

Bid rigging: For multinationals, more than just a local law violation

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BID RIGGING: AN INTRODUCTION

In many countries, purchases of products or services¹ by government or public entities take place primarily through public tenders. The theory behind conducting such tenders is that they will allow the purchasing entity to evaluate competitive bids and to select those that are of the best quality and that represent the best value for money, increasing transparency in the purchasing process and reducing the risk of corruption.

Generally, a public tender begins when a purchasing entity publicly issues a set of tender specifications for the type of product that it wishes to purchase, as well as instructions on how to prepare and submit a bid. After a specified number of bids are submitted or the allotted time for the public tender ends, the end user or a designated tender committee will evaluate the bids and select the one that they find to be the best fit according to defined criteria.

Of course, the particular rules and procedures for public tenders vary from jurisdiction to jurisdiction. In China, for example, local law requires that for most purchases made by government entities, the purchasing entity must receive a minimum of three competitive bids and select one bid from among them.

While public tenders have many uses, the significant value of the transactions that are often conducted through these tenders means that participating companies and/or their sales employees have an incentive to try to subvert the process. Therefore, participating companies and the third-party intermediaries that represent them in bidding often try to find ways to ensure that their company's product is the one selected. This is an activity referred to as "bid rigging."

The most straightforward type of bid rigging involves collusion between a bidder (either a participating company or a third-party intermediary) and an individual at the purchasing entity who has decided that he or she favors the participating company's product. In one version of such collusion, the individual at the purchasing entity may assist a bidder to win the bid by issuing technical specifications for the public tender that favor that bidder's product or make it impossible or unlikely for other products to win.

Alternatively, the individual at the purchasing entity may give information about the other bids to a bidder such that the bidder can craft its bid to ensure winning, or allow the bidder to revise its entry despite tender rules prohibiting such behavior.

A somewhat more complicated version of bid rigging is where bidders engage in a system of "accompanying bidders," in which multiple bidders (or multiple entities affiliated with the same bidder) conspire to determine the outcome of a bidding process.

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Again, this can be done either by participating companies or by third-party intermediaries acting for them.

The most common approach is that one bidder is designated among the colluding parties as the "main bidder" that is intended to win the tender process. The main bidder's proposal is submitted alongside bids from accompanying bidders that offer inferior products and/or higher pricing to ensure that the main bidder wins the tender, while the requirement of multiple bids for a public tender is nominally satisfied.

Notably, this type of bid rigging may take place with or without knowledge by the purchasing entity. Sometimes, the purchasing entity has chosen which product it would like to purchase, and thus agrees to look the other way while accompanying bidders are organized and not to look too carefully into their bids.

At other times, the purchasing entity may not be aware of the plan to present accompanying bidders. In that case, the individual colluding bidders may simply agree amongst themselves that some of them will put in sub-par bids, perhaps in exchange for a fee or with the understanding that the main bidder will in a future tender act as an accompanying bidder in order to repay the favor. In an alternate version of the accompanying bidder scheme,



colluding third-party intermediaries may put forward fake bids for companies that are not even aware that the tender is taking place.

PUBLIC TENDERS AND BID RIGGING IN ASIA

Most countries have laws and regulations on bidding and tenders that prohibit bid rigging. For example, in China — where public tenders are common in industries that involve dealings with state-owned entities (“SOE”) or the use of government funds — the Bidding Law of the People’s Republic of China (“PRC Bidding Law”) issued in 2000 contains express provisions that, amongst others, prohibit:

- The tenderee disclosing information regarding potential bidders or other information that may affect fair competition;
- The tenderee disclosing details of minimum bid;
- The bidders colluding with each other or the tenderee;
- The bidders paying bribes to the tenderee or the bid evaluation committee;
- The bidders submitting bids that are lower than cost;
- The bidders submitting bids in other persons’ names; and
- The bidder using other fraudulent or deceptive methods to win the bid.

The prohibitions of the PRC Bidding Law are further clarified in the Regulations on the Implementation of the Bidding Law of the People’s Republic of China (“PRC Bidding Regulations”) issued in 2011. For example, “bidders colluding with each other” includes situations where:

- bidders discuss with each other bidding prices or other substantive contents of the bidding documents;
- bidders agree on the winning bidder;
- bidders agree that some bidders would pursue or forego the tender;
- bidders from the same group or organization agreeing to submit bids in accordance with the group’s or organization’s demands;
- bidding documents for different bidders are drafted by the same individual or entity;
- different bidders delegate tender-related affairs to the same individual or entity;
- different bidders submit bids with suspicious pricing patterns; and

- different bidders pay bid guarantee deposits from the same entity or bank account.

Violations of the PRC Bidding Law or the PRC Bidding Regulations may result in invalidation of the bid, confiscation of illegal gains, additional monetary penalties, suspension of bidding rights, and revocation of business license. Moreover, if any action violates applicable criminal laws, there may be further criminal liability as well, which includes monetary fines and imprisonment.

In addition to this centralized guidance, there are also industry- and sector-specific rules and regulations regarding tenders with further prohibitions against bid rigging, such as the Construction and Engineering Design Bidding Management Measures for construction projects, and various municipal and/or provincial Measures for the Administration of Centralized Bidding Procurement of Drugs in Healthcare Institutions for drug procurements.

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Moreover, bid rigging activities may be in violation of laws and regulations governing antitrust and unfair competition, including the Anti-Unfair Competition Law of the People’s Republic of China, and the Anti-Monopoly Law of China.

In Korea, public tenders are also common, as they are required for all construction contracts by central government agencies worth over 200 million won or for goods or services contracts by central government agencies worth over 20 million won, as well as many contracts by local government entities.

The Act on Contracts to Which the State is a Party (the State Contract Act) mandates that all participating bidders in public tenders promise not to “offer or receive money, goods, entertainment, or any other benefit directly or indirectly in the course of making or accepting a tender or signing or performing a contract,” and, further, that they make an “integrity agreement” with the tendering entity specifying that the contract may be cancelled if this promise is broken.

The State Contract Act further mandates that the determination of the successful bidder shall be made according to certain competitive factors based on price and the criteria specified in the tender notice, and that the bidding be carried out according to the principles of transparency and fairness.

A person or entity found to have offered a bribe in relation to a public tender or who has engaged in collusive behavior in relation to such will be restricted from participating in public tenders for all central government agencies for a period of up to two years. Criminal penalties are also possible for involved individuals.

Because numerous situations involving bid rigging have been uncovered in Korea, the country's Fair Trade Commission (FTC) has implemented a Bid Rigging Indicator Analysis System (BRIAS) designed to identify cases of collusion. For bids above a certain price, BRIAS automatically analyzes data such as bid price as a percentage of the reference price and the number of participants in public tenders, and the method of competition, applying a formula that produces a score intended to show risk of bid rigging. For bids where the score is above a certain threshold, the FTC undertakes further investigation.

RISKS OF BID RIGGING AND OTHER PUBLIC TENDER MANIPULATION

In addition to local law risks, bribes or improper benefits are often provided to either the accompanying bidders or to the end users in connection with these arrangements. Thus, participation in public tenders brings with it an elevated risk of bribery.

In bid rigging cases that involve collusion between a participating company and an end user, these payments will be direct; that is, a payment will be made by the company to an end user to pervert the public tender process.

For example, a company may pay a customer to favor that company's bid in the tender, to issue tender specifications in a manner favorable to the company, to falsify documents, to look the other way in the case of accompanying bidders, or to otherwise corrupt the bidding process in a manner favorable to the Company. Such payments may be cash or may come in the forms of gifts and entertainment provided to customers or tender officials during the tender process.

Where the arrangement of accompanying bidders or other bid rigging behavior is carried out not directly by the company but by a third-party intermediary, the company may make a payment directly to that intermediary that is either passed through to the purchasing entity or — in a case where the purchasing entity is unaware of the accompanying bidder situation — taken by that third-party intermediary as a fee for the service.

Alternatively, the cost incurred by a third-party intermediary in making arrangements to win the bid may be considered and allowed for when sales employees at the company offer discounts to that intermediary, and will thus be paid out of that intermediary's margin.

PRACTICAL CASE STUDIES

As early as 1999, the United States Department of Justice had noted that payments as part of a bid rigging scheme may also be corrupt payments that violate the United States Foreign Corrupt Practices Act or local anti-corruption laws. In an unnamed case, U.S. regulators discovered that improper payments were made both to an intermediary to facilitate a conspiracy to rig bids, and to contracting government officials of companies preparing to award contracts, for the purpose of influencing the award decision.

A publicized example that highlights the relationship between bid rigging and corruption is the recent allegations against pharmaceutical bidding agents in Malaysia. In or around June 2018, media sources reported that local bidding agents, with the assistance of international pharmaceutical companies, would engage in bid rigging known as "bid-rotation" to limit competition and take turns to secure supply contracts.

Moreover, bid rigging activities may be in violation of laws and regulations governing antitrust and unfair competition, including the Anti-Unfair Competition Law of the People's Republic of China, and the Anti-Monopoly Law of China.

The bidding agents allegedly pocketed close to 4 billion Malaysian Ringgits (approximately 990 million USD) through the alleged collusion. Moreover, some of these entities are allegedly close to or owned by Malaysian politicians, high-ranking government officials, and/or their family members. The allegation has led at least one Malaysian MP to urge the central government to cut out tendering agents with regard to public pharmaceutical procurements.

In recent local enforcement matters, we see instances where one bidding agent, with the assistance of international product suppliers, would make improper payments to other bidding agents (who represented either the same supplier or competitor suppliers) in order to secure government procurement contracts on behalf of the international product supplier.

In rare instances, the recipient of the improper payments may later be selected — either by chance or on purpose — to sit on the assessment committee of the relevant tenders. As a result of the recipients' change in status, a payment that may have originally violated only local bidding laws could now be seen by regulators as an improper payment to a government official, which would be in violation of anti-bribery laws as well.

SUGGESTIONS FOR MULTINATIONALS

As highlighted above, bid rigging in public tenders is often difficult to detect and may lead to notable adverse consequences for implicated individuals and entities. Therefore, companies should incorporate measures in their internal control framework that help prevent, detect, remediate, and deter bid rigging. These measures may include:

- Adopting and implementing clear and reasonably detailed policies and procedures regarding public tenders, including specific provisions prohibiting bid rigging and other corrupt conduct;
- Providing routine and periodic compliance trainings and policy reminders to all staff involved in the public tender process;
- Maintaining a centralized database to record all public tender activities and documents, and conducting regular reviews of the database to understand statistical trends and look for potential anomalies;
- Conducting reasonable background checks on and justifying involvement of any third parties (e.g., distributors, agents, etc.) involved in the tender process;
- Comparing bid quotations to entries in the accounting system to check for discrepancies or anomalies;
- Regularly monitoring public tender announcements, including the final winning bid/price, and comparing the final bid to internal bid documents;
- Establishing protocols that seek to fairly and adequately address allegations of bid rigging should such allegations arise;
- Staying current on industry news and insights to understand new and/or prevalent forms of big rigging practices; and
- Conducting periodic reviews, possibly with the assistance of professional external advisors, to assess adequacy of existing internal controls and make enhancements where needed.

Although the risk of bid rigging is inherent to public tenders and difficult to eliminate, these and other suitable internal control measures can help mitigate the relevant risks and provide a defense to government regulators. Many multinationals that rely on public tenders as part of their business strategies already have put some, if not all, of the above measures in place, and we urge those that still do not to do the same.

NOTES

¹ The behavior discussed in this Alert applies to public tenders both for product purchases and service contracts. For linguistic convenience, however, this alert refers only to product purchases.

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