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Working Party No. 3 on Co-operation and Enforcement

PUBLIC PROCUREMENT/BID RIGGING ISSUES

-- Australia --

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The attached document is submitted to Working Party No. 3 of the Competition Committee FOR DISCUSSION under item III of the agenda at its forthcoming meeting on 15 June 2010.

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1. Introduction

1. An overview of the operation of government procurement in Australia is provided to give context to the Australian Competition and Consumer Commission's (ACCC) efforts to combat bid rigging as it impacts upon government procurement.¹

2. Public sector procurement is a multi-billion dollar industry that makes a vital contribution to the economy and the welfare of the community. In Australia, procurement by Commonwealth agencies accounted for \$AUD33 billion in terms of notified contracts in the 2008/09 financial year.² It is imperative that the community receives the best value for every taxpayer dollar spent. This makes effective competition in public sector procurement essential.

3. The *Trade Practices Act 1974* (TPA) is enforced by the ACCC and has broad application across both business and government to prohibit anti-competitive conduct. The High Court of Australia recently clarified that businesses involved in government tenders are subject to prohibitions against anti-competitive conduct in the TPA.³

4. The *Commonwealth Procurement Guidelines*⁴ (CPGs) establish the core Procurement Policy Framework and articulate the Australian Government's expectations of all Commonwealth departments and agencies subject to the *Financial Management and Accountability Act 1997* and relevant *Commonwealth Authorities and Companies Act 1997 bodies*⁵ and their officials, when performing duties in relation to procurement. The Commonwealth Department of Finance and Deregulation is responsible for administering the Commonwealth's Procurement Policy Framework.

5. The CPGs define procurement in the following way:

Procurement encompasses the whole process of acquiring property or services. It begins when an agency has identified a need and decided on its procurement requirement. Procurement continues through the processes of risk assessment, seeking and evaluating alternative solutions, contract award, delivery of and payment for the property or services and, where relevant, the ongoing management of a contract and consideration of options related to the contract.

6. The core procurement objective is to obtain value for money. Value for money is enhanced in government procurement by encouraging competition, establishing efficient, effective and ethical use of resources and being accountable and transparent.⁶

7. Effective competition requires non-discrimination in procurement and the use of competitive procurement processes. All potential suppliers should have the same opportunities to compete for

¹ This paper is a supplement to the paper submitted to the OECD in February 2010, and in some sections repeats the information provided as part of that paper.

² The Department of Defence is responsible for a significant proportion of that value.

³ *ACCC v Baxter Healthcare Pty Ltd & Others* [2007] HCA 38.

⁴ A copy of the CPGs is available at <http://www.finance.gov.au/publications/fmg-series/procurement-guidelines/index.html>.

⁵ Relevant *Commonwealth Authorities and Companies Act 1997* bodies are listed in Schedule 1 of the *Commonwealth Authorities and Companies Regulations 1997* and can be directed by the Finance Minister to apply the CPGs.

⁶ Refers to paragraph 4.2 of the CPGs.

government business and be treated equitably based on their legal, commercial, technical and financial abilities. Equitable treatment of suppliers enables business to be conducted fairly, reasonably and with integrity.⁷

8. Procurement methods must not discriminate against potential suppliers due to their degree of foreign affiliation or ownership, location or size. The property or services on offer must be considered on the basis of their suitability for their intended purpose and not on the basis of their origin.⁸

9. All procurements should be conducted in an ethical, accountable and transparent manner. Ethical behaviour encompasses the concepts of honesty, integrity, probity, diligence, fairness, trust, respect and consistency. Ethical behaviour identifies and avoids conflicts of interests, and does not make improper use of an individual's position.⁹

10. Accountability and transparency encourage the efficient, effective and ethical use of Commonwealth resources. Officials have the responsibility of ensuring that any procurement process is open and transparent and that decisions are justified. Procedures should be in place to ensure that procurement processes are conducted soundly and that procurement related actions are documented, defensible and substantiated in accordance with legislation and government policy.¹⁰

11. The procurement process itself is an important consideration in achieving value for money. Participation in a procurement process imposes costs on agencies and potential suppliers and these costs should be considered when determining a process commensurate with the scale, scope and relative risk of the proposed procurement.¹¹

2. Australia's approach to procurement

12. The CPGs represent the policy framework under which Australian Government agencies govern and undertake their own procurement. These guidelines focus on value for money and how it may be achieved by agencies when undertaking procurement.

2.1 ACCC approach to procurement

13. The ACCC is Australia's national competition regulator. It is responsible for administering and enforcing the TPA, including by educating Australian consumers, businesses and governments about their trade practices rights and responsibilities. The ACCC is the only national agency dealing generally with competition matters and the only agency with responsibility for enforcing the TPA and the state/territory application legislation.

14. The ACCC has actively engaged with procurement officials across all levels of government to alert them to the issues and risks that may arise in relation to cartel conduct. In particular the ACCC has focused on:

- risks for government

⁷ Refers to paragraph 5.2 of the CPGs.

⁸ Refers to paragraph 5.2 of the CPGs.

⁹ Refers to paragraph 6.17 of the CPGs.

¹⁰ Refers to paragraph 7.2 of the CPGs.

¹¹ Refers to paragraph 5.7 of the CPGs.

- the law in Australia
- procurement design
- detection tips
- deterrence tips, and
- do's and don'ts in public procurement.

15. Experience internationally indicates that bid rigging for government tenders is a prime target for cartels. There are numerous examples of cartels targeting government procurement in Australia, including:

- demolition service providers in the state of South Australia for defence contracts
- concrete contracts affecting a number of Queensland councils
- fire sprinkler installation in Queensland which affected many government and non government building projects
- air-conditioning contracts in Western Australia affected both government and private projects.

16. Below are two specific case examples.

2.1.1 Concrete constructions

17. In 1988, a tender was released for the construction of a building for a Commonwealth agency in Sydney, New South Wales. Prior to the close of tenders, an industry association, the Australian Federation of Construction Contractors (AFCC) called a meeting of the four firms bidding for the contract. It was agreed that the winning firm should pay unsuccessful tenderers an 'unsuccessful tenderers fee' (UTF) of AUD\$750,000 each, and that the AFCC should be paid a 'special fee' of AUD\$1 million.

18. This case was exposed as a result of a NSW Royal Commission into the construction industry.¹² The ACCC obtained the transcripts of the Royal Commission and pursued the particular tender in relation to the Haymarket site. The tender had been awarded to the value of AUD\$160 million.

19. While the Royal Commission could make findings it could not issue any sanctions for illegal conduct. Further, the information provided to the Royal Commission, as a general rule, could not be used in Court proceedings.

20. The AFCC and the unsuccessful tenderers each sent invoices purporting to make claims on the successful tenderer for fees for 'consultancy services' which the ACCC proved had not been provided.

¹² A Royal Commission is a public advisory body appointed by a government to obtain information relating to a specific issue. Royal Commissions are led by members (Commissioners) appointed by the government. The Commissioners are usually drawn from the judiciary or other senior legal practitioners. A Royal Commission is required to investigate a matter based on the "terms of reference" provided by the government and present its findings in the form of a written report. In the course of its investigation, a Royal Commission will typically call witnesses to give evidence, collect other evidence and receive submissions from interested parties. The recommendations contained in the report may form the basis for changing or implementing government policy.

21. The making of UTF understandings in respect of large construction projects was deliberate and organised, and had been carried on in the building industry for some thirty years.

22. In reaching the decision that the agreement between the companies and association was a breach of competition law, the judge said:

“The inference is that the tenders submitted...were \$3,150,000 more than what they would have been but for the arrangements or understandings. This was, of course, a gross imposition on the Commonwealth and on the people of Australia.

The corruption of market forces to the detriment of the Commonwealth and the public deserves strong condemnation.”¹³

2.1.2 Air-conditioning cartel

23. In 2004 the ACCC instituted proceedings against 17 companies and 22 individuals in relation to an air-conditioning cartel on projects valued at over AUD\$100million. The cartel related to bid-rigging and price fixing affecting the supply and installation of commercial and industrial air conditioning and mechanical services in the state of Western Australia.

24. The conduct involved entering into arrangements or understandings with some or all of the various parties agreeing which company among them would submit the lowest tender for particular commercial projects that were let for tender. Projects the subject of the cartel involved tenders for a government agency, public hospitals and high schools.

25. For some periods from 1997 to 2003, some of the respondents, who were members of the Air Conditioning and Mechanical Contractors’ Association of Western Australia, would attend regular weekly meetings at the AMCA premises at which they would discuss upcoming tenders and endeavour to agree which tender would be designated to submit the lowest price.

26. Over the duration of the proceedings, the Federal Court imposed a total of \$9.2 million in pecuniary penalties.¹⁴

3. Compliance initiatives in Australia

27. Australian Government departments and agencies subject to the *Financial Management and Accountability Act 1997* and relevant *Commonwealth Authorities and Companies Act 1997* bodies (agencies) must comply with the Mandatory Procurement Procedures (MPPs) where the estimated value of property or services subject to procurement indicates that it may be a *covered procurement*.¹⁵ The MPPs enhance the delivery of value for money through consistent and transparent procedures. MPPs complement the principles set out in Division 1 of the CPGs and ensure that Australia’s international obligations in relation to Government Procurement are met.

28. Agencies are also required to publicly advertise their potential business opportunities, publish all open approaches to the market, and report on all contracts and standing offers valued at AUD\$10,000 or more, on AusTender - the Australian Government procurement information system.

¹³ *ACCC v CC (NSW) Pty Ltd* [1999] FCA 954: the Federal Court of Australia issued penalties of AUD\$1.75 million on the companies and individuals involved.

¹⁴ *Australian Competition & Consumer Commission v Admiral Mechanical Services Pty Ltd* [2010] FCA 348

¹⁵ Paragraph 8.4 of the CPGs defines covered procurements.

3.1 *ACCC compliance initiatives*

29. Despite the fact that many cartels and other types of anti-competitive conduct detected by the ACCC have involved government purchasing, it is the ACCC's experience that government agencies themselves have been reluctant to report suspicion of cartels to the ACCC.

30. In 2005, the ACCC launched its first specific compliance program consulted widely and engaged in discussions with officials who were directly involved in Commonwealth procurement. The primary objective of this program was to alert officials on how to detect possible cartel activity in the procurement process. The material released by the ACCC included guidance to officials on how to detect the warning signs of cartel conduct.

31. The central component of the program was a multi-media CD-ROM which was provide to public sector procurement agencies, as well as private companies involved in procurement.

32. The initial rollout of the ACCC's procurement strategy comprised over 50 presentations by ACCC staff, at all levels, to procurement officials from Commonwealth, state and local governments. Importantly, a number of these seminars were delivered to national and state conferences for procurement officials.

33. In addition to the initiatives targeting procurement officials, the ACCC wrote to Commonwealth Government Ministers and the Premiers and Chief Ministers of each of Australia's states and territories.

34. As a result of the initial procurement compliance program, the ACCC received various reports from procurement officials identifying activity which may breach competition laws. Whilst there were some investigations as a result of these reports, none of these have led to enforcement action by the ACCC.

3.2 *Review of assistance to procurement officials*

35. The ACCC instituted proceedings against Baxter Healthcare Pty Ltd (Baxter) in relation to anti-competitive conduct that related to government procurement contracts.¹⁶ An important issue decided in these proceedings was the fact that the court removed any uncertainty regarding the application of the competition provisions of the TPA to collusive practices involving government tenders; the effect is that companies can not derive immunity from prosecution under the TPA simply because the conduct relates to procurement with the Crown.

36. Following the High Court's decision, the ACCC embarked on a redevelopment of the compliance program to assist government agencies. The purpose of the redevelopment was to help government agencies to protect their procurement, grant and program funding from collusion, as well as to ensure that those who abuse those processes are prosecuted to the fullest extent of the law.

37. As part of the compliance program, the ACCC trialled a new education and advocacy approach in relation to public procurement. The trial program involved extensive consultation and liaison with state and local government entities, including over 70 presentations by ACCC staff.

38. In addition to these presentations, an ACCC Outreach Officer was specifically tasked to liaise directly with these government entities, focusing on education and advocacy for procurement reform.

¹⁶ *Australian Competition and Consumer Commission v Baxter Healthcare Pty Ltd* [2005] FCA 581: see High Court decision *ACCC v Baxter Healthcare Pty Ltd & Others* [2007] HCA 38.

3.2.1 *Guideline for procurement officers*

39. In April 2009, the ACCC released a new guidance publication for procurement officials “*Cartels: deterrence and detection – a guide for government procurement officers*”.¹⁷

40. The ACCC recognised that procurement officials were often the first in line to be able to detect collusive conduct. Procurement officials are best placed to use their expertise, observations and sound judgement in assessing tenders to secure the best procurement outcomes for government.

41. The guideline assists procurement officials to better understand cartel behaviour, and considers some of the steps that procurement officials can take to maximise competition and save government agencies money, while also disrupting the possible operation of cartels by suppliers. The guideline also provides some practical tips and warning signs that indicate when tenderers may be colluding, as well as providing illustrative hypothetical examples of when to report conduct to the ACCC.

3.3 *Anti-collusion clauses*

42. By issuing the guidelines, the ACCC aims to provide procurement officials with sufficient knowledge about collusive behaviour in order to adopt practices in public procurement processes that deter bidders from colluding in the first instance.

43. One tool available to procurement officials to alert bidders that officials are on the lookout for cartel conduct is the incorporation of anti-collusion clauses into tender documents. While not required under the CPGs, the ACCC considers it is good practice to employ anti-collusion clauses to deter such behaviour because it:

- requires bidders to sign a warranty that their bid has been developed independently from their competitors and that no consultation, communication, contract, arrangement or understanding with any competitor has occurred in respect of their bid
- warns bidders in tender documents that procurement officials may report suspected instances of collusion to the ACCC
- requires disclosure of all subcontracting arrangements that involve dealings with competitors, including those made after awarding the contract. It also ensures that procurement officials are notified if a winning bidder assigns their contract to a competitor. If unsuccessful bidders receive work from the successful bidder, the subcontracts may be a reward for submitting a non-competitive bid, and
- requires tenderers to disclose any past proceedings involving anti-competitive conduct, in Australia or overseas. This may give procurement officials valuable information about the marketplace behaviour of bidders, and allows officials to better assess any risks.

44. The guidelines also suggest that procurement officials keep track of past tenders and pricing movements so that these may be analysed over time. The ACCC believes that this helps procurement officials to understand the market to which the tender relates and assist in estimating and budgeting, as well as making it harder for cartels to target tenders. It may also assist in detecting irregularities, such as tender rotation amongst market participants.

¹⁷ The guide is available at <http://www.accc.gov.au/content/index.phtml/itemId/869010>.

3.4 Enforcement outcomes post guidelines release

45. During the four years following the release of the ACCC's compliance program, the ACCC did not bring any bid-rigging case to court. However, in 2009 this changed when the ACCC instituted proceedings against American-based company, DRS C3 Systems¹⁸ (DRS), for alleged market sharing in the international military defence training system industry.

46. The conduct related to an alleged agreement between DRS and another company in relation to a procurement contract issued by the Australian Government. The agreement was to the effect that DRS would withdraw from a proposed procurement of air combat manoeuvring instrumentation system by the Commonwealth of Australia for use as part of a joint training exercise between Australian military forces and the US Air Force in the Pacific region. The resolution of this litigation took into account that the conduct by DRS was an isolated incident, was over a confined period of time and did not cause any evident loss or damage to the Department of Defence.

47. The ACCC and DRS reached a settlement of the proceedings with DRS agreeing to pay AUD\$1 million in pecuniary penalties.

4. Summary

48. The Australian Government procurement market is characterised by a high degree of transparency and accountability. The Australian Government procurement reporting system, AusTender, makes the results of all procurements over AUD10,000 public and the Commonwealth Procurement Guidelines underline the importance of the principle of transparency and mandate open procurement processes as the default mechanism for all procurements over AUD80,000.

49. In the course of implementing compliance programs, the ACCC has learnt that to successfully achieve its compliance objectives, particularly with respect to public procurement, it is necessary to have a mix of strategies and approaches. For example, education and advocacy messages (while necessary) will not be successful in raising awareness about the economic harm associated with bid-rigging for government tenders, or in preventing breaches of the law, without strong enforcement action.

50. The ACCC continues to work with procurement officials to increase awareness and equip them with the knowledge and tools they need to ensure they can detect and report suspicious behaviour in public procurement activities.

¹⁸ *ACCC v DRS C3 Systems, Inc* NAS588/2009.