Detect and Prevent Antitrust Violations

Robert Connolly

Bid rigging, price fixing, and other typical antitrust violations have a more devastating effect on the American public than any other type of economic crime. Such illegal activity contributes to inflation, shakes public confidence in the country's economy, and undermines our system of free enterprise. In the case of government procurement, such crimes increase the costs of government, boost taxes, and erode the citizens' trust in their government.

Because managers receive bids and quotes and award contracts, they are in a good position to observe and identify violations of the antitrust laws. If all those involved in procurement had a working knowledge of the antitrust laws and understood how to identify violations, they could make a significant contribution to law enforcement.

Antitrust Violations and Procurement Personnel

The federal antitrust laws were enacted to preserve our system of free competition. They serve as our primary defense against unlawful attempts to limit competition and to raise the purchase prices of products and services. As purchasers of goods and services, purchasing departments can be both prime targets for, and sensitive detectors of, antitrust violations.

The Sherman Act, which prohibits any agreement among competitors to fix prices, is enforced by the Antitrust Division of the United States Department of Justice. Violation of the Sherman Act is a felony punishable by a fine of up to $10 million for corporations, and up to $350,000 or three years' imprisonment (or both) for individuals.

Civil actions for injunctive relief and for treble damages (under 15 U.S.C. § 15) also are effective enforcement tools. In addition, collusion among competitors may break the federal mail fraud law, violate the Racketeer-Influenced Corrupt Organization (RICO) statute, or constitute making false statements to a government agency, if false information has been provided on a noncollusion affidavit. All of these activities are felony violations punishable by a fine and imprisonment.

Bid Rigging, Price Fixing, And Other Types of Collusion

Commencement of criminal prosecution under Section 1 of the Sherman Act requires that the unlawful contract, combination, or conspiracy have occurred within the previous five years. The offense most likely to arise in a procurement context is commonly known as price fixing, or bid rigging, and also is referred to as collusion. A specific, expressed agreement is not always necessary, and the offense can be established either by direct evidence (such as the testimony of a participant) or by circumstantial evidence (such as big awards that establish a pattern of business' being rotated among competitors).

Any agreement or informal arrangement among independent competitors by which prices or bids are fixed is per se unlawful. Where a *per se violation* is shown, defendants cannot offer any evidence to demonstrate the reasonableness or the necessity of the challenged conduct. Thus, competitors may not justify their conduct by arguing that price fixing was necessary to avoid cutthroat competition, that price fixing actually stimulated competition, or that it resulted in more reasonable prices.

Having multiple bidders can lead a purchaser to believe that prices are competitive when this may not be the case, as collusive complementary bids have been arranged.

Price fixing among competitors can take many forms. For example, competitors may take turns being the low bidder on a series of contracts, or they may agree among themselves to adhere to published list prices. It is not necessary that all competitors charge exactly the same price for a given item; an agreement to raise present prices is enough to violate the law.

There are other examples of price fixing, including agreements: to establish or adhere to uniform price discounts; to eliminate discounts; to adopt a standard formula for the computation of selling prices; not to reduce prices without prior notification to others; to maintain specified discounts; to maintain predetermined price differentials among different quantities, types, or sizes of products; and not to advertise prices. Usually, but not always, price-fixing conspiracies include mechanisms for policing or enforcing adherence to the prices fixed.

Typical Antitrust Bid-Rigging Violations

Following are some common bid-rigging patterns that managers may recognize.

Bid suppression. In bid suppression or bid-limiting schemes, one or several competitors—who would otherwise be expected to bid or who have previously bid—refrain from bidding or withdraw a previously submitted bid, so that a competitor's bid will be accepted.

Complementary bidding. Complementary bidding (also known as protective or shadow bidding) occurs when competitors agree to submit token bids that are too high to be accepted. Or, if the bids are competitive in price, then they are made on special terms that will not be acceptable. Such bids are not intended to secure the buyer's acceptance but are merely designed to give the appearance of genuine bidding. Having multiple bidders can lead a purchaser to believe that prices are competitive when this may not be the case, as collusive complementary bids have been arranged.

Bid rotation. In bid rotation, all vendors participating in the scheme submit bids, but by agreement they take turns being the low bidder. A strict bid rotation defies the law of chance and suggests collusion.

Competitors also may take turns on contracts according to the size of the contracts. Many cases of bid rigging have been exposed in which certain vendors or contractors have gotten contracts valued above a certain figure, while others have received contracts worth less than that figure.

Subcontracting. Subcontracting is another area for attention. If losing bidders or nonbidders frequently receive subcontracts from the successful low bidder, the subcontracts, or supply contracts, may be rewards for submitting noncompetitive bids or for not bidding at all.

Market division. Market division schemes are agreements to refrain from competing in a designated portion of the market. Competing firms may, for example, allocate specific customers or

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types of customers so that one competitor will not bid (or will submit only a complementary bid) on contracts let by a certain class of potential customers. In return, his or her competitors will not bid on a class of customers allocated to the first competitor.

A vendor of office supplies, for instance, may agree to bid only on contracts let by certain federal agencies and refuse to bid on contracts for private companies.

Allocating territories among competitors is also illegal. This practice is similar to the allocation-of-customers scheme except that geographic areas are divided instead of customers.

Detecting Bid Rigging, Price Fixing, and Other Types of Collusion

Certain patterns of conduct suggest that illegal restraints on trade have occurred. The following is a checklist of some factors, any one of which may indicate collusion. Managers and purchasing departments should therefore be sensitive to their occurrence.

Checklist for Possible Collusion

- Some bids are much higher than published price lists, previous bids by the same firms, or engineering cost estimates. In this case, a local government manager should suspect complementary bids.
- Fewer competitors than usual submit bids. This could indicate a deliberate plan to withhold bids.
- The same contractor has been the low bidder and has been awarded the contract on successive occasions over a period of time.
- There is an inexplicably large dollar margin between the winning bid and all other bids.
- There is an apparent pattern of regular recurrence of low bids, as when Corporation X always wins a bid in a certain geographical area for a particular service or in a fixed rotation with other bidders.
- A certain company appears to be bidding substantially higher on some bids than on other bids, with no logical cost discrepancies to account for the differences.
- A successful bidder repeatedly subcontracts work to companies that submitted higher bids on the same projects.
- Irregularities exist (e.g., identical calculation errors) in the physical appearance of the proposals or in the method of their submission (e.g., the use of identical forms or stationery), suggesting that competitors have copied, discussed, or planned one another's bids or proposals. If the bids have been obtained by mail, there are similarities of postmarks or postage-metering machine marks.
- Two or more competitors file a "joint bid," even though at least one of the competitors could have bid on its own.
- A bidder appears in person to present his or her bid and also submits the bid or bond of a competitor.
- Competitors regularly socialize, appear to hold meetings, or otherwise get together in the vicinity of procurement offices shortly before bid-filing deadlines.
- Competitors meet as a group with procurement personnel to discuss or review the terms of bid proposals. These meetings may facilitate subtle exchanges of pricing information.
- Competitors submit identical bids or frequently change prices at about the same time and to the same extent.
- Bidders that ship their products over short distances to the buyer charge the same prices as those that ship over long distances.
- Local competitors are bidding higher prices for local delivery than for delivery to points farther away, possibly indicating rigged prices in the local market.
- Bid prices appear to drop whenever a new or infrequent bidder submits a bid.

The probability of collusion increases if the product cannot easily be substituted for another product. The gains from colluding will be high if the product has few, if any, good substitutes.

Suspicious Statements

Statements made by marketing representatives or suppliers may suggest that price fixing is afoot. Here are some examples of such statements and other representations that are suspicious and may indicate price fixing.

- Any reference to "association price schedules," "industry price schedules," "industry-suggested prices," or "industry-wide" or "market-wide" pricing.
- Justification for the prices or terms offered "because they follow industry (or industry lenders') pricing or terms" or because they "follow (a named competitor's) pricing or terms."
- Any reference to "industry self-regulation," etc., such as justification for price or terms "because they conform to (or further) the industry's guidelines" or "standards."
- Any references showing that the representative's company has been meeting with its competitors for whatever reason.
- Justification for prices or terms "because our suppliers (etc.) require it" or "because our competitors (etc.) charge about the same" or because "we all do it."

- Any reference to the effect that the representative's company "does not sell in that area" or that "only a particular firm sells in that area" or "deals with that business."
- Statements to the effect that "such and such a salesman (of a competitor) should not be making a particular proposal to you" or "should not be calling on you."
- Statements to the effect that it is a particular vendor's "turn" to receive a particular job or contract.
- Statements by a bidder that it was "protecting" another supplier or was submitting a "courtesy," "complementary," "token," or "cover" bid.
- Statements by bidders that suppliers have discussed their prices or bids or that they have some deal or understanding about prices or bids.

Conditions Favorable to Collusion

While price fixing can occur in almost any industry, it is most likely to occur in industries in which only a few firms compete and in which the products of those firms are similar. Managers should be sensitive to industry conditions that increase the probability of collusion.

Collusion is more likely to occur, for instance, if there are few sellers. The fewer the sellers, the easier it is for them to get together and agree on prices. Collusion may also occur when the number of firms is fairly large but there are a small group of major sellers, with the rest being "fringe" sellers who control only a small fraction of the market.

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The more standardized a product is, the easier it is for competing firms to reach agreement on a common price structure. It is much harder to agree on other areas of competition, such as quality or service.

Soliciting numerous suppliers will not necessarily prevent a conspiracy, but it can reduce the effectiveness of a conspiracy by providing a larger competitive base.

What Managers Can Do

Local government managers can assist in the enforcement of the antitrust laws, not only by playing an active role in the detection of collusive bidding but also by taking positive steps to stimulate competition and prevent collusive behavior.

First, managers can expand their lists of bidders to make it more difficult for them to collude. To reduce the ability of conspirators to coordinate illegal activities, buyers should solicit as many reliable sources as economically possible. As the number of bidders increases, the probability of successful collusive bidding decreases. Soliciting numerous suppliers will not necessarily prevent a conspiracy, but it can reduce the effectiveness of a conspiracy by providing a larger competitive base. While there is no magic number of bidders above which collusion does not occur, past experience suggests that collusion is more likely to arise where there are five or fewer competitors.

Consolidate purchases as a defensive tactic. The existence of a large number of contract opportunities makes collusion among sellers easier. When buyers are numerous and each buyer purchases only a small amount, sellers have less incentive to grant price cuts. Consolidation of purchases tends to increase the value of winning the bid. Even if part of a conspiracy, a firm may be tempted to cheat and take the prize.

Another option is to reconsider the process used to award contracts when a tie bid has occurred. Not all identical bids are the results of price-fixing conspiracies. Managers should not, however, inadvertently encourage tie bids by assuring identical bidders an equal or reasonable share of the buyer's business. From the vendor's standpoint, it may be better to share business equally with other suppliers at significantly higher prices than to have an uncertain share of the business at lower, competitive prices. Thus, in a tie-bid situation, agencies should consider reletting the contract or in some way awarding the bid to one of the tied bidders. A lottery system of awarding contracts should not be used.

Ensure that the elements of collusion, such as bid rigging and market allocation, are understood. Provide information to others on how to detect collusion.

Keep procurement records, e.g., bid lists, abstracts, and awards, readily available. Looking at a single contract is not enough to detect collusion because records of past bids are needed to determine if a pattern of allocation or rotation has been present.

Report any suspected collusion (based upon a bid analysis, an audit, a complaint from other competitors, or statements by persons who appear knowledgeable, e.g., former employees) to the Antitrust Division of the Department of Justice for appropriate action.

The United States Justice Department, Antitrust Division, believes that it is important for all employees who are involved in procurement or purchasing to report suspicious behavior that raises antitrust concerns. Such behavior should be reported to the author at: Middle Atlantic Office, U.S. Department of Justice, Antitrust Division, The Curtis Center, Suite 650 West, 170 South Independence Mall West, Philadelphia, Pennsylvania 19106; telephone, 215/597-7405. PM

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