Losing bidders are hired as subcontractors
 - Rotation of winning bidders by time, location or job type
 - Subcontracts awarded to losing bidders
- 4. Do a computer-aided analysis of the bids, looking for unusual bid patterns.
- 5. Do due diligence background checks on the winning and losing bidders to identify, for example, undisclosed common ownership, employees or other affiliations, or prior involvement in other collusive bidding schemes.
- 6. Collect and review bid securities submitted by the winning and losing bidders (or, if the actual securities are unavailable, look for information on the bid securities in the Bid Evaluation Report). Note such securities issued by the same bank on the same day to different bidders. Also note such securities that appear to be forged (this information can be used to induce the guilty party to cooperate in the investigation).
- 7. Contact local trade associations, competition authorities or anti-corruption commissions to obtain leads for further investigations.
- 8. Interview any "divers" (companies that submit legitimate, low bids, in defiance of the collusive group); question the diver on any threats received or other efforts to block its bid.
- 9. Interview qualified companies that failed to bid, including such firms that purchased bid packages. Then interview the losing and disqualified bidders and attempt to obtain their cooperation, using the evidence obtained in the investigation.
- 10. Exercise audit rights on the winning bidder; look for evidence of collusion, including emails between bidders setting bid prices, etc.
- 11. Interview the winning bidder based on the evidence obtained in the investigation.
- 34. Collusive bidding is a "collusive practice" under International Financial Institution (IFI) Guidelines.

4. Elements of proof of collusive practices

4.1 Definition

35. IFI Guidelines define collusive practices as:

"...an arrangement between two or more parties designed to achieve an improper purpose, including to influence improperly the actions of another party."

4.2 Elements of proof

- An arrangement between two or more parties
- Designed to achieve an improper purpose
- Including to influence improperly
- The actions of another party

4.3 An arrangement between two or more parties

- 36. An "arrangement" means an agreement, explicit or implicit, based on the conduct of the parties. The parties can be private or public entities, companies, individuals, or public officials.
- A company and its employees are considered to be one party and cannot collude with themselves.
- 38. The arrangement can be proven directly through witness statements or incriminating documents that record the illicit agreement, or circumstantially through, for example, evidence showing the rotation of winning bidders in a collusive bidding scheme, which indicates concerted action by more than one party.

4.4 Designed to achieve an improper purpose

- 39. An "improper purpose" means a purpose prohibited by law, regulation, procurement or IFI Guidelines, and includes attempts as well as completed offenses. More specific examples of an improper purpose include efforts to defeat competition and artificially raise prices in a collusive bidding scheme.
- 40. The design to achieve an improper purpose, like the arrangement between two or more parties, can be proven by direct evidence or inferred from the circumstances, such as unusual bidding patterns, the exclusion of other bidders or the quotation of unreasonably high bid prices.

4.5 Including to influence improperly

41. Covers agreements to pay bribes or commit other offenses, such as fraudulent or collusive practices, even if not successful.

4.6 The actions of another party

42. The other party can be a company, individual, government agency or other entity.

REFERENCES

This paper is mainly based on the author's own work and experience.

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