



## The Basics of Bid Rigging

*Bid rigging is a form of collusion, i.e. a cartelised anti-competitive practice which results in costs that are in excess of justifiable levels. This briefing paper endeavours to explain the concept of bid rigging with representative examples of cases which have been handled by competition authorities and makes policy recommendations.*

### 1. Introduction

A bidding process is one by which a government or company seeks and receives quotes from various firms for a particular project (such as a construction job) that is to be contracted out. The award of contract is based on quality and price considerations.

The bidding process can only work when competitors make their bids honestly and independently. However, the competitive system in bidding process can be tailor-made for anti-competitive conduct. The most prevalent anti-competitive practice in bidding is bid rigging that essentially refers to a situation in which bidders for a particular contract or tender collude to pre-arrange the outcome of the bid or more specifically to pre-determine the winning bidder.

The tacit consent is then that the losing bidders will be nominated by the winning cartel to win other contracts or will be rewarded in some other way. Competition is thereby entirely eliminated or at least severely circumscribed depending on the kind of bid rigging that has taken place. The result is that the contract price is usually higher than the true competitive price level.

Bid rigging permeates trade not only at the national level, but also at the regional and international level as well. Since the majority of contracts open to bidding involve governments, it is they who are most often the target of bid rigging. In fact, bid rigging is a form of fraud and almost always results in economic harm to the agency that is seeking the bids, and to the public, who ultimately bears the costs as taxpayers or consumers.

### 2. Classification

The most common forms of bid rigging are as follows:

- **Sub-contract Bid Rigging:** Where some of the bidders opt out of the process under the agreement that some parts of the bid will be sub-contracted to them.
- **Complementary Bidding:** Where some of the bidders submit bids which are either too high or contain unacceptable conditions, defrauding purchasers in the process by creating the appearance of genuine competitive bidding.

- **Bid Rotation:** Where the bidders take turns winning the bid.
- **Bid Suppression:** Where some of the bidders opt out of the bid so that the designated winning competitor's bid will be accepted.
- **Market Division:** Where competing firms allocate specific customers or types of customers, products, or territories among themselves and the winning bid is decided in accordance with such allocation.
- **Common Bidding:** Where firms agree to submit common bids, thus eliminating price competition. (US Antitrust Division, <http://www.jftc.com>, <http://www.tca.ie>)

There was an interesting case of bid rigging in France, which involved a collective boycott. The *Conseil de la concurrence* issued an order against five defibrillator manufacturers imposing a fine of Euro 2.6 million (US\$4.05mn) for agreeing to boycott a nation-wide call for tenders organised by 17 university hospitals for defibrillators supplies.<sup>1</sup> In May 2001, the Montpellier Hospital called for tenders for the purchase of implantable defibrillators.

When no tenders were submitted till the deadline, the call for tender was declared unsuccessful. Following a referral by the Ministry of Economy, the investigation showed that the five suppliers met several times to discuss the behaviour they should adopt regarding this nation-wide call for tenders and reached a joint decision to refuse to answer the call for tenders.

Horizontal agreements in the context of public procurement are harmful by their very nature, regardless of the importance of the affected market and the duration of infringements because they directly impede the competitive process. In the case at hand, the infringement led to the failure of the first nation-wide call for tenders for a grouped purchase of medical equipment. This failure impeded the hospitals' ability to derive the benefits expected from a new type of call for tender. It also led the relevant hospitals to forgo other similar tender procedures.

### 3. Harm to the Economy

Bid rigging has detrimental repercussions on the economy. The practice almost always leads to higher prices. The multiplier effect is perceivable in the economic impact of bid rigging. The callers of the bid are affected as they usually end up paying far more than they would have had to pay otherwise. This, in turn, increases the cost to the consumers, as the higher prices are inevitably passed to them.

It has been estimated that practices such as bid rigging, can raise the price of a product or service by more than 10 percent (<http://www.usdoj.gov>). A representative of the Japan Fair Trade Commission (FTC) estimates that bid rigging pushes up contract prices by 20 to 30 percent (Shoga, 2006). As the higher prices result from bid rigging, the purchaser will have fewer resources available to devote to other needs.

Certain types of bid rigging entail the designated winning bidder having to pay off the losers, either in cash or kind (for instance by sub-contracting parts of the bid) and to recoup this loss. The winning bidder has been known in such cases to inflate prices, over bill for materials and labour and/or underdeliver on quantity and quality in comparison to what the bid and the contract specify (World Bank, 2004).

Collusion for bid rigging purposes is often aimed at eliminating domestic competitors within the purchasing country as well as potential international competitors and as such impedes overall economic development. Furthermore, bid rigging discourages qualified bidders to compete and stop them from bidding, which may lead to reduction in quality standards.

It is conceivable that bid rigging may not lead to higher prices and be detrimental to efficiency. Depending upon the kind of bid rigging taking place, for instance, bid rotation in a collusion may result in the most efficient producer, at the time, winning the bid. But even then the very fact that the process is not competitive and that new entrants are effectively barred may well lead to detrimental repercussions (in the form of higher prices and non-optimal levels of performance) in the long run, especially in the case of repetitive purchases.

Also, bid rigging is amongst those anti-competitive practices, which are actively perpetuated by international cartels. In some areas of the world, where a few companies dominate local markets, bid-rigging cartels are very common and greatly inflate prices (Kramer, 2000). A conservative estimate of the harm caused by such cartels exceeds billions of dollars per year. The extent of harm, which may be attributed solely to bid rigging, cannot be accurately quantified; however, the aforementioned statistical estimate may be considered an indication of the substantial harm inflicted on the economy by the practice of bid rigging.

#### ***The Impact on Developing Projects***

At times governments may allocate a huge amount of money for public work projects keeping in view a particular set of socio-economic reforms. Bid rigging affects these public projects by pushing up prices that

leads to inefficient allocation of resources. This affects the flow of funds to other such projects. Resources thus lost are an unacceptable drain on developmental effectiveness. Given the nature of the projects in question, the poor standard of work often associated with bid rigging directly impacts society at large. Moreover, it also affects the poor in particular since many projects are conceptualised for their exclusive benefit.

One instance of bid rigging in development projects is the case of 113 companies in Japan engaging in bid rigging for at least 317 sewage construction projects worth a total of Yen 40.6 billion (US\$376mn) between April 1999 and September 2003. Several general contractors and local companies coordinated the bidding process to decide winners in advance (The Japan Times, 2004).

Another pertinent example would be the bid-rigging scheme involving international construction companies vying for projects in Egypt. As part of the Camp David Peace Accords in the 1970s, the US agreed to fund construction projects to improve the treatment of drinking and wastewater in Egypt. Contracts were awarded based on sealed competitive bids from bidders pre-qualified by the US Agency for International Development (USAID). Four of the pre-qualified bidders conspired to manipulate their bids so as to result in a pre-decided company winning the contract. The bidders who agreed to lose were compensated through "loser fees", lucrative subcontracts or promises of future work, and the winning bidder added these costs to its bid. As a result, USAID paid an inflated amount for the project – money which could otherwise have been channelled into realising other development projects (Hennigh, 2005).

Bid rigging in development projects damage the credibility of lending institutions, such as the World Bank, which often lend funds to countries for such projects. The World Bank is accordingly taking stringent investigative measures against such practices and upon finding evidence of bid rigging resorts to an array of measures ranging from debarring companies to ordering repayment of misused loans.

When developing countries lose development bank funds through practices such as bid rigging, the taxpayers of those countries are still obligated to repay the development banks. So, not only are the impoverished cheated out of development benefits, they are left to repay the resulting debts to the banks (Ravindran, 2004).

#### ***Effect on Developing Countries***

Developing countries are particularly vulnerable to the practice of bid rigging due to the high incidence of government procurement, lack of a strong legal and regulatory framework for antitrust enforcement and general absence of awareness. Another factor that renders developing countries more susceptible to bid rigging at an international scale is that they often do not have the capacity to implement large projects on their own and have to invite tenders from foreign companies.

In addition, developing countries often invite tenders with respect to imports, which they wish to make from

### Box 1: Fighting Bid – Rigging in Development Projects

The World Bank is taking a pro-active stance against corruption in Bank funded projects and bid rigging is considered a grave offence in this context. Some cases of bid rigging taken up by the World Bank are discussed here.

The World Bank initiated an investigation into a Bank financed education project in the Russian Federation. One of the findings of the investigation was that the bidders on this project colluded with each other to maximise the prices that could be obtained during the procurement of education supplies. This and other findings prompted the Bank to declare mis-procurement on a significant portion of the relevant loan. A substantial number of contractors, who were subsequently sanctioned, were declared ineligible to participate in future Bank-financed contracts for a stated period.

As a long-term measure, the Bank entered into negotiations with the Indian Government to promote changes to procurement methods in the sector to reduce the chances of bid rigging in future. In another instance of action against bid rigging, the World Bank cancelled Taka 68 million (US\$1.01mn) from three projects in Bangladesh, after investigations found evidence of collusive bidding practices. The three projects are: **Municipal Services Project**, **Health and Population Programme Project** and **National Nutrition Programme**. The World Bank asked the Government to refund the cancelled amount and to take appropriate action against the responsible officials (World Bank, 2004).

The World Bank's efforts in the area, however, have their share of detractors, which contend that it engages in selective censure, with smaller companies getting debarred and larger companies somehow avoiding sanctions (Ravindran, 2004).

It has been contended that governments of developing countries are anxious to perpetuate corruption because of the resistance to an International Monetary Fund (IMF) proposal to link external assistance to elimination of corruption which includes practices such as bid rigging (Ravindran, 2004). Development assistance 'linkages' may however well have its pitfalls. Corruption may not be eliminated easily despite a government's best efforts, especially in developing countries where legal and regulatory regimes are still weak. While it is imperative to encourage elimination of corruption in developing countries, making the availability of required funds contingent on corruption levels is a questionable trade-off, which will impact the socio-economic development of nations and affect the masses for the fault of a handful of individuals.

developed countries. If such international level transactions involve bid rigging, the governments of the Third World countries have limited scope for effective remedial action when the practice in question originates with enterprises outside their national territories. This is not only because of their weaker enforcement regimes but also because of the power politics involved in cases at the international level, especially when the companies at fault are developed country companies.

#### 4. Bid Rigging across the Globe: Selected Countries

Bid rigging has occurred with frequency across the globe and has even been classified as a criminal offence in some jurisdictions. The following country cases offer useful illustrations (see Box 2).

In the US, bid rigging is conclusively presumed to be illegal. Individuals found guilty of bid rigging are subject to a maximum fine of US\$250,000 and/or three years imprisonment, while corporations are subject to a maximum fine of US\$10mn (<http://www.jftc.com>). In addition, bid rigging may also warrant prosecution for various other federal crimes, including mail or wire fraud, conspiracy to defraud the government with respect to claims and so on (US Department of Justice, 2005).

According to Indonesia's competition law, the Commission can impose civil fines up to Rupiah 25 billion (US\$2.7mn) for violations of the law or criminal fines up to Rupiah 100 billion (US\$2.3bn) and a prison term of up to six months, as sanctions for bid rigging (OECD, 2001).

In Japan, bid rigging in public procurement is pervasive, especially in the construction sector. It was already criminalised under the penal code and regulated

under the fair trade law, but the Act Concerning Elimination and Prevention of Involvement in Bid Rigging goes a step further. It came into effect in January 2003, and empowers the FTC to require the head of a ministry or local government to conduct investigations and punish individuals involved in bid rigging and also to take internal measures aimed at eliminating it. However, between 1850 and 2005, there have been only 13 criminal cases and no one has been jailed for anti-monopoly violations (Transparency International, 2004).

Nepal does not have a competition law as yet, although there are a few legislations that have scattered provisions relating to competition, which may in some cases cover bid rigging.

In India, the high level of government procurement makes it very probable that there is a high incidence of bid rigging in the country. While the earlier competition law, the Monopolies and Restrictive Trade Practices (MRTP) Act, 1969 covered the practice of bid rigging generally under restrictive trade practices, the new Competition Act, 2002 specifically mentions bid rigging as an anti-competitive practice. The new Act empowers the MRTP Commission to impose heavy fines on discovery of bid rigging, which cannot however exceed 10 percent of the average of the involved company's turnover for the three preceding financial years.

The Act also allows for recovery of personal damages. Because of provisions allowing extraterritorial jurisdiction international bid rigging which adversely affects Indian economy can also be acted upon. While enforcement against bid rigging is still quite weak, the MRTP Commission has passed orders in a number of cases.

It is evident from the afore-mentioned countries and illustrative cases that the offence of bid rigging is

accorded due gravity and dealt with in a commensurate manner. In other jurisdictions, however, the existing legal response against bid rigging seems inadequate or too newly formulated to deal with the practice effectively.

Apart from the information that may be gleaned from the legal framework of the aforementioned countries, studies indicate that the general trend is that bid rigging is actively prosecuted in developed countries. It is also noteworthy that as much as a quarter of documented competition law enforcement actions in developing economies involve bid rigging against state purchasers (Clarke and Evenett, 2003).

While most countries prohibit bid rigging, numerous cases of collusive tendering continue to be discovered in domestic markets. In international trade, while the laws of various countries prohibit such practices insofar as imports into their markets are concerned, relatively few

countries have prohibited collusive tendering on exports when the harmful effects of such practices are felt only in other countries (<http://www.sunsonline.org>, 1984).

## 5. International Response

### *The SET*

The United Nations Conference on Trade and Development (UNCTAD) Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices (resolution 35/63 of December 05, 1980) mandate that enterprises should refrain from practices restraining competition and specify collusive tendering as one such practice. But while this Set is valuable for the purposes of capacity building and information exchange, it is a 'soft law' and there is no mechanism to enforce any of its principles.

### Box 2: Case Illustrations

**US:** Eight former executives of the nation's leading insurance brokerage firm, Marsh Inc, were recently accused of colluding with executives of leading insurance companies to arrange non-competitive bids and of conveying these bids to Marsh clients under false pretences. By misleading customers, the conspirators fraudulently obtained millions of dollars in commissions and fees for Marsh and millions of dollars in premiums for the insurance companies. Marsh itself faces no criminal sanctions. After the filing of a civil lawsuit in 2004, the company settled the case by agreeing to replace top management, apologising for "unlawful" and "shameful" business practices, and agreeing to set up an US\$850mn restitution fund for policyholders (New York State Insurance Department, 2005).

**Indonesia:** Four companies were prosecuted for participation in bid rigging involving the supply of pipe and pipe processing services. Three of the companies exchanged their prices with each other before the bidding process. Caltex, the company who announced the tender, was held responsible for not ensuring fair bidding. As this was the first case ever brought before the commission, no sanctions were imposed. Instead, the Commission ordered that the entire tender process be redone (OECD, 2001).

**Japan:** 14 executives from 11 heavy industry companies including sector leader Mitsubishi Heavy Industries, were arrested in connection with one of Japan's biggest bid rigging scandals in recent years. The raids took place on companies allegedly involved in a four decade cartel that rigged steel bridge contracts worth Yen 350 billion (US\$3.24bon). The move marks a step forward in efforts to quash *dango*, an institutionalised form of bid rigging that distorts competition for public works contracts and excludes many foreign bidders (The Financial Times, May 27, 2005).

**Nepal:** Bid rigging occurs mainly in army supplies and pipe manufacturing. Specific cases have been known to arise in connection with supplies to the Royal Nepalese Army and Nepalese Police. A number of polythene pipe manufacturers engaged in bid rigging while bidding for the contract to supply pipes to the Nepal Drinking Water Corporation. Fearing poor quality as a result of this bid rigging, municipalities do not even adhere to the 'lowest bidder' legal provision (OECD, 2005).

**India:** Certain tyre manufacturers had engaged in a form of bid rigging by acting in concert to increase prices in response to the tenders floated by the various State Road Transport Undertakings. The competition authority directed the manufacturers not to repeat the same practices in future (Association of SRT Undertakings & Others vs. M/s Premier Tyres Ltd. & Others, 1994).

**Vietnam:** In the Van Lam-Son Hai two road construction project in 1998, there were four companies participating in the tendering process. The participants engaged in complementary bid rigging. Three of the companies were directed by the winning company to participate in the bidding process just to create a 'competitive' image. These three companies offered prices higher than the price of the tendering package. No legal action could be taken at the time of the case since the competition law of Vietnam was not yet in place (Ninh Thuan Newspaper, December 17, 2002).

**France:** French Competition Council fined 12 construction companies Euro 47 million (US\$73.7mn) or five percent of the companies' turnover for sharing markets in a school-building programme. The penalty followed a separate criminal proceeding where these companies were charged of bid rigging for building schools in *Ile-de-France*. The criminal case established that illegal acts had affected 88 school building projects between 1989 and 1996 (Global Competition Review, May 14, 2007).

### Guidelines

There are guidelines prescribed by multilateral organisations such as the World Bank and the Asian Development Bank (ADB), which provide best practice standards and codes of conduct for national and international competitive bidding. The World Bank has also set standards on e-procurement. These guidelines again have little enforcement value (Crishna Vikram, 2003).

### Measures against International Cartels

There have been ongoing efforts to adopt a coherent international approach against international cartels and these efforts will evidently be relevant for bid-rigging, an activity in which cartels actively engage. International institutions that have been involved with or are currently working on the legal and conceptual challenges of the shared commitment to fight international cartels include, amongst others, the Organisation for Economic Co-operation and Development (OECD), the International Competition Network (ICN), UNCTAD and the World Trade Organisation (WTO).

International cooperation, key to developing a coherent international approach against cartels, can also be achieved by the means of bilateral agreements. Issues covered by such bilateral agreements include investigatory cooperation, jurisdictional issues and the sharing and exchange of confidential information when allowed under national laws. The US is particularly prolific in signing such agreements, although whether this leads to active cooperation is another matter altogether. International enforcement cooperation needs to be further strengthened in the context of bid rigging.

## 6. Dealing with Bid-Rigging

To deal effectively with the practice of bid rigging, a three-pronged approach may be considered:

1. There are certain conditions which favour bid rigging and persons responsible for the bidding process, including any other party which might be involved in reviewing the process must remain particularly alert when such conditions are in play.

### Box 3: Examples of Factors Favouring Bid Rigging

- Fewer sellers as it is easier to collude
- Products not easily substitutable
- Highly standardised product, as it is easier to agree on a common price
- Repetitive purchases involving the same firms as bidders become familiar with each other and future contracts allow competitors to share work easily

(The US Antitrust Division, <http://www.tca.ie>)

Depending on the situation, effective utilisation of this method can aid in both deterring bid rigging or in detecting its incidence.

While bid rigging can occur in almost any industry, it is likely to occur more in some industries than

others. Bid rigging is particularly likely to be encountered in sectors where firms compete for very large contracts, such as the engineering and construction industries (<http://www.jftc.com>). There are multiple factors, which facilitate the practice of bid rigging.

2. Deterring bid-rigging and making its occurrence less likely by putting in place preventive measures is essential for procurers to deal with the practice.

Certain innovative measures have been used as preventive measures in certain World Bank funded projects, which governments may consider emulating in relation to development projects.

The Bank-financed Second Eastern Indonesia Regional Transport Project involved almost 200 community observers for key procurement events (World Bank, 2004). To make such a system effective in fighting bid rigging it will be necessary for governments to equip involved observers with knowledge of its telltale signs.

### Box 4: Instances of General Preventive Measures

- Bid qualifications made as broad as possible so that they can be met by the widest range of supplies
- Advertisements to be widely publicised to attract many suppliers
- Bids required to be broken down into as much detail as possible
- Records to be kept of bids for comparison purposes
- Main contractors to be made to assign subcontractors through a competitive process
- Awareness of procurement officials to be raised so that they can easily detect signs of unlawful bidding arrangements

(<http://www.jftc.com>, <http://www.tca.ie>)

In the West Java Basic Education Project, communities were given preference over contractors in the task of contract supervision. The concept is to empower communities to complete rehabilitation of schools and even build new schools. The communities have completed works at lower prices and better quality (World Bank, 2004). These projects involve the co-operation of communities, which is easily elicited when the projects in question are development-oriented as the communities are the end users.

Sanctions and agreements may be so designed as to act as a deterrent for potential offenders. For example, the US sometimes “debars” companies convicted of bid rigging from bidding on future government contracts. While this remedy must be applied cautiously to avoid reducing competition for the duration of the debarment, its availability and selective use is seen as a substantial deterrent. In some countries, every participant in a procurement procedure is required to sign a written statement of

compliance or a statement of independent bid determination. Such statements can deter bid rigging by requiring firms to disclose the material facts about any communications and arrangements with competitors regarding the tender call, or by requiring bidders to certify that there were no consultations, communications, or agreements with competitors relating to pricing or intent to submit an offer (OECD, 2005).

3. Detection of the practice of bid rigging and effective enforcement of the relevant law is another fundamental aspect of dealing with the offence. The secrecy with which bid rigging is conducted renders it difficult to discover its practice. There are certain indicators, which may conclusively reveal to customers and competitors the incidence of bid rigging or which may at least create suspicion of possible bid rigging. There ought to be a thorough review of the bidding process prior to award of the contract based on ascertaining the presence of such indicators.

During recent years econometric methods with the aim to detect collusive behaviour in the bidding process have been developed (Jakobsson, 2004). These methods should be incorporated while conducting the aforementioned review of the bidding process. External experts in economics may be invited to aid procurement officials in this aspect. Once detected, if observations are found to be valid, investigation needs to be initiated for which proper investigative techniques need to be utilised.

The competition authorities may grant immunity by means of leniency programmes to individuals or corporations who provide timely information that is needed to prosecute competition law violations, such as bid rigging or price fixing. Since competition authorities seek insider information it is necessary that they offer whistleblower protection programmes; otherwise people may be too intimidated by possible consequences to divulge information. Such programmes are particularly rare in developing countries and need to be developed on a priority basis.

For effective investigation and enforcement of the law, it is vital to strengthen the capacities of national competition authorities, especially in developing countries. One step to be considered, which facilitates both the deterrence and discovery of bid rigging by providing a more transparent system is a system of e-procurement, which is already being used on quite a large scale and its further adoption needs to be actively encouraged.

#### Box 5: Illustrations of Indicators

- The same company always wins a particular procurement contract.
- The same suppliers submit bids and each company seems to take turns at being the successful bidder.
- Some bids are much higher than published price lists, previous bids by the same firms, or engineering cost estimates.
- Bid prices drop whenever a new or infrequent bidder submits a bid.
- A successful bidder subcontracts work to competitors that submitted unsuccessful bids on the same project.
- There are irregularities (e.g., identical calculations or spelling errors) or similar handwriting, typeface, or stationery in the proposals or bid forms submitted by different vendors (indicating that the lowest bidder may have prepared some or all of the bids of the losing vendors).

It is to be noted that while these indicators may arouse suspicion of collusion they cannot be considered as proof of collusion.

(US Antitrust Division, <http://www.jftc.com>, <http://www.tca.ie>, <http://www.usdoj.gov>)

Collusion is rendered difficult if the names of the bidders are withheld, as bidders cannot be sure of the identity of the other bidders. For example, in one system of e-procurement in use by a state government department of India only the name of the successful bidder is made known to the public (Crishna Vikram, 2003).

Also, since all the bidding process data may be captured in the database, e-procurement may be used by procurement officials to efficiently search for the aforementioned indicators by utilising diverse software options. Bidders themselves will be able to spot discrepancies in a tender process they are involved in, allowing them to take action. For countries using e-procurement it has proved to be an effective tool in fighting collusive conduct in the bidding process (World Bank, 2005).

#### 7. Conclusion

Bid rigging is an anti-competitive activity with adverse economic implications such as loss of efficiency and diversion of money away from development programmes. Even though in most cases sanctions and punishments for engaging in bid rigging are quite severe its detection might pose a challenge. This paper suggests a three-pronged approach to deal with bid rigging: recognition of conditions facilitative of bid rigging and deterrence; enforcement through procurement reform; and the use of trained community observers.

#### Endnote

- 1 Source: Decision 07-D-49 of December 19, 2007, relative to practices implemented by Biotronik, Ela Medical, Guidant, Medtronic and Saint Jude Medical in hospital supply in implantable defibrillators. <http://www.conseil-concurrence.fr/user/avis.php?avis=07-D-49>

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