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Commercial notes

Number 14 | 24 February 2005

Cracking down on anti-competitive practices and cartels in procurement

Given the emphasis placed on the need for competitive procurement processes in the latest revision of the *Commonwealth Procurement Guidelines*, it is timely to highlight some examples of recent anti-competitive and cartel conduct engaged in by companies dealing with the public sector. Such unlawful activity has the potential to substantially increase costs to the public sector.

Mr Graeme Samuel, Chairman of the Australian Competition and Consumer Commission (ACCC) recently stated at a conference on 'Cracking Cartels' that the ACCC is implementing a new campaign to assist government agencies to detect and report cartel behaviour in government contracts. [1] Through publication of a procurement package later in 2005 the ACCC aims to better inform and motivate buyers or procurement agents in both government and the private sector. He said:

> Government purchasing is particularly exposed to cartel formation and continuation because the transparency required in government contracts provides cartels with the information to allocate markets, fix prices and police their members to ensure they stick to the deal. Purchasing or procurement agents should therefore be in the front line of the fight against cartels.

Mr Samuel also said:

> When you think about it, those in charge of buying or tenders should have reasonable knowledge of industries from which they regularly obtain substantial goods and services, and therefore are in a good position to identify conduct that might indicate the existence of cartels.

This note briefly reviews the relevant law and then describes four recent cases in which significant anti-competitive conduct involving contraventions of the *Trade Practices Act 1974* (TPA) has been found or alleged.

Relevant law

Anti-competitive and cartel conduct is prohibited by Part IV of the TPA. The three types of conduct most commonly associated with such cartel conduct involve competitors making contracts, arrangements or reaching understandings with each other in order to:

— substantially lessen competition in a market

— fix, control or maintain the price for goods or services (commonly referred to as 'price fixing'), or

— implement 'exclusionary' provisions.

Perth

Justin Jones *Lawyer*
Australian Government Solicitor
T *08 9268 1125* ***F*** *08 9268 1196*
justin.jones@ags.gov.au

Sydney

Jane Hutchison *Lawyer*
Australian Government Solicitor
T *02 9581 7460* ***F*** *02 9581 7413*
jane.hutchison@ags.gov.au

This issue

Substantially lessen competition

The prohibition against provisions of contracts, arrangements or understandings which substantially lessen competition is contained in sections 45(2)(a)(ii) and 45(2)(b)(ii) of the TPA. This prohibits both the 'making' of such provisions and the 'giving effect to' (or carrying out of) such provisions.

In order to determine whether particular conduct substantially lessens competition it is necessary to understand the market and the effect of the impugned conduct on that market.

Price fixing

Price fixing is prohibited outright, meaning that even if the price fixing conduct does not have an adverse effect on competition, it is illegal. In competition law parlance, such outright offences are referred to as 'per se' offences.

Price fixing is defined in section 45A of the TPA as any provision of a contract, arrangement or understanding which fixes, controls or maintains the price or discount for, or an allowance or rebate or credit in relation to, either the supply of goods or services, or the acquisition of goods or services.

Section 45A 'deems' such conduct to substantially lessen competition. As a consequence, price fixing is prohibited by sections 45(2)(a)(ii) and 45(2)(b)(ii) of the TPA as conduct that substantially lessens competition.

Exclusionary provisions

Exclusionary provisions are prohibited by sections 45(2)(a)(i) and 45(2)(b)(i) of the TPA. As with other provisions, both the making of and giving effect to an exclusionary provision is prohibited.

Exclusionary provisions themselves are defined in section 4D of the TPA and have been the subject of considerable judicial debate in recent years. An exclusionary provision is a provision of a contract, arrangement or understanding made between two competitors which has the purpose of preventing, restricting or limiting the supply of goods or services to, or the acquisition of goods and services from, a particular person or class of persons.

It may be likened to a 'boycott'; however, the terms of exclusionary provisions apply beyond the commonly understood meaning of a boycott. In essence this conduct often involves 'market sharing' or 'bid rigging' between competitors.

Anglo Estates *illustrates the importance of obtaining good legal advice on whether a proposed course of action complies with the TPA.*

ACCC v Anglo Estates Pty Ltd

[2005] FCA 20 (21 January 2005)

Competition law can be complex. This recent case illustrates the importance of obtaining good legal advice on whether a proposed course of action complies with the TPA.

Anglo Estates concerned a small family company called Anglo Estates Pty Ltd. The company owned a block of land in Western Australia. In 2001 the company commenced the subdivision and development of the land, which it intended to sell to the general public.

Before commencing the development, the company claimed that officers of the Shire of Esperance had represented to them that the shire did not intend to start a competing development. This representation was important to the company, as competition from the shire would have limited the profitability of the development.

After the company had begun its development, the shire began to undertake a similar development. The company threatened the shire with litigation and subsequently had a number of meetings with shire officers in a bid to resolve the matter.

During the course of those meetings, the company made two proposals to the shire, which were later referred to as the 'compromise agreement'. The proposals were:

— the shire would only sell residential lots at a price not less than a set minimum price, or

— the shire would defer releasing its developed land until 2010.

The shire said that it would consider these proposals only if the company obtained legal advice that the proposals would not contravene the TPA. The company obtained legal advice to that effect. The company forwarded that advice to the shire in hope of proceeding with the compromise agreement. The shire told the company that it disagreed with a number of aspects of the legal opinion. The shire then sought its own legal advice which stated that the compromise agreement was likely to contravene the TPA.

In November 2003, the company sued the shire in the Supreme Court of Western Australia, claiming damages for negligent misrepresentation and misleading or deceptive conduct, based on the shire's previous representations that it would not develop the land. The proceedings were dismissed by consent on 11 August 2004.

The ACCC instituted proceedings against the company and two of its directors for attempting to contravene the TPA.

The company and the directors ultimately admitted that they had attempted to breach the TPA, saying that had they realised the illegality of the compromise agreement they would never have pursued it.

By attempting to make the compromise agreement, they had attempted to contravene certain sections of the TPA, which gave rise to relief under the TPA. The Court made declarations that:

— by seeking an arrangement or understanding that the shire would not sell residential lots below a minimum price, they had attempted to contravene section 45(2)(a)(ii) of the TPA, in other words, they had attempted to make a price fixing agreement

— by seeking an arrangement or understanding that the shire would not sell residential lots to the public before the end of 2010, they had attempted to contravene section 45(2)(a)(i) of the TPA by making an exclusionary provision.

Text of the decision is available at: <http://www.austlii.edu.au/au/cases/cth/federal_ct/2005/20.html>

The company and the directors ultimately admitted that they had breached the TPA, saying that had they realised the illegality of the compromise agreement they would never have pursued it.

ACCC v Admiral Mechanical Services Pty Ltd[2]

On 17 December 2004 the ACCC instituted proceedings against seventeen companies and twenty-two directors and/or managers in the commercial and industrial air conditioning industry in Western Australia. As the proceedings are presently before the Court, the matters raised in it are yet to be determined. The case does, however, highlight the extent to which cartel conduct and its consequences can impact on public sector agencies.

By way of background, the commercial and industrial air conditioning industry in Western Australia comprises 'projects' for either:

— the supply and installation of air conditioning systems, or
— the refurbishment (or upgrading) of those systems

in commercial and industrial buildings. These buildings include high rise buildings, offices, hospitals, schools, shopping centres, cinemas, retail outlets and public buildings.

The managers of those projects, being builders, consultants, architects or owners, generally put those projects to tender.

In simplified terms, the ACCC has alleged that competitors in the industry held meetings and had discussions about forthcoming tenders, with a view to arranging a 'winner' from among themselves.

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This was allegedly done by selecting a 'designated tenderer' from among the competitors tendering for a project. The designated tenderer would then provide each of the other tenderers with a 'cover price'. When the time came to submit tenders, those other tenderers would submit a tender price that was at least as high as the cover price. This allowed the designated tenderer to submit a price below the other tenderers and win the project.

These 'designated tenderer agreements' were alleged to have been first made on an ad hoc basis from the early 1990s until May 2003. During that period, other industry forums also arose.

The ACCC alleges that the designated tenderer agreements contravene both the price fixing and exclusionary provisions of the TPA.

Significantly for government, a number of the projects that are alleged to be the subject of a designated tenderer agreement concern substantial projects relating to public buildings, such as:

— Exmouth Naval Station
— public hospitals including Sir Charles Gardiner Hospital, Princess Margaret Hospital for Children and King Edward Memorial Hospital
— public universities including Curtin University, the University of Western Australia, Murdoch University and Edith Cowan University.

This case, while not yet heard, demonstrates the need for those responsible for public sector procurement to be vigilant when tendering and to be alert for signs that bidders might be colluding with each other.

ACCC v Baxter Healthcare[3]

In proceedings which are currently reserved for judgment before Allsop J in the Federal Court, the ACCC has alleged that contractual terms which were offered to various state and territory government agencies involve a contravention of the TPA by a company called Baxter Healthcare Pty Ltd. Contracts were entered into, following extensive tender and procurement processes in the case of some of the states.

The ACCC has alleged that contractual terms which were offered by a company to various state and territory government agencies involve a contravention of the TPA.

Baxter is alleged to have misused its market power and engaged in exclusive dealing in the supply of medical products to Australian government health purchasing agencies in contravention of the TPA.

Baxter entered into long term contracts of between three and five years to be the sole or primary supplier of various sterile fluids and kidney dialysis products, with government agencies in New South Wales, the Australian Capital Territory, Western Australia, South Australia and Queensland. Each government agency acquires these products for supply to publicly funded health facilities. Some also supply to private health service providers which operate within their state or territory.

Baxter is the only manufacturer in Australia of particular essential sterile fluids but it competes with other companies in the production of other health products. The ACCC alleges that Baxter has taken advantage of its market power in relation to the product over which it is alleged to have a monopoly by requiring the state or territory to acquire the products as a tied bundle of products if it wishes to have the benefit of significantly lower prices.

The ACCC alleges that this conduct was engaged in for the purpose of damaging Baxter's competitors. The ACCC further alleges that the bundling of all of these products into long term exclusive contracts contravened the exclusive dealing provisions of the TPA. It is alleged that Baxter engaged in this conduct for the purpose and with the effect or likely effect of substantially lessening competition in the relevant markets in contravention of section 47 of the TPA.

Baxter and the state and territory agencies have argued that Baxter is protected by the doctrine of Crown immunity and this doctrine prevents a contravention from being found because it was contracting with the Crown. A judgment is not expected for some months.

ACCC v McMahon Services Pty Ltd

[2004] FCA 1425 (4 November 2004)

In early November 2000, the Department of Defence invited a number of companies to tender for a project at its Salisbury site in South Australia. The project was valued at approximately $2.4 million and involved the removal of asbestos and demolition of all structures at the site before its sale to the South Australian Government for development as an automotive supply park. McMahon Services Pty Limited and SA Demolition & Salvage Pty Limited were two of the companies invited to tender.

Prior to the tender, McMahon Services and SA Demolition arrived at an understanding that SA Demolition would submit its tender for a total figure of around $2,488,600. Further, McMahon Services would submit its tender at a figure that was lower than the figure communicated to SA Demolition, such that SA Demolition would not be successful in winning the tender ahead of McMahon Services.

... the understanding contained provisions which were likely to have had the effect of fixing and/or controlling the price for the services which were the subject of the tender.

McMahon Services' tender nominated D&V Services as its subcontractor for the removal of the asbestos component of the works which were the subject of the Request for Tender.

SA Demolition's tender was considered by the Department of Defence as a 'poor submission', and McMahon Services was selected as the successful tenderer.

The ACCC took proceedings against McMahon Services, SA Demolition and D&V Services and representatives of those companies. They admitted that the conduct that was engaged in was a contravention of the TPA and acknowledged that the understanding contained provisions which were likely to have had the effect of fixing and/or controlling the price for the services which were the subject of the tender. Under section 45A of the TPA, this conduct is deemed to be likely to have had the effect of substantially lessening competition, in contravention of section 45 of the TPA.

By consent, each of the companies and individuals gave undertakings to the Court. The undertakings relate to the provision of asbestos and demolition services and include that the parties refrain from price fixing, making available to competitors, or discussing with them, tender pricing

information, and acting upon tender pricing information provided by competitors. The parties also undertook to establish and/or attend trade practices compliance training.

Selway J noted that the knowledge that the parties had regarding SA Demolition's bid not being a 'serious bid', was itself uncompetitive. The understanding had a commercial effect and affected the contract ultimately entered into by the Department of Defence. He stated that '[c]ollusive bidding practices are unacceptable whatever their effect in a particular transaction. Those involved in them must expect significant penalties' [16].

Text of the decision is available at: <http://www.austlii.edu.au/au/cases/cth/federal_ct/2004/1425.html>.

What can be done

Look for warning signs of anti-competitive behaviour including price fixing, exclusive dealing, market sharing, bid rigging and misuse of market power. If you have any basis for being suspicious consider seeking legal advice or referring the matter to the ACCC. Your legal adviser or the ACCC will be assisted if you retain and make available documents including:

— those recording any communications between your agency and tenderers

— copies of pre-tender documents, including calls for expressions of interest and requests for tender

— copies of all tenders received

— logs of when and who delivered the tender

— your records relating to any of the suspicious behaviour described below.

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There are certain industries where anti-competitive behaviour is more likely to occur. They may have characteristics such as:

— the products involved are 'homogenous', that is, the competing products have identical, or nearly identical, characteristics (e.g. concrete blocks, cement or petrol)

— the industry is dominated by a small number of large companies with few new companies entering the market

— the product or service is uncomplicated

— the product has few or no close substitutes (e.g. petrol or cement)

— the industry has an active trade association which facilitates meetings of competitors and assists in coordinating activities among firms

— the industry has historically been part of government sanctioned 'orderly marketing arrangements'.[4]

Market sharing or bid rigging are sometimes present where:

— tendered prices exceed published price lists or pre-tender estimates given by the same firms

— the successful bidder subcontracts work to its competitors that submitted higher bids for the same contract

— tender documents from competing companies are in similar form or contain the same irregularities (such as spelling or calculation errors)

— competitors submit tenders containing identical prices or other terms and conditions

— tenders of two or more competitors are submitted in the same envelope or are delivered by one person

— competitors meet or communicate somewhere in the vicinity of where tenders are submitted

— a tenderer expresses to you some knowledge of the detail of a competitor's tender before the tender has been awarded

— you are aware that only one bidder contacted wholesalers to obtain the prices logically required to prepare bids

— tenders received from local companies contain the same transport price as competing companies that must transport the product further

— bidders explain their prices by referring to industry suggested pricing or 'standard market prices'.[5]

Signs of possible misuse of market power include:

— one tenderer has a very large share of the market and it is difficult for other companies to provide products or services at or near the price offered by that tenderer

— the unsuccessful tenderer or tenderers cease to supply products which compete with those of the successful tenderer

— one tenderer has substantially lowered its prices below what you believe its costs are likely to be.

The Canadian Competition Bureau (CCB) has published an electronic guide to competition law issues for use by those responsible for assessing tenders – its 'Bid-Rigging Presentation', located on the CCB website under 'Business Services' <http://cb-bc.gc.ca/epic/internet/incb-bc.nsf/en/ct02301e.html>. The guide contains suggestions on action that tendering agencies can take to prevent collusive conduct in a tender process. For example, it suggests keeping the identity of bidders secret, requiring the disclosure of potential subcontractors and their pricing in tender documents and training your staff in how to detect anti-competitive or collusive conduct. AGS understands that in the first half of 2005 the ACCC intends to publish a procurement package which will be an interactive model similar to the Canadian guide.

If you are concerned about the conduct of any company that you deal with, you should ensure that those concerns are raised in the first instance with your CFO, who may seek legal advice and contact the ACCC.

Justin Jones *practises primarily in competition, commercial and property law and has experience in government tender processes, including reviewing RFTs, evaluation reports and providing probity advice. Before joining AGS, Justin was an investigator at the ACCC in Perth.*

Jane Hutchison *practises predominantly in competition law, as well as telecommunications, broadcasting and administrative law. Jane has developed her competition law and trade practices experience through working at AGS in Sydney, Perth and Canberra, and through previously working at the ACCC in both Perth and Canberra.*

Notes

1 24 November 2004, Sydney <http://www.accc.gov.au/content/index.phtml/itemId/550606/fromItemId/459302>.

2 See ACCC media release # MR 291/04, issued: 21 December 2004 <http://www.accc.gov.au/content/index.phtml/itemId/557064>.

3 See ACCC media release # MR 266/02, issued: 1 November 2002 <http://www.accc.gov.au/content/index.phtml/itemId/88219>.

4 Most of these matters are listed in the Canadian Competition Bureau's Bid-Rigging Presentation (see page 7) under the heading 'Detection'.

5 Most of these matters are listed in the Canadian Competition Bureau's Bid-Rigging Presentation under the heading 'Warning Signs'.

AGS contacts

AGS has national teams of lawyers specialising in government procurement and competition and trade practices law. For further information on the articles in this issue, or on other procurement or competition issues please contact John Scala (procurement) or Glenn Owbridge (competition), or any of the lawyers listed below. *

Canberra	Tony Burslem (C)	02 6253 7460
	Linda Richardson (P)	02 6253 7207
	John Snell (P)	02 6253 7025
Sydney	Marcus Bezzi (C)	02 9581 7470
	Ian McNeilly (C)	02 9581 7541
	Jackie Gleeson (C)	02 9581 7427
	John Berg (P)	02 9581 7624
	Simon Konecny (P)	02 9581 7585
Melbourne	Ross McClure (C)	03 9242 1395
	Susan Pryde (C)	03 9242 1426
	Paul Lang (P)	03 9242 1322
	Kenneth Eagle (P)	03 9242 1290
	Lynette Lenaz (P)	03 9242 1358
Brisbane	Glenn Owbridge (C)	07 3360 5654
	Robert Claybourn (P)	07 3360 5767
Perth	Nick Gvozdin (C)	08 9268 1119
	Lee-Sai Choo (P)	08 9268 1137
Adelaide	Sarah Court (C)	08 8205 4231
	Vesna Vuksan (P)	08 8205 4512
Hobart	David Wilson (C)	03 6220 5471
	Peter Bowen (P)	03 6220 5474
Darwin	Jude Lee (C)	08 8943 1405
	Ashley Heath (P)	08 8943 1408

** Competition and trade practices team lawyers are indicated by 'C' and procurement team lawyers by 'P' following their name.*

National
John Scala *Chief Counsel, Commercial*
T *03 9242 1321* ***F*** *03 9242 1481*
john.scala@ags.gov.au

National
Glenn Owbridge *Senior Executive Lawyer*
T *07 3360 5654* ***F*** *07 3360 5795*
glenn.owbridge@ags.gov.au

Canberra
50 Blackall Street Barton ACT 2600

Sydney
Level 23, Piccadilly Tower, 133 Castlereagh Street Sydney NSW 2000

Melbourne
Level 21, 200 Queen Street Melbourne VIC 3000

Brisbane
Level 12, Samuel Griffith Place, 340 Adelaide Street Brisbane QLD 4000

Perth
Level 19, Exchange Plaza, 2 The Esplanade Perth WA 6000

Adelaide
Level 20, 25 Grenfell Street Adelaide SA 5000

Hobart
Level 8, 188 Collins Street Hobart TAS 7000

Darwin
Level 3, 9–11 Cavenagh Street Darwin NT 0800

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ISSN 1433-9549
Approved Postage PP 255003/05310