ADVOCACY SERIES 9

Competition Act, 2002

Public Procurement

Fair Competition
For Greater Good

भारतीय प्रतिस्पर्धा आयोग
COMPETITION COMMISSION OF INDIA

VISION

To promote and sustain an enabling competition culture through engagement and enforcement that would inspire businesses to be fair, competitive and innovative; enhance consumer welfare; and support economic growth.

MISSION 2020

Competition Commission of India aims to establish a robust competitive environment through

- *proactive engagement with all stakeholders, including consumers, industry, government and international jurisdictions*

- *being a knowledge intensive organization with high competence levels*

- *professionalism, transparency, resolve and wisdom in enforcement.*

DISCLAIMER

This quick guide is published as part of the Competition Advocacy and Awareness Programme of the Competition Commission of India (the Commission). Its contents should, in no way, be treated as official views of the Commission. Readers are advised to carefully study the Competition Act, 2002, as amended by the Competition (Amendment) Act, 2007 and the Competition (Amendment) Act, 2009, and seek legal advice, wherever necessary.

PUBLIC PROCUREMENT

Public procurement is the purchase of goods and services by the public sector and is a key economic activity of governments, accounting for on average, for 15% of GDP worldwide. In India, government procurement constitutes about 30% of the GDP.

Procurement of goods and services is carried out by various ministries, departments, municipal and other local bodies, statutory corporations and public undertakings both at the Centre and at the State level.

The primary objective of an effective procurement policy is the promotion of efficiency, i.e. selection of a supplier with the lowest price or, more generally, the achievement of the best value for money. Effective public procurement avoids mismanagement and waste of public funds. Vigorous competition among suppliers helps governments realize these objectives. Conversely, when competition is curtailed - for example when suppliers engage in bid rigging -taxpayers' money is wasted as governments pay more than a fair price.

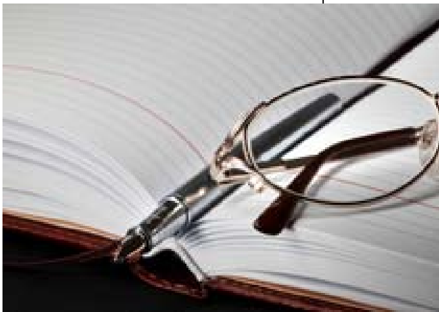
It is critical that procurement regulations do not unwittingly facilitate collusive arrangements. The formal rules that govern procurement, the way in which an auction is carried out and the design of the auction itself can all act to hinder competition and help promote or sustain bid-rigging conspiracies.

COMPETITION CONCERNS IN PUBLIC PROCUREMENT

The competition concerns arising from public procurement are largely the same that can arise in an ordinary market context such as collusive agreements between bidders during the auction process or across actions. In past, many Comptroller and Auditor General of India (CAG) audit reports, vigilance reports of Central Vigilance Commission (CVC) and various studies have highlighted wide scale prevalence of cartelization and bid rigging in government procurements.

The overarching concern with public procurement is that, because formal rules governing public procurement make communication among rivals easier, they can promote collusion among bidders and therefore reduce rivalry, with detrimental effects on the efficiency of the procurement process. In particular, in those instances where entry is difficult and when bidding is not based on a 'winner-takes-all' competition, collusion can emerge as easily in auctions and bidding processes as in ordinary economic markets.

It is frequently noticed that the procurement mechanism adopted in most government departments is itself not designed keeping in mind the importance of competition in ensuring efficient outcome. Moreover, in some cases the mechanism itself is facilitating anti-competitive practices. The peculiarity in case of public procurements is that, due to the regulations and legislations, the officials have limited strategic options to curb such practices. Whereas a private purchaser can choose his purchasing strategy flexibly, the public sector has limited options to respond dynamically to anti-competitive behaviours owing to strict regulatory/ legislative framework and detailed administrative regulations/ procedures at multiple levels.These rules are set as an attempt



to avoid any abuse of discretion by the public sector. However, full transparency of the procurement process and its outcome can promote collusion. Disclosing information such as the identity of the bidders and the terms and conditions of each bid allows competitors to detect deviations from a collusive agreement, punish those firms and better coordinate future tenders.

IMPORTANCE OF COMPETITION IN PUBLIC PROCUREMENT

An efficient public procurement policy can affect competition in a number of ways:

(i) Short-term effects on competition amongst potential suppliers i.e. effects on the intensity of competition amongst existing suppliers in a particular tender is just one possible effect, but it is not the only one.

(ii) Apart from immediate impact (loss of public money) of anti-competitive practices, there is a deeper consequence on overall efficiency in the domestic market. Public procurement can have other, longer-term effects on competition as public procurement can affect important features of an industry sector (such as the degree of innovation, the level of investment, vertical integration, etc.). This in turn would be reflected in the level of competition in future tenders.

ROLE OF COMPETITION AGENCY IN PUBLIC PROCUREMENT

Reducing collusion in public procurement requires strict enforcement of competition laws and the education of public procurement agencies at all levels of government to help them design efficient procurement processes and detect collusion.

A. Enforcement

The most direct way for the competition authority to promote competition in the public procurement market is to identify and correct bid-riggings through strict law enforcement. By increasing the bid-rigging detection rate and heavily punishing identified bid-riggers, the competition authority can effectively prevent bid-rigging as companies will learn that the benefits of bid-rigging is smaller than the loss they will suffer once their collusion is identified.

Many jurisdictions have specific prohibitions in their competition laws forbidding bid rigging or considering bid rigging *as per* se violation of the competition rules. Other countries simply base their enforcement practice against bid rigging on the general anti-trust laws against anti-competitive agreements. In India,the Competition Act, 2002 specifically prohibits bid-rigging or collusive bidding (direct or indirect) under section 3(1) read with section 3 (3) (d) thereof. It is one of the four horizontal agreements that are presumed to have appreciable adverse effect on competition (AAEC).

The Competition Commission of India ('the Commission'/ CCI) is empowered to inquire into such anti-competitive agreements, and to impose on each person or enterprises which are parties to such agreements, a penalty of up to 10% of the average turnover for the last three preceding financial years.

Further,in case such agreement has been entered into by a cartel, the Commission may impose upon each producer, seller, distributor, trader or service provider included in that cartel, a penalty of up to three times of its profit for each year of the continuance of such agreement or 10% of its turnover for each year of the continuance of such agreement, whichever is higher.

In case an enterprise is a 'company', its directors/officials who are guilty are also liable to be proceeded against.

In addition, the Commission has the power to pass *inter alia* any or all of the following orders (section 27):

- direct the parties to a cartel agreement to discontinue and not to re-enter such agreement;

- direct the enterprises concerned to modify the agreement;

- direct the enterprises concerned to abide by such other orders as the Commission may pass and comply with the directions, including payment of costs, if any; and

- pass such other order or issue such directions as it may deem fit.

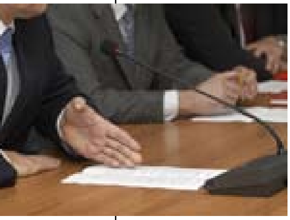
B. Advocacy

Many competition authorities are also involved in advocacy efforts to increase awareness of the risks of bid rigging in procurement tenders. There are many examples of educational programs to this end. Some authorities have regular bid rigging educational programs for procurement agencies; others organize *ad hoc* seminars and training courses.

These outreach programs have proved extremely useful for a number of reasons:

(i) they help competition and public procurement officials to develop closer working relationships;

(ii) they help educate procurement officials about what they should look for in order to detect bid-rigging through actual examples of bidding patterns and conduct which may indicate that bid-rigging is occurring;



(iii) they train procurement officials to collect evidence that can be used to prosecute better and more effectively bid rigging conduct;

(iv) they help educate public procurement officials and government investigators about the cost of bid rigging on the government and ultimately on the taxpayers; and

(v) they warn procurement officials not to participate in bid rigging and other illegal conduct which undermines competition in procurement tenders.

INDUSTRY, PRODUCT AND SERVICE CHARACTERISTICS THAT HELP SUPPORT COLLUSION

The Organisation for Economic Co-operation and Development (OECD) has enlisted various industries and product characteristics that are prone to collusion. These are:

(i) **Small number of companies:** Bid rigging is more likely to occur when a small number of companies supply the good or service. The fewer the number of sellers, the easier it is for them to reach an agreement on how to rig bids.

(ii) **Little or no entry:** When few businesses have recently entered or are likely to enter a market because it is costly, hard or slow to enter, firms in that market are protected from the competitive pressure of potential new entrants. The protective barrier helps support bid-rigging efforts.

(iii) **Market conditions:** Significant changes in demand or supply conditions tend to destabilize ongoing bid-rigging agreements. A constant, predictable flow of demand from the public sector tends to increase the risk of collusion. At the same time, during periods of economic upheaval or uncertainty, incentives for competitors to rig bids increase as they seek to replace lost business with collusive gains.

(iv) **Industry associations:** Industry associations can be used as legitimate, pro-competitive mechanisms for members of a business or service sector to promote standards, innovation and competition. Conversely, when subverted to illegal, anti-competitive purposes, these associations have been used by company officials to meet and conceal their discussions about ways and means to reach and implement a bid rigging agreement.

(v) **Repetitive bidding:** Repetitive purchases increase the chances of collusion. The bidding frequency helps members of a bid-rigging agreement allocate contracts among themselves. In addition, the members of the cartel can punish a cheater by targeting the bids originally allocated to him. Thus, contracts for goods or services that are regular and recurring may require special tools and vigilance to discourage collusive tendering.

(vi) **Identical or simple products or services:** When the products or services that individuals or companies sell are identical or very similar, it is easier for firms to reach an agreement on a common price structure.

(vii) **Few 'if any' substitutes:** When there are few, if any, good alternative products or services that can be substituted for the product or service that is being purchased, individuals or firms wishing to rig bids are more secure knowing that the purchaser has few, if any, good alternatives and thus their efforts to raise prices are more likely to be successful.

(viii) **Little or no technological change:** Little or no innovation in the product or service helps firms reach an agreement and maintain that agreement over time.

WARNING SIGNALS OF BID RIGGING

The following factors are helpful in detecting bid-rigging:

(i) In Bids

- The same supplier is often the lowest bidder.
- There is a geographic allocation of winning tenders. Some firms submit tenders that win in only certain geographic areas.
- Regular suppliers fail to bid on a tender they would normally be expected to bid for, but have continued to bid for other tenders.
- Some suppliers unexpectedly withdraw from bidding.
- Certain companies always submit bids but never win.
- Each company seems to take a turn being the winning bidder.
- Two or more businesses submit a joint bid even though at least one of them could have bid on its own.
- The winning bidder repeatedly sub-contracts work to unsuccessful bidders.
- The winning bidder does not accept the contract and is later found to be a sub-contractor.
- Competitors regularly socialize or hold meetings shortly before the tender deadline.

(ii) In Documents

- Carefully compare all documents for evidence that suggests that the bids were prepared by the same person or were prepared jointly.

- Identical mistakes/ corrections in the bid documents or letters submitted by different companies, such as spelling errors.

- Bids from different companies contain similar handwriting or typeface or use identical forms or stationery.

- Bid documents from one company make express reference to competitors' bids or use another bidder's letterhead or fax number.

- Bids from different companies contain identical miscalculations.

- Bids from different companies contain a significant number of identical estimates of the cost of certain items.

- The packaging from different companies has similar postmarks or post metering machine marks.

- Bid documents from different companies indicate numerous last minute adjustments, such as the use of erasers or other physical alterations.

- Bid documents submitted by different companies contain less detail that would be necessary or expected, or give other indications of not being genuine.

(iii) In Bid Pricing

Bid prices can be used to help uncover collusion. When other bids are much higher than the winner's bid, bidders may be using a cover bidding scheme. Bid prices that are higher than the engineering cost estimates or higher than prior bids for similar tenders may also indicate collusion. The following may be considered suspicious:

- Sudden and identical increases in price or price ranges by bidders that cannot be explained by cost increases.

- Anticipated discounts or rebates disappear unexpectedly.

- Identical pricing can raise concerns especially when one of the following is true:

  - Suppliers'prices were the same for a long period of time,
  - Suppliers' prices were previously different from one another,
  - Suppliers increased price and it is not justified by increased costs, or
  - Suppliers eliminated discounts, especially in a market where discounts were historically given.

- A large difference between the price of a winning bid and other bids.

- A certain supplier's bid is much higher for a particular contract than that supplier's bid for another similar contract.

- There are significant reductions from past price levels after a bid from a new or infrequent supplier, e.g. the new supplier may have disrupted an existing bidding cartel.

- Local suppliers are bidding higher prices for local delivery than for delivery to destinations farther away.

- Similar transportation costs are specified by local and non-local companies.

- Only one bidder contacts wholesalers for pricing information prior to a bid submission.

- Unexpected features of public bids in an auction, electronic or otherwise such as offers including unusual numbers where one would expect a rounded number of hundreds or thousands may indicate that bidders are using the bids themselves as a vehicle to collude by communicating information or signaling preferences.

(iv) In the Statements of Bidders

When working with vendors watch carefully for suspicious statements that suggest that companies may have reached an agreement or coordinated their prices or selling practices.

(v) In the Behavior of Bidders

Look for references to meetings or events at which suppliers may have an opportunity to discuss prices, or behavior that suggests a company is taking certain actions that only benefit other firms. Forms of suspicious behavior could include the following:

- Suppliers meet privately before submitting bids, sometimes in the vicinity of the location where bids are to be submitted.

- Suppliers regularly socialize together or appear to hold regular meetings.

- A company requests a bid package for itself and a competitor.

- A company submits both its own and a competitor's bid and bidding documents.

- A bid is submitted by a company that is incapable of successfully completing the contract.

- A company brings multiple bids to a bid opening and chooses which bid to submit after determining (or trying to determine) who else is bidding.

- Several bidders make similar enquiries to the procurement agency or submit similar requests or materials.

ADDITIONAL CHECK-LIST FOR DETECTING BID-RIGGING:

Be alert for:

- Opportunities that bidders have to communicate with each other

- Relationships among bidders (e.g. JVs and sub-contracting)

- Suspicious bidding patterns and pricing patterns (e.g. unexpectedly high prices or unexpectedly low discounts)

- Unusual behavior (e.g. unjustified withdrawal from tender, submitting the bid without required info).

In order to avoid bid-rigging, a check-list can be devised for designing tenders, which can be used by PSUs and State agencies. Such a check-list can be on following lines:

- Learn about the market and suppliers
- Maximize participation of potential bidders
- Define requirements clearly and avoid predictability
- Reduce communication among bidders

Use Certificates of Independent Bid Determination (CIBD) on an affidavit. CIBD typically require each bidder to sign a statement under oath that:

- it has not agreed with its competitors about bids,
- it has not disclosed bid prices to any of its competitors,
- it has not agreed to join or collude with others in any from which could lead to bid rigging in any form or manner whatsoever, and
- it has not attempted to convince a competitor to rig bids.

METHODOLOGY TO REDUCE THE RISK OF BID RIGGING

(i) Gather all Relevant Information of the Product/ Services

- Be aware of the characteristics of the market from which one will purchase and recent industry activities or trends that may affect competition for the tender.
- Determine whether the market in which one will purchase has characteristics that make collusion more likely.
- Collect information on potential suppliers, their products, their prices and their costs. If possible, compare prices offered in B2B procurement.

- Collect information about recent price changes. Inform oneself about prices in neighboring geographic areas and about prices of possible alternative products.

- Collect information about past tenders for the same or similar products.

- Coordinate with other public sector procurers and clients who have recently purchased similar products or services to improve your understanding of the market and its participants.

- If one uses external consultants to help estimate prices or costs ensure that they have signed confidentiality agreements.

(ii) Encourage Participation of Maximum Potential Bidders

- Avoid unnecessary restrictions that may reduce the number of qualified bidders. Specify minimum requirements that are proportional to the size and content of the procurement contract. Do not specify minimum requirements that create an obstacle to participation, such as control on the size, composition, or nature of firms that may submit a bid.

- Note that requiring large monetary guarantees from bidders as a condition for bidding may prevent otherwise qualified small bidders from entering the tender process. If possible, ensure amounts are set only so high as to achieve the desired goal of requiring a guarantee.

- Reduce constraints on foreign participation in procurement whenever possible.

- To the extent possible, qualify bidders during the procurement process in order to avoid collusive practices among a pre-qualified group and to increase the amount of uncertainty among firms regarding the number and identity of bidders. Avoid a very long period of time between qualification and award, as this may facilitate collusion.

- Reduce the preparation costs of the bid. This can be accomplished in a number of ways:

  - By streamlining tendering procedures across time and products (e.g. use the same application forms, ask for the same type of information, etc.).
  - By packaging tenders (i.e. different procurement projects) to spread the fixed costs of preparing a bid.
  - By keeping official lists of approved contractors or certification by official certification bodies.
  - By allowing adequate time for firms to prepare and submit a bid. For example, consider publishing details of pipeline projects well in advance using trade and professional journals, websites or magazines.
  - By using an electronic bidding system, if available.

- Whenever possible, allow bids on certain lots or objects within the contract, or on combinations thereof, rather than bids on the whole contract only.

- Do not disqualify bidders from future competitions or immediately remove them from a bidding list if they fail to submit a bid on a recent tender.

- Be flexible in regard to the number of firms from whom you require a bid. For example, if you start with a requirement for 5 bidders but receive bids from only 3 firms, consider whether it is possible to obtain a competitive outcome from the 3 firms, rather than insisting on a re-tendering exercise, which is likely to make it all the more clear that competition is scarce.

(iii) Train Staff Members

- Implement a regular training program on bid rigging and cartel detection for your staff, with the help of the competition agency or external legal consultants.
- Store information about the characteristics of past tenders (e.g., store information such as the product purchased, each participant's bid, and the identity of the winner).
- Periodically review the history of tenders for particular products or services and try to discern suspicious patterns, especially in industries susceptible to collusion.

(iv) Adopt a policy to review selected tenders periodically

- Undertake comparison checks between lists of companies that have submitted an expression of interest and companies that have submitted bids to identify possible trends such as bid withdrawals and use of sub-contractors.
- Conduct interviews with vendors who no longer bid on tenders and unsuccessful vendors.
- Establish a complaint mechanism for firms to convey competition concerns. For example,clearly identify the person or the office to which complaints must be submitted (and provide their contact details) and ensure an appropriate level of confidentiality.
- Make use of mechanisms, such as a whistleblower system, to collect information on bid rigging from companies and their employees. Consider launching requests in the media to invite companies to provide the authorities with information on potential collusion.
- Whistleblower Protection: Establish internal procedures that encourage or require officials to report suspicious

statements or behaviour to the competition authorities in addition to the procurement agency's internal audit group and comptroller, and consider setting up incentives to encourage officials to do so.

- Establish cooperative relationships with the competition authority.

(v) Define Requirements of Procurement clearly (so as not to leave any room for the suppliers to define key terms to its own advantage).

(vi) Criteria for evaluating tender should be such that facilitates participation by maximum number of bidders in the bidding process, especially the small and medium level bidders.

STEPS PROCUREMENT OFFICIALS SHOULD TAKE IN CASE OF SUSPECTED BID-RIGGING IS SUSPECTED

- Have a working understanding of the Competition Act, 2002 and other related laws/ rules dealing with public procurement.
- Do not discuss one's concerns with suspected participants.
- Keep all documents, including bid documents, correspondence, envelopes, etc.
- Keep a detailed record of all suspicious behavior/events/ statements.
- After consulting with your internal legal staff, consider whether it is appropriate to proceed with the tender offer.
- File a formal reference with the Competition Commission of India.

OTHER FACTORS CAUSING COMPETITION DISTORTIONS

There are competition distortions caused by government policies and laws which require periodical reviews. Some such factors causing distortions to fair competition in bid riggings are:

Limiting number of suppliers

The number of suppliers in the procurement process may be limited when procurement rules lay down technical specification in terms of a proprietary product and do not lay down generic specifications

Barriers to entry

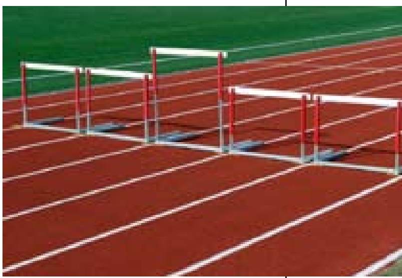
There is a tendency among public procurers to restrict participation to select big and reputed firms. Often this is done to reduce the cost of evaluating bids or to ensure the stability and quality of supply. However, this tendency could raise high entry barriers for new entrants leading to inefficient outcomes.

Competitive Neutrality

Competitive neutrality aims to provide a level playing field to public as well as private entities in the markets. The markets tend to be distorted as a result of structural advantages enjoyed by public entities which may cause distortionary effects on competition.

Information Asymmetry

It has been observed that there is no information available in the public domain suggesting goods or services and their quantum to be procured by the public authorities and sudden decision to procure any good or service strains the existing capacity of supply which creates a price pull factor often leading to inefficient procurement.



CONCLUSIONS

Ensuring effective functioning of public procurement in markets is a part of good governance. This necessitates addressing the challenge of promoting effective competition among suppliers and preventing collusion amongst the potential bidders. The competition law explicitly prohibits collusion among the bidders which ultimately affects the public exchequer and causes loss to public money. Thus, fair dealing in public procurement will not only help the procurer to get the best deal but also help the country to use its resources effectively.

Reducing collusion in public procurement requires efficient regulatory mechanism, strict enforcement of competition laws and awareness among public procurement agencies at all levels towards the adverse impacts of collusion. Fight against corruption and competition promotion policies is highly complementary.

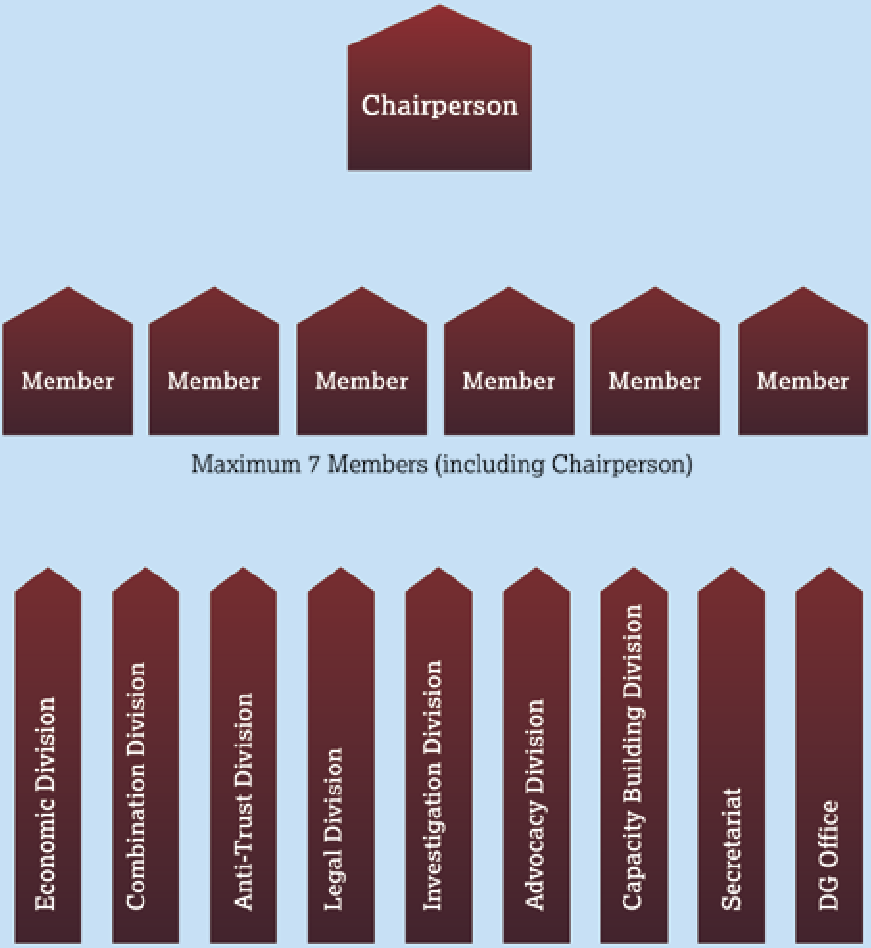
To sum up, the policy planners, public procurement officials and CCI should work together as a team to deter bid rigging through robust enforcement, increased vigilance, and better designed public procurement programs.

Note: Procurement officials are also advised to consult CCI's Advocacy Booklet on " Provisions relating to Bid Rigging".

ACKNOWLEDGEMENT

The contents of this booklet are mainly drawn from OECD Guidelines for Fighting Bid Rigging in Public Procurement.

ORGANOGRAM


Chairperson
Member
Member
Member
Member
Member
Member
Maximum 7 Members (including Chairperson)
Economic Division
Combination Division
Anti-Trust Division
Legal Division
Investigation Division
Advocacy Division
Capacity Building Division
Secretariat
DG Office

Regulations

notified by the Competition Commission of India

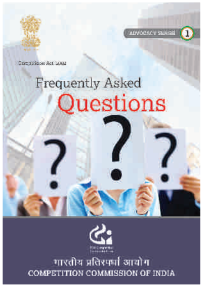
- The Competition Commission of India (Procedure for Engagement of Experts and Professionals) Regulations, 2009; (No. 1 of 2009)
- The Competition Commission of India (General) Regulations, 2009; (No. 2 of 2009)
- The Competition Commission of India (Meeting for Transaction of Business) Regulations, 2009; (No. 3 of 2009)
- The Competition Commission of India (Lesser Penalty) Regulations, 2009; (No. 4 of 2009)
- The Competition Commission of India (Determination of Cost of Production) Regulations, 2009; (No. 5 of 2009)
- The Competition Commission of India (General) Amendment Regulations, 2009; (No. 6 of 2009)
- The Competition Commission of India (Manner of Recovery of Monetary Penalty) Regulations, 2011; (No. 1 of 2011)
- The Competition Commission of India (Procedure in regard to the Transaction of Business relating to Combinations) Regulations, 2011

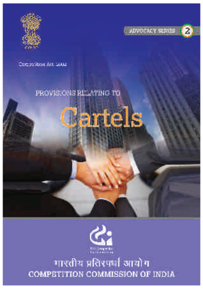
Above regulations are available at www.cci.gov.in

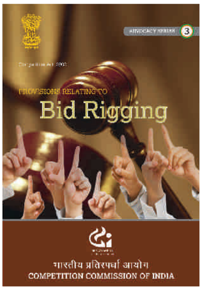
Advocacy Booklets

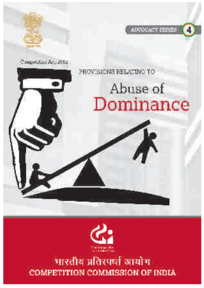
by

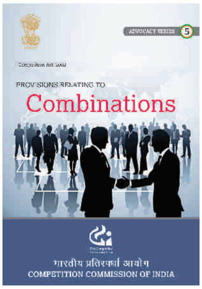
Competition Commission of India

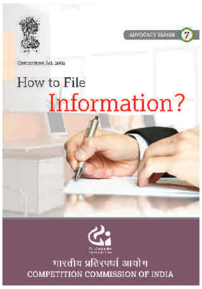


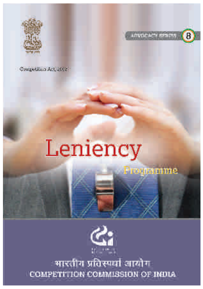












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