Top tips for purchasing professionals on spotting possible vendor collusion

Antitrust Alert
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By:

This year promises to be another in which corporate purchasing departments work hard to keep costs down while vendors try to increase their margins. In this marketplace tug of war, vendors will occasionally engage in a little self-help by reaching out to their competitors and agreeing to end “ruinous competition” and establish “fair prices.”

This is illegal.

The Sherman Antitrust Act, passed in 1890, makes agreements among competitors to fix prices or rig bids per se illegal; that is, they are illegal no matter what excuse or justification is offered.¹

Vendor collusion is not an everyday occurrence. The vast majority of vendors are tough, fair competitors. Nonetheless, price fixing and bid rigging schemes do continue to be uncovered by antitrust enforcers and purchasers. When reviewing bids and prices received from suppliers, the warning commonly seen on public transportation is also apt for purchasing professionals: “If you see something, say something.”

Coincidence or collusion? Things that make you go hmmm...

The essence of price fixing is an agreement between competitors to reduce or eliminate competition - to raise, fix or otherwise maintain the price at which goods or services are sold. Price fixing agreements may, but do not always, involve setting identical prices. In fact, identical prices, like identical bids, are usually too obvious. Instead, when vendors collude, they often agree to respect each other’s customers, with one or more vendors quoting an intentionally high price. This complementary bidding creates the appearance of competition (and helps avoid detection) while raising prices and controlling the outcome.

Ø Agreements to eliminate discounts, adhere to a price list or add a surcharge are all forms of price fixing.

Not every supplier needs to be a member of the scheme for competitor collusion to be illegal. Some fringe competitors may lack the power to disrupt a cartel because of quality issues or limited capacity.

Ø Price fixing is illegal even if the agreement is not always adhered to.
Even the most successful conspiracy usually involves some cheating. As prices rise, the lure of additional profits can become too tempting. Cartel members may cut prices and take additional market share when they think they can do so without being detected by other cartel members.

Ø Bid rigging, another form of collusion, can occur when a purchaser – whether it be a government agency or a private entity – solicits bids and the bidders agree among themselves who will submit the winning bid.

Like price fixing, it is not necessary that every bidder be part of the scheme for it to be illegal. Bid rigging can involve an agreement whereby a competitor agrees not to bid or to bid high. A bid rigging agreement involves a *quid pro quo* wherein the losing bidder gets a cash payoff, a subcontract agreement or, in most cases, the right to be the low bidder on a future job. These illegal schemes are not always obvious, but an experienced and knowledgeable purchasing professional can often see telltale signs.

Ø Vendor collusion is more likely to occur if there are few sellers in the marketplace.

The fewer sellers there are, the easier it is to agree on prices, bids, customers or territories.

Ø Collusion may also occur when the number of firms is fairly large, but a small group of major sellers controls a large portion of the market.

Standardized products make it easier to fix prices because it is easier to agree on prices than other forms of competition such as design, quality or service. Restrictive specifications can serve a legitimate interest for the buyer, but this too limits competition and makes collusion easier. Also, cartels are sometimes borne out of desperation – overcapacity and falling prices sometimes drive executives to seek the solution of illegal collusion.

Ø Finally, it takes a certain level of trust to form a cartel since a crime is being committed.

It is easier for cartels to form if competitors know each other well through trade associations or other venues.

Telltale signs

Illegal agreements like price fixing and bid rigging are by their nature secret and difficult to detect. However, if a buyer is very familiar with the market, clues can sometimes arise that signal the possibility of collusion:

Ø A change in pricing patterns, such as an industry-wide elimination of discounts or price protection, could indicate collaboration among sellers. Over time, a buyer may notice patterns of pricing, patterns in who wins bids, the winning bidder subcontracting to the losing bidder, an increase in identical or nearly identical bids or a number of other circumstances that seem curious.

Ø Purchasers should also pay attention to increases in prices that don't seem attributable to increases in cost inputs or other market conditions.

Ø Salespersons may sometimes make a remark that subtly (or directly) indicates suppliers are talking to each other.

Ø Additionally, collusion by a multi-product supplier in one product market often indicates a culture of collusion that may affect the company’s other products.

None of these factors standing alone means that collusion is ongoing, but the presence of one or more indicators of collusion may be cause for concern and further inquiry.

Trust your instincts

A purchasing professional who is experienced in a given market often has an intuitive sense whether collusion may
be afoot. If pricing or bids seem to be non-competitive, it is a good idea to ask questions. Get an explanation. The answers may alleviate any concern of collusion. What may look suspicious at first may be just coincidence or have some other perfectly innocent explanation.

But if the answers (or non-answers) still leave you scratching your head, it may be best to talk to in-house counsel to determine if further investigation is warranted. If sufficient concern arises, it may be a good idea to seek new bidders if possible or to consider some change to the procurement process.

A sharp eye can lead to a big payoff

Finally, why should a purchasing professional be concerned about possible collusion? Because the goal of cartels is to raise prices, and often they are quite successful in doing so. Many studies conclude that, on average, price-fixing conspiracies raise prices at least 10 percent over pricing that would prevail in a competitive market. Simply restoring competition can result in huge savings.

Furthermore, cartels may not be commonplace, but they can last for a sustained period of time. When they do occur, they not only cause substantial overcharges but long-term ones. Cartels generally end only when new competition enters the market or they are exposed. That can mean a lot of expense for your company, over many years.

Even more, however, if your company is victimized by a cartel, there is another financial benefit for you in its exposure: if a cartel is uncovered, victims are entitled to damages of up to three times the overcharges. That in itself is a solid reason to keep your eyes peeled.

It’s a small world: the international aspect

The Sherman Act applies to domestic and, in some cases, foreign commerce. Price fixing and bid rigging can often involve collusion by local companies on construction, cleaning or other contracts. But the Sherman Act also extends to products and services that are imported into the United States.

Even if a vendor is located overseas, it can be prosecuted/sued if it fixes the prices of goods imported into the United States. For example, the Antitrust Division of the US Department of Justice collected over US$1 billion in fines in the last year and also imposed numerous jail sentences against corporate and individual defendants in international price fixing cartels. Almost all of the corporate defendants in these cases are foreign entities.

Currently, the Antitrust Division is prosecuting companies and individuals for fixing the prices of rubber hoses and many other parts sold to major automakers. Past international cartel investigations have involved lysine, vitamins, LCD panels, paper products, graphite electrodes, ocean shipping and air cargo, to name a few. Each of these investigations was followed by lawsuits that allowed victims of the price fixing scheme to recover significant damages from being overcharged. Notably, some of the investigations were triggered or assisted by observations from procurement professionals.

Ø It is not necessary for the government to first charge a company with price fixing for a victim of price fixing to recover damages.

A significant foreign cartel case recently resulted in a US$162 million jury verdict against Chinese manufacturers of vitamin C for price fixing. This case was notable because the plaintiffs, American purchasers, were able to obtain enough evidence to prove the existence of the cartel, which operated exclusively in China. Also, the defendants argued (with the support of the Chinese government) that they were immune from suit because they collaborated at the direction of the Chinese government. The court and the jury both rejected this “sovereign compulsion” argument and found that the defendants willingly fixed the price at which they sold vitamin C to buyers in the United States. The success of the plaintiffs in this case, who were victorious even without the assistance of the Department of Justice, may encourage similar actions.
Ø Competition authorities now exist in over 130 countries.

The United States is often considered the elder statesman among world-wide competition enforcement agencies because the Sherman Act was passed in 1890 and the Department of Justice vigorously prosecutes price fixing as a criminal violation. But in the last decade or more, the world has begun to catch up. Price fixing and bid rigging are universally condemned, though not every country imposes criminal penalties and prosecutes individuals. But this is only part of the picture. Competition laws may vary by country, and not every country has one, but virtually every major US trading partner has a competition watchdog agency.

This is just a small sampling of the jurisdictions that brought antitrust cases last year and the market affected: Canada (chocolate); Brazil (air cargo); Russia (fish); India (rubber shoes); China (milk powder); the European Union (interest rates); South Africa (construction contracts); Australia (power cables). All told, competition authorities, including those in the United States, imposed over US$4 billion in fines for collusion in 2013.

Ø Additional regulatory obligations could apply in certain business sectors.

For example, in the Government Contracting sector, competitors are frequently required to certify, subject to civil and criminal penalties, that they have arrived at their prices independently, have not disclosed their prices to other competitors, and have not induced any competitor to submit or not submit a proposal. In addition, government contracting regulations identify nine specific factors that may evidence violations of the antitrust laws, so purchasing departments in the Government sector should pay special attention such factors.

Federal Acquisition Regulation 3.303(c) identifies the following indicators of potential antitrust violations:

(1) The existence of an “industry price list” or “price agreement” to which contractors refer in formulating their offers

(2) A sudden change from competitive bidding to identical bidding

(3) Simultaneous price increases or follow-the-leader pricing

(4) Rotation of bids or proposals, so that each competitor takes a turn in sequence as low bidder, or so that certain competitors bid low only on some sizes of contracts and high on other sizes

(5) Division of the market, so that certain competitors bid low only for contracts let by certain agencies, or for contracts in certain geographical areas, or on certain products, and bid high on all other jobs

(6) Establishment by competitors of a collusive price estimating system

(7) The filing of a joint bid by two or more competitors when at least one of the competitors has sufficient technical capability and productive capacity for contract performance

(8) Any incidents suggesting direct collusion among competitors, such as the appearance of identical calculation or spelling errors in two or more competitive offers or the submission by one firm of offers for other firms and

(9) Assertions by the employees, former employees or competitors of offerors, that an agreement to restrain trade exists.

Protecting a consumer’s right

So whether your company does purchasing in Peoria, Illinois, or Pretoria, South Africa, keep in mind that competition laws protect a consumer’s right – your right – to the best goods and services at the lowest possible price in a free market.
Legitimate joint ventures between competitors are not considered *per se* illegal and, in some sectors (*e.g.*, government contracting), are common. The difference is that a joint venture is done openly and is known to the purchaser. Also companies may form a joint venture to better compete by combining resources and expertise or spreading risk. On the other hand, a *secret* agreement to fix prices is universally condemned because it reduces or eliminates competition without any redeeming procompetitive benefits.