Enquiry Report

In the Matter of Bid Rigging in Peshawar Electric Supply Company's Tender

Background

1. This enquiry report has been prepared pursuant to Section 37(1) of the Competition Ordinance 2010 (the 'Ordinance'). The Competition Commission of Pakistan (the 'Commission') had taken *suo motto* notice of possible bid rigging in a Peshawar Electric Supply Company (PESCO) tender for procurement of power distribution equipment.

2. The Cartels, Monopolies and Trade Abuses (CMTA) Department of the Commission first noticed indicators of possible collusive bidding after it reviewed details of the public procurement carried out by PESCO in the past few years. The review was part of the CMTA Department's Bid Rigging Detection Program aimed at identifying and curtailing collusive bidding in public procurement.

3. On recommendation of the Department, the Commission authorized an enquiry into the matter and appointed Mr. Tariq Bakhtawar, Director General, Mr. Syed Umair Javed, Assistant Director as Enquiry Officers (Collectively, the 'Enquiry Committee') to submit a report on the matter. The Enquiry Committee was authorized to inquire as to whether any violation of Section 4 of the Ordinance had taken place during the procurement in question.

4. For the purposes of this enquiry report, the Enquiry Committee took into consideration the documents provided by PESCO, including but not limited to the following: the bid documents submitted by potential bidders, communication between PESCO and the potential bidders, the joint venture agreement between various pole manufacturers, the report and review of PESCO's evaluation committee and information obtained from online sources.

Facts

5. Pakistan received a loan from Asian Development Bank under the Power Distribution Enhancement Investment Program (ADB-2438-PAK). PESCO, a power distribution company of Pakistan Electric Power Company (PEPCO), decided to utilize part of this loan to purchase certain power distribution equipment through a competitive bidding process.

6. PESCO, in line with its decision, floated a tender numbered ADB-PESCO-06-2009 for the procurement of, *inter alia*, 4759 HT PC and 3678 LT PC poles. These two items constituted Lot III of the tender. The Invitation for Bids

advertisement was published in various newspapers. Copy of one such advertisement is attached as Annex A.

7. Subsequently various companies requested PESCO to issue tender documents: Redco Pakistan Limited (Redco) on 15 April 2009; Nam International (Pvt.) Limited (Nam) on 21 June 2009; M.R Electric Concern (Pvt.) Limited (Mrec) on 30 June and Creative Engineering (Pvt.) Limited (Creative) on 7 July 2009. PESCO record indicates that another company Amin Brothers Engineering Pak (Pvt.) Limited (Amin Brothers) also submitted their bid against this tender. However it is unclear when they obtained the tender documents. Copies of the letters are attached as Annex B, C, D, and E respectively.

8. All the companies mentioned in the preceding paragraph are registered under the Companies Ordinance 1984, are engaged in manufacturing and supplying engineering products, including HT PC and LT PC poles, and are undertakings as per the definition given in Section 2(1) (p) of the Ordinance.

9. On 3 August 2009, one day before the deadline for submission of bids, PESCO received two bids for the HT PC and LT PC poles. One of the bids was from Creative-Mrec-Redco-Nam (JV) claiming to be a joint venture between Creative, Mrec, Redco and Nam. The other bid was from Amin Brothers.

10. PESCO Review Evaluation Committee's Recommendation indicates that Amin Brothers quoted a unit price of PKR 14610 for HT PC poles and PKR 10410 for LT PC poles while the JV quoted PKR 14500 and PKR 10300 for the same items respectively. Copy of the relevant portion of the PESCO Review Evaluation Committee's Recommendation is attached as Annex F.

Collusive Bidding

11. Bid rigging is defined by OECD as 'a particular form of collusive price-fixing behavior by which firms coordinate their bids on procurement or project contracts.'[1] It is a term applied to a wide range of practices whereby competitors in a bidding process coordinate amongst themselves to raise the cost of goods and services being purchased thereby artificially increasing the profits made. Bid rigging can be achieved in many ways. One way is to divide the procurement goods or services amongst the many bidders by way of joint ventures in situations where at least one competitor could have easily bid independently. Another method is to provide a cover bid wherein bids which are unlikely to succeed are submitted to give an appearance of competitive bidding. There are many more methods and one instance of bid rigging can incorporate many of the methods together. Public procurement is often the target of collusive bidding.

[1] OECD, Glossary of Statistical Terms available at http://stats.oecd.org/glossary/detail.asp?ID=3334

12. By artificially raising prices, the colluders raise the cost of procurement. This distorts competition in the market and is especially problematic in case of public procurement where the taxpayer foots the inflated bill.

13. Collusive bidding is exclusively prohibited by Section 4(1) read with Section 4(2) (e) of the Ordinance. Since collusive bidding may divide markets and fix quantities of production and sale of goods and services, it maybe also infringe Section 4(1) with reference to Section 4(2) (a) and (b). The relevant portions are reproduced here for ease of reference.

    4. Prohibited agreements:- (1) No undertaking or association of undertakings shall enter into an agreement or, in case of an association of undertakings, shall make a decision in respect of the production, supply, distribution, acquisition or control of goods or the provision of services which have the object or effect of preventing, restricting or reducing competition within the relevant market unless exempted under section 5 of this Ordinance.

    (2) Such agreements include but are not limited to-

    (b) dividing or sharing of markets for the goods or services, whether by territories, by volume of sales or purchases, by type of goods or services sold or by any other means;

    (c) fixing or setting the quantity of production, distribution or sale with regard to any goods or the manner or means of providing any services;

    (e) Collusive tendering or bidding for sale, purchase or procurement of any goods or service.

Relevant Market

14. Bid rigging is a form of collusion which is a *per se* violation of competition law. This means that bid rigging is illegal without regard to the market it is done in and without any analysis into its effects in the market. Since this is a possible case of bid rigging, therefore, the identification of a relevant market is not mandatory.

15. However, for reference purposes, a brief description of the relevant market is given. This case deals with bid rigging in a particular tender of PESCO namely ADB-PESCO-06-2009 LOT-III (PESCO's Tender). The tender dealt with the purchase of High Tension Pre-stressed Concrete Poles and Low Tension Pre-stressed Concrete Poles. These poles are primarily used in the transmission and distribution of electricity by power companies. They are also used for industrial

lighting and as utility poles. The relevant product market, hence, comprises LT PC and HT PC Poles

16. LT PC and HT PC Poles are produced within Pakistan, and with no substantial import and export, which makes the latter the relevant geographic market in this case.

17. The relevant market, with regard to Section 2(1) (k) of the Ordinance, therefore, is the market for supply of HT PC and LT PC Poles in Pakistan.

Collusive Bidding in PESCO's Tender

18. It appear from the documents reviewed by the Enquiry Committee that Nam, Creative, Mrec, Redco and Amin Brothers, *prima facie*, colluded to rig the bidding for PESCO's tender. In doing so they agreed to raise the cost of procurement to PESCO and derive artificially high profits from the bidding. This was, *prima facie,* done by entering into a joint venture agreement and sending in a cover bid.

19. Joint ventures are an increasingly popular way of doing business. Joint ventures are designed to provide strategic advantages that are not available or achievable by individual business entities. Such advantages may include breaking down entry barriers, increasing coverage in market and gaining access to technology or intellectual property etc. Joint ventures also allow business entities to pool in resources to complete projects not in the individual capacity of any partner.

20. Joint ventures are normally created for finite long term projects as separate entities. All parties to a joint venture agree to pool in equity, assets and share expenses, revenues and control of the former according to an agreed formula. Liability of a joint venture may vary according to the joint venture agreement, the legal status of the entity and the laws of the jurisdiction it operates under.

21. The joint venture agreement of the JV (the 'JV Agreement') signed on 3 August 2009, to collectively bid for PESCO's Tender, appears to be more of a quota agreement instead of a joint venture agreement. The JV Agreement is attached as Annex G. According to clause 5 of the JV Agreement, the JV partners agreed to divide the overall quantity of LT and HT PC required by PESCO according to the table below. They further agreed that incase one partner did not supply its requisite quantity the quantity would be distributed equally amongst the rest. In words of the PESCO Evaluation Report paragraph 7.2.2, the JV had 'shared quantities among the joint venture partner firms.' The relevant portion of the PESCO Evaluation Report is attached as Annex H.

	HT PC Poles	LT PC Poles
Creative	1128	872
MREC	1375	1062

REDCO	1128	872
NAM	1128	872
Total	4759	3678

22. In addition, the JV does not correspond to the typical characteristics of a joint venture. Although one person has been nominated to deal on behalf of the JV, the JV Agreement envisions no collective control over the activities of the partners. As mentioned in the last paragraph, the quantities to be supplied to PESCO have been divided almost on equal basis. Moreover, it has been agreed that every partner would submit their own performance bond and advanced payment guarantee for their share of the contract (JV Agreement, Clause 6) and would directly receive payment for their share from PESCO (JV Agreement, Clause 7). The contents of the JV Agreement clearly show that this is not a joint venture agreement, merely a quota sharing one.

23. Joint ventures are generally formed for projects that are beyond the technical and financial capacity of the individual entities. It is clear from List of Purchase Orders submitted by the JV to PESCO that each of the company has in the recent past individually executed works of values far more than the PESCO's Tender and hence were financially able to undertake work under PESCO's Tender independently. Similarly according to the Manufacturing Capacity submitted by the JV to PESCO, it is amply clear that all of the JV companies had the production capacity to independently complete the project within a few months time. Out of the four JV entities, only Creative had existing order while the other three did not and were completely free. Copies of The List of Purchase Orders and Manufacturing Capacity are attached as Annex I and Annex J.

24. This clearly shows that there was no reasonable justification for the JV entities to make a collective bid though the JV. In addition, the JV Agreement was reached just one day before the deadline of PESCO's Tender, much after all the constituent companies had obtained tender documents individually from PESCO. This fact augments the belief that the JV agreement is merely an eye wash to cover up a quota agreement.

25. The only reasonable rationale that appears to comes out regarding the formation of the JV is that all the possible competitors for the tender did not want to compete against each other and divided the tender amongst themselves thereby ensuring a win-win situation for all. It appears extremely plausible that since three out of four companies, namely Redco, Nam and Mrec, had no existing orders, they all desperately wanted to win the contract. However, since competitive bidding would have decreased their chances of winning and earning a significant profit, therefore they joined hands and divided the tender quantities amongst each

other. However, it appears that, in order to 'seal the deal' they included Creative, which was the only other competitor and which had existing orders, in the arrangement and gave out a larger share of the tender quantity to it in order to guarantee its commitment. Thereafter, the JV waited till one day before the tender deadline to sign the agreement and send in its collective bid.

26. *Prima Facie,* it appears that the bid from Amin Brothers was just a cover bid to make the JV bid look somewhat competitive to outsiders. Both Amin Brothers and Nam are companies of the same corporate group, namely the Wire Manufacturing Industries Ltd.[2] It does not make any sense as to why two companies of the same corporate group would compete against its each other in the same tender unless one of them is designed to be cover bid. The covering nature of the bid becomes vividly apparent when the particulars of Nam and Amin Brothers bids are compared. Copy of Amin Brothers' bid is attached as Annex K. First, Nam's letter to PESCO to obtain tender documents and Amin Brothers bidding documents bear the same signature. Second, both companies have the same business address as well as the same telephones and facsimile numbers. Third, and most significantly, Amin Brother's unit price for both HT PC and LT PC can be arrived at by adding PKR 110 to the unit price offered by the JV for both the products. It is highly unlikely that this is a matter of coincidence especially given that fact that the same person was involved in the bidding process of both the companies. Last, both the JV bid and Amin Brothers bid was made on the same day.

27. Regarding the element of extracting artificially high profits, it is important to mention here that PESCO's Review Evaluation Committees Recommendation obverses in paragraph 5 and 6 that M/s Creative (JV) quoted a lower figures of PKR 1200 and 7867 for HT PC and LT PC respectively in its last bid to PESCO and that the present bid should only be accepted if M/s Creative (JV) voluntarily reduces its quoted prices according to its last offer. Minutes of the PESCO Board of Directors dated 10 March 2010 indicate that the JV offered a reduced price, indicating that the JV had a clear intention of artificially increasing the prices at the time of submitting the bid.

Conclusion

28. It appears from the discussion above that Nam, Creative, Mrec, Redco and Amin Brothers, *prima facie*, colluded to rig the bidding for PESCO's Tender in order divide the tender quantities amongst themselves, and to bid at a uniform price, while giving an impression of a competitive bidding process. This constitutes a *prima* facie violation of Section 4(1) read with Section 4(2) (a), (b), and (e) of the Ordinance.

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[2] See WMIL group companies at http://wmil.com.pk/groupcompanies.htm

Recommendation

29. As mentioned at the beginning, bid rigging mostly affects public procurement and puts an unwarranted cost on tax payer money. It is the public at large ends up paying the inflated costs of purchasing goods and services from private enterprises. In this context, it is in the public interest to proceed with this case.

30. It is, therefore, recommended that Section 30 proceedings against Nam, Creative, Mrec, Redco and Amin Brothers be initiated for the *prima facie* violation of Section 4(1) read with Section 4(2) (a), (b), and (e) of the Ordinance.

Tariq Bakhtawar Director General	Syed Umair Javed Assistant Director