SPO 127 Understanding, Detecting and Preventing Antitrust Violations

Slide - Title Page: SPO Workshop No. 127 Understanding, Detecting and Preventing Antitrust Violations by Rod Kimura, Deputy Attorney General

Welcome to the workshop. What you see is the first page of a powerpoint that I've structured to be a take-away resource so you can listen to me today without having to take notes. I highly recommend you put your pen down and paper on the side. Put your feet up and just listen.

Slide - Objective of this Workshop

What's the purpose of this workshop? Objective is to provide you, the procurement professionals, with basic training on detecting and preventing certain economic crimes. I want to emphasize that we will be covering is basic training and nothing more. You might be wondering - why are we doing this; why are we focusing on the procurement professional?

Slide - Why Procurement Professionals?

Well, short answer is that you play a critical role in the award and distribution of a very valuable asset – namely tax dollars. Because of your role, you can help us prevent and detect these economic crimes as well as assist in the investigation and prosecution of these economic crimes. You can see I am emphasizing economic crimes because that is exactly what we are talking about.

Slide - Crimes?

Crimes - bid rigging, price fixing, and market allocation are economic crimes and are subject to stiff penalties and even jail sentences. So you're wondering how stiff are the penalties?

Slide - What Sort of Penalties?

For federal prosecution, a corporation can be fined up to $100 million and possibly more such as twice the gain derived from the crime or twice the loss suffered by the victims. A person can be fined up to $1 million and face up to 10 years in prison.

For State prosecution, the fine is up to $1 million per corporation, and a person can be fined up to $100,000 dollars ,and face up to 3 years in prison. Do they really fine corporations $100 million?

The answer is yes.

Slide - Criminal Penalties Obtained by the USDOJ

Largest single fine ever imposed by US DOJ was $500 million. The lucky recipient was Hoffman-LaRoche for its leadership role in the international vitamin cartel.

The largest collective fine was $1.6 billion imposed by the US DOJ for price fixing conspiracies in the air cargo transportation industry.

You might be thinking, these are corporations do they really go after individuals? The short answer is yes.

Slide - Examples of USDOJ Activities

This slide shows three examples of fairly recent DOJ activities involving persons. In the first example, the former president of a shipping company was sentenced to 60 months in jail for his role in a price fixing conspiracy.

In the second example, an executive of an LCD producer was sentenced to 24 months and forced to pay a $50,000 fine because of his price fixing conspiracy.

In the third example, three former GE executives were engaged in bid rigging and forced to spend at least 24 months in prison.

Slide - Examples of USDOJ Activities

And it can get worse. Here are 2 examples where DOJ charged individuals with not only bid rigging but mail fraud. And so you can see the effect of adding the mail fraud charge is to add more fines and more jail time.

So you might be wondering what are these laws that can impose these stiff penalties.

Slide - What are these laws that can impose stiff penalties?

Well, we’re talking about the anti-trust laws. These are laws that are there to protect competition and encourage competition. Why - why do you want to protect and encourage competition?

Slide - Why Do We Want to Encourage Competition?

Well, because competition provides benefits that are deemed to be desirable to society - such as lower prices, lower supply costs, innovation, and better information.

Slide - So what are the Antitrust laws?

The antitrust laws consist of 2 tiers. We have the federal tier which consists of the Sherman Act, the Clayton Act, and the Federal Trade Commission Act.

And of course, we have the Hawaii counterpart that’s found in Hawaii Revised Statutes Chapter 480.

Slide - Our Focus: Sherman § 1 & its Hawaii Counterpart

For this presentation, we are focusing on the Sherman Act and its Hawaii counterpart – and you can see the salient language on this slide. I put the language up there just to illustrate the application of the laws. The Sherman Act applies to interstate commerce or commerce among the several states or with foreign nations. In contrast the Hawaii law applies to intrastate commerce.

That’s all I’m going to do about the statutes because I want to get to the gist of the laws.

Slide - What Does Sherman § 1 Do?

The gist of these laws is that they prohibit collusive agreements. Bid rigging, price fixing, and market allocation are collusive agreements because (1) they involve agreements among competitors, and (2) they are unreasonable restraints of trade.

Slide - So What Do We Need to Show a Violation?

So what do we need to show a violation? Two things. We need an agreement and an unreasonable restraint of trade.

Slide - What is an Agreement?

Sounds simple. But what is an agreement. Well, generally speaking, it is a meeting of the minds - an understanding reached between two or more unrelated persons. But keep in mind that people don’t put down in writing “we hereby agree to fixed prices for the next 5 years by increasing our prices by 10% every month.” You don’t find that. So what you’re going to have to do is look at the circumstances such as the conduct, communication, economic data . . . things of that sort.

So here’s an example to ponder. Let’s say that there are 5 of us in a room. And we all sell widgets. And one person says we should all increase our prices by $10 starting tomorrow morning. No one else says a word. Tomorrow comes and all of us have increased our prices by $10. Is there an agreement? (Pause) I’m going to leave that one to you to ponder.

Slide - What about restraints of trade?

Let’s move on to restraints of trade. The first point is to understand that trade is often restrained legally. Take for example when you issue a RFP, with the objective to find a particular vendor to provide a good or service. You go through the evaluation and decide on the best bidder - the low winning bidder to go with - and enter into a contract. And that bidder will be the sole source of your good or service. Is trade restrained? Certainly - you can’t go out and buy the good or service from someone else.

Our concern is not with that type of restraint of trade. It’s with an unreasonable restraint of trade - which is where the free play of competition has been unlawfully interfered with by collusion.

Slide - Segue Slide

Ok. With that brief overview, let’s dive in and take a look at some types of collusive arrangements.

Slide - Let's Talk About – Bid Rigging: Context

First let's talk about bid rigging. Let me lay out the context. You've got a bid solicitation by the agency. And what you have is the bidders agreeing in advance on who's going to be the winner. What's the harm? It's the elimination of competition.

Slide – Let's Talk About – Bid Rigging

Alright . . . now how can bid rigging occur? Well, there are 3 basic forms of bid rigging - Bid rotation, bid suppression and complementary bidding. Let's talk first about bid rotation.

Slide - Let's Talk About – Bid Rigging: Bid Rotation

Bid rotation is exactly what it sounds like - where the bidders or competitors are rotating or taking turns on who will be the winning bidder, and this rotation can take place on the basis of time, product or geographic area.

Slide - Let's Talk About – Bid Rigging: Bid Rotation - by Year

Here's an example of bid rotation by year. Take a look at the right side of the screen and the year 2013, bidder one is the losing bidder - bidder 2 is the winning bidder. Does it look like there's a problem? No. All looks fine. However, when you go back and look at the time spectrum of 2010 to 2012, now you start to see a pattern of conduct where the bidders are rotating on who's going to be the winner. So bid rotation is one of those situations where you need to see prior years and have an understanding of the history of the bidding patterns in order to find out if there was a violation going on.

Slide - Let's Talk About – Bid Rigging: Bid Rotation by Product

Here's an example of bid rotation by the product. You got 2 products and 2 bidders. In 2013, bidder 1 wins the right to provide product A, and bidder 2 wins the right to provide product B. Doesn't look to be a problem. Go back a year and now you see a situation that's the reverse of 2013. Now this is a little more complex because you got the 2 factors at play: time and different products.

Slide - Let's Talk About – Bid Rigging: Bid Rotation by Geographic Area

Here's an example of bid rotation by geographic area. You got 2 bidders, and 2 markets - Oahu and the neighbor islands. In 2013, bidder 1 has Oahu and bidder 2 has the neighbor islands. Go back a year and you find the reverse situation.

* * *

Ok, so that's an overview of bid rigging called bid rotation on the basis of time, product and geographic area.

Slide - Let's Talk About – Bid Rigging: Bid Suppression

Now let's look at bid rigging in the form of bid suppression. The key word here is suppression. We're talking about a bid that has been suppressed or eliminated. Here's a scenario. You issued your RFP. You know there are at least 3 qualified bidders out there ,and low and behold, only one submits a bid. And there's no logical reason for the others not bidding.

Slide - Let's Talk About – Bid Rigging: Complementary Bidding

Here's an example of bid rigging in the form of complementary bidding. And this is basically a situation where a bidder agrees to bid high and foster the other vendor to be the low winning bidder. So here's an example. You do an RFP, you got at least 3 qualified bidders out there, and low and behold, you've got 2 very high bids and one low bid that's the winner.

Slide - Segue Slide

Let's move on now to the 2nd economic crime called price fixing.

Slide - Let's Talk About – Price-Fixing

What is it? It's an agreement among competitors that affects the price or the terms of sale for a product or service.

Slide - Let's Talk About – Price-Fixing continued

Clearly, the easiest example is where all the competitors agree on prices. But price fixing does not have to always involve agreement in prices. It could involve an agreement on terms or variables that affect prices such as the profit margin, discounts, pricing formula, credit terms, pricing differentials . . . .

Slide - Let's Talk About – Price-Fixing continued

Now let's pause here for a moment. Think about this. Every company sets its own prices. Every company has pricing differentials - it has pricing formulas, it has discount policy, it has credit terms. Is that a problem? Absolutely not. A company can certainly do that. The problem here is that we're talking not about a specific company, but a group of companies who compete against each other agreeing among themselves about prices and pricing terms.

Slide - Let's Talk About – Price-Fixing continued

So what's the problem? Well the problem is that they deprive the market of competition. That's the harm.

Slide - Let's Talk About – Price-Fixing: The Lysine Conspiracy

Now one of the more famous price fixing conspiracies was the lysine conspiracy. Lysine is feed additive that's used for livestock to increase the quality and availability of protein in the diet of the livestock. Now this conspiracy involved Japanese and Korean suppliers, and one major US Company - Archer Daniels Midland. And what these companies did was they agreed to divide the worldwide market and fix the price of lysine down to the penny. The significance of this case was that there was an informant, and the FBI and DOJ were actually able to record price fixing meetings - and the island of Maui played a critical role.

Slide - Let's Talk About – Price-Fixing: The Lysine Conspiracy continued

What happened was that there was a cartel meeting held on Maui at which time they conducted their price fixing meetings and arrived at the agreement. So here's the backdrop. You had an informant working for the US Company. And he reported the conspiracy to the FBI. Well, the FBI and DOJ wanted tapes of the meetings. But to get the tapes, the meeting had to be held in the United States because Japan law prohibited secret taping. So the trick used to get the conspirators to the US was the offer of golf on Maui. And what happened was that the conspirators created a bogus trade association meeting at the hotel as a cover and they even created bogus minutes of the trade meeting, but they were holding the side price fixing meetings in the hotel room. This was so compelling that there as a movie made on the conspiracy

Slide - Let's Talk About – Price-Fixing: The Lysine Conspiracy continued

Starring Matt Damon. I'm not sure if it was a blockbuster but it was a movie. If anyone is interested, I do have the DVD and you're welcome to contact me to see the movie.

Slide - Segue Slide

Ok. We talked about bid rigging, price fixing, let's move on to the 3rd economic crime - market allocation.

Slide - Let's Talk About- Market Allocation

What is it? It's an agreement among competitors to divide the market among themselves in some sort of form or fashion - on the basis of customers, territories or products. The harm is we deprive the market of competition.

Slide - Let's Talk About- Market Allocation by Customer

Let's talk about market allocation by customer. In this example for 3 years, you have bidders A, B, and C bidding on all government projects - Federal, State, and County. Then in 2012 and repeated in 2013, you find that you're getting only sole bidders: A is focusing on Federal projects and is the only bidder; B is focusing on State projects and is the sole bidder; and C is focusing on County projects as the sole bidder. There's no logical reason such as a reduction in operation, or a vendor being disqualified on federal projects, or a vendor being disqualified or failing to meet licensing requirements in accordance with State law.

Slide - Let's Talk About- Market Allocation by Territory

Here's an example that might suggest market allocation by territory. In 2007 to 2012 you've got 2 bidders bidding for work on all islands. And you come to 2013 and you find that you don't have competitive bids. What you have is a sole bid by A for work on Oahu and Hawaii, and [a sole bid by] B for work on Maui and Kauai, and there's no logical explanation such as shift in base yard location, or downsizing, or some other economic factor.

Slide - Let's Talk About- Market Allocation by Product

Here's an example of possible market allocation by product. For years, you had both A and B competing and submitting bids to provide office supplies and copier paper to the government. But 2013, you're finding that they're specializing - you have one bidder just for office supplies, and one bidder just for paper.

Slide- Segue Slide

Alright so where are we? We talked about 3 economic crimes. Let's briefly turn the corner and talk about conditions that might foster collusion. Are there such conditions? Yup.

Slide - Conditions Conducive to Collusion

There are some situations that could create opportunities for competitors to collude or just make it easier for them to collude.

Slide - Conditions Conducive to Collusion

As an example, you've got a market with few sellers and bidders - it allows for easier coordination of conspiracies.

You've got a standardized product with the key variables being pricing and quantity, and not product differentiation or quality . It's a lot easier to arrive at an agreement.

Repeated sales - now you have a recurring event, and that fosters the potential for bid rotation.

Or where you have bidders with opportunities such as a trade convention or trade association meeting or being able to mill around a bid opening because the bid submission and the bid opening take place at the same place and time - these provide cover for competitors to get together and talk.

Slide - Transitioning…

We're going to transition.

We've actually gone thru 2/3 of the presentation. In this last third, we're going to talk about red flags now and what you can do. So I really need your attention.

Slide - Red Flags

Let me start by saying red flags are not violations. Red flags are just an indication that there's something unusual going on and you want to ask questions or report the matter to someone.

Slide - Red Flags: two types- immediate or pattern

I categorize red flags as either immediate or pattern. Lets first talk about immediate red flags.

Slide - Red Flags: Immediate Red Flags – identical syntax or spelling errors

You can have a red flag that's generated by identical syntax or spelling errors.

Slide - Red Flags: Immediate Red Flags Example

Here an example. These are 2 bid letters were supposedly submitted by 2 bidders on a particular Guam public works project. If you look at it, you've got different letterhead, different signature, different names for the signers . . . even the first paragraph is different. But I have highlighted certain text for a reason.

Slide - Red Flags: Immediate Red Flags Example

Both letters have the same syntax errors. "Please give us a call US (emphasized) if you have any questions." Now the audit officials saw this and alerted the FBI and DOJ, and low and behold, after an investigation, it resulted in a Guam public official being convicted of bid rigging and having to serve, I believe, 7 years in jail.

Slide - Red flags: Immediate Red Flags- identical items in "competing" bids

You can also find immediate red flags in the form of identical terms in what should be competing bids - like the postmarks, return addresses, telephone numbers, fax numbers, calculations, stationery, hand writing, email addresses, or in the metadata in electronic bids. We had a situation where we received a complaint because the sign-in sheet for the bid drop off showed 2 competing bidders with identical fax numbers.

Slide - Red flags: Immediate Red Flags- Unusual items or events

You can also see things like whiteouts or other indications of a possible last minute change, or bidder requesting a bid package for a competitor.

Or a bidder submitting a bid when you know as a procurement professional, that this bidder just cannot do the job either because of the lack of expertise, equipment, labor, or even resources.

Or if you see someone milling around at a bid submission site with multiple bid packages and kind of looking around to see who's showing up.

Slide - Red flags: Immediate Red Flags- Unusual items or events continued

You [could] have a situation where there's a successful bidder who subcontracts work to competitors who had unsuccessful bids. Now it could be simply nothing or it could be that there's a complementary bid situation going on.

Or worse yet, you got a company that won the bid, the RFP, and then withdraws its bid and then subsequently gets involved to be a subcontractor on the 2nd winning contractor.

Or if you're looking at the bid responses, you say hey, they're increasing the prices and I'm not aware of any basis for increased costs generating increased prices, or other known or documented reason.

Or if you find that the bids you're receiving are well over cost estimate that you prepared.

Slide - Red flags: Immediate Red Flags- Tunnel Construction Case

Now that latter situation was involved in a federal tunnel construction case. It was a pretty big project and what the procurement professionals did was they had a detailed engineering cost estimate prepared that was expanded just a bit to cover any last minute unknown contingencies. There were 4 bidders out there who [each] submitted a bid, and low and behold, all the bids came in higher than the cost estimate. This troubled the procurement professionals so they launched an investigation and it turned out there was a complementary bidding and a kickback scheme in place; Flatiron, the winning bidder, had agreed to give the kickback to Corn Construction and Peter Kiewit for their participation in this scheme; and to reward Asphalt Paving, Asphalt got a subcontract.

Slide - Red flags: Immediate Red Flags- Unusual statements

You can also find immediate red flags through the statements made by people when referring to the industry pricing or association pricing. We're not talking about a MSRP - we're talking about the industry itself having a particular price.

Or someone being disgruntled and perhaps saying "Hey, we're supposed to win this RFP," or "We were supposed to be the lowest bidder."

Or someone referring to their bid as a "courtesy," or token," or "cover," or "complementary bid."

Or someone using the royal "we" when referring to the industry.

These are just examples of immediate red flags. I'm sure there are more. But these are basic examples of immediate red flags.

Slide - Red Flags- Pattern Red Flags- Bidding Patterns

Alright let's move on to pattern red flags. These are red flags that emanate from patterns and require a little bit of historical knowledge of prior bidding history - patterns such as the same suppliers bidding and appear to take turns on who's going to be the winning bidder.

Or you find that the same bidder always wins a particular procurement.

Or you seen that capable companies out there consistently don't bid or consistently submit very high bids.

Slide - Red Flags- Pattern Red Flags- Bidding Patterns continued

You see bids that are much higher than prior bids.

Or a reduced number of competitors submitting bids in comparison to past RFPs, and there's no justification like workload, bankruptcy, or exiting the market.

Or you find that a bidder submits a very high bid on one RFP than on another RFP for the same product or service, with no cost differences to account for the higher bid.

Slide - Red Flags- Pattern Red Flags- Pricing Patterns

You could see a change in the pricing patterns - like you might be seeing identical prices when past prices were consistently different.

Or you see a change in the terms of the prices such as discounts being eliminated where it might have been standard in the past.

Or you see a company that was very aggressive all of a sudden becoming very passive - passive in a sense of not competing on price, submitting very high prices, or even worse yet, refusing to provide a quote.

Slide - Red Flags- Pattern Red Flags- Market Patterns

Or you got a company that used to always sell and bid, all of a sudden saying they're not going to bid and they start referring you to a competitor.

Slide - Segue Slide

Ok. You're getting very close to the end.

Slide - What Can You Do?

And so what can you do? Well, know the market. Become familiar with the market in which you make your purchases in.

And from time to time look over the bidding history.

Become familiar with some of the red flags that I laid out in the prior slides.

And certainly retain all bid documents: Sign-in sheets, bids, envelopes, fax transmittal sheets, even email transmittals.

Slide - What Can You Do? continued

To the extent possible, expand your bidder list. Now, having said that, I realize we're in a very small market and a lot of times you're already facing just a handful of bidders. But you know, keep your eye out there on the market. There may be someone who is entering the market or is capable of doing the work. And perhaps they don't know about your RFP - give them a call and encourage them to consider become a bidder. Or find out why they're not bidding.

When the bids come in, date and time stamp the bids, and try and set a bid public opening at least one day after the specified due date so that you don't provide cover for these bidders.

Slide - What Can You Do? Continued

You can require the bidders to submit a certificate of independent price determination and that's a certificate saying that they arrived at their pricing independently and not through collusion. If they submit a certificate and it turns out that they did indeed collude, that's an unsworn falsification to authorities and that's a misdemeanor penalty under State law.

And if you start to see things that are just don't make sense, press your vendors to explain and justify their prices.

Slide - What Can You Do? continued

Basically, really trust and use your "spidey senses." You don't have to make out a case. If you suspect that there's something going on, give me a call as soon as possible. And if for some reason you feel uncomfortable calling me, you can call my colleague over at the US Department of Justice in San Francisco. I can assure that whoever you call, your identity and the substance of your call will be held in confidence.

Slide - Contact Information

Here's the contact information for me and for my counterpart in San Francisco. I want to thank you very much for your attention, and that is the end of the program.

Rodney Kimura
Deputy Attorney General
Department of Attorney General
(808) 586-1180
Rodney.i.kimura@hawaii.gov

Jacklin Chou Lem
USDOJ, Antitrust Division
(415) 436-6660
Jacklin.lem@usdoj.gov