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**Consultations and discussions regarding peer reviews on competition law and policy, review of the Model Law, and studies related to the provisions of the Set of Principles and Rules**

**Competition policy and public procurement**

**Note by the UNCTAD secretariat**

*Executive summary*

There is increased awareness of the power of public procurement to shape supply and to thereby influence a whole array of economic factors. Yet for States to get good value for money and hence make good use of scarce public resources, competition is paramount.

This background paper emphasizes the role of competition in public procurement. Substantive and institutional aspects of public procurement systems are discussed, including strategies to broaden the circle of potential bidders, to incentivize competitive behaviours and to fight bid rigging. The paper also aims at initiating and provoking further discussion on applied issues, on bid rigging prevention, detection and enforcement as well as to share learnt lessons on policy frameworks and procuring practices that effectively promote competition in procurement markets.

## Contents

	<i>Page</i>
Introduction.....	3
I. The design of a public procurement system that promotes competition .....	4
A. Elements of the regulatory framework .....	4
B. Ensuring competition through the design of the institutional framework for public procurement: Centralized versus decentralized procurement systems.....	7
C. Broadening the circle of potential bidders .....	8
D. Balancing competition with other objectives of public procurement.....	10
II. Prevention, detection and prosecution of bid-rigging .....	11
A. Prevention of bid rigging .....	12
B. Detection of bid rigging.....	15
C. Enforcement – Prosecution of bid rigging .....	16
III. Conclusion and issues for further discussion .....	18
A. Procurement of competition through the design of the public procurement system and individual tenders.....	18
B. Use of policy tools to make competitive behaviour the optimal choice for potential bidders, in other words: “How to fight bid rigging effectively?” .....	18
C. Issues for further discussion .....	19

## Introduction

1. States need to procure goods and services in order to carry out public functions, e.g. procurement of equipment for public schools and hospitals or construction services for roads and other infrastructure. Given limitations of public resources, the state has a strong interest to procure the required goods and services of adequate quality at the lowest possible price. With this aim, public procurement procedures shall promote competition for public contracts to ensure best value for money.

2. Considering the economic importance of public procurement, competition for public contracts does not only protect the financial interests of the procuring state, but also economic opportunities for bidders. In fact, it is reported that public procurement accounts for up to 25–30 per cent of GDP in developing countries<sup>1</sup> and for approximately 15 per cent of GDP in OECD countries. Thus, rules on public procurement ensure that bidders enjoy equal opportunities in sizeable areas of the economy.

3. The ideal level of competition for public contracts is not always realized in practice for reasons that may relate to (i) the regulatory framework for public procurement; (ii) market characteristics; (iii) collusive behaviour of bidders, and (iv) further factors.

4. In addition, there may be further objectives pursued by public procurement (e.g., green procurement, sustainable procurement, social objectives). The question arises how best to conciliate them with the requirements of competition in public procurement.

5. The present background paper for the twelfth session of the Intergovernmental Group of Experts on Competition Law and Policy explores how to ensure the desired competition in public procurement taking into account the aspects mentioned above. In this regard, it needs to be highlighted that while competition authorities are in charge of detecting and prosecuting bid-rigging, the design of public procurement procedures, as well as their implementation, generally fall outside their jurisdiction. Nevertheless, competition authorities can play a crucial role in advocating rules for public procurement that ensure competition in the related markets and they can support public procurement entities with the prevention of bid-rigging. It therefore appears important that competition authorities have an in-depth understanding of the whole range of competition issues that affect public procurement, which go beyond the prosecution of bid-rigging.

6. Therefore, this paper firstly addresses the question of how to ensure competition through the regulatory framework of public procurement – an area suitable for competition advocacy. The subsequent part of the paper is dedicated to means of preventing, detecting and prosecuting bid-rigging as one of the most serious threats to competition in public procurement. In this regard, in addition to competition advocacy, the competition authorities' role includes cooperation with procurement authorities and law enforcement.

7. Note that while corruption and collusion between bidders and procurement agents also put competition in public procurement at risk, it would go beyond the scope of this paper to address this additional topic.<sup>2</sup> Furthermore, the paper does not cover the issue of government procurement and public private partnerships.

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<sup>1</sup> Sustainable Public Procurement: Briefing Note by Rita Roos on behalf of the United Nations Procurement Capacity Development Centre and the United Nations Environment Programme, available at [http://www.unpcdc.org/media/390120/spp\\_brief\\_en\\_2012-02-06.pdf](http://www.unpcdc.org/media/390120/spp_brief_en_2012-02-06.pdf).

<sup>2</sup> For a discussion of the issue of public procurement and corruption, see e.g. Ensuring integrity and competition in public procurement markets: a dual challenge for good governance by Robert Anderson, William Kovacic and Anna Müller, in *The WTO Regime on Government Procurement*:

## I. The design of a public procurement system that promotes competition

### A. Elements of the regulatory framework

#### 1. Competition as a guiding principle for public procurement laws

8. The starting point for achieving best value for money in government procurement is a regulatory framework that is based on the principle of competition and that submits public spending to the adherence to competitive procurement methods. While this appears evident today, it is the result of an ongoing process of thorough modernization and reform of public procurement systems that has taken place in recent decades both in developed and developing countries.

#### *Reform of public procurement in Russia since 2005<sup>3</sup>*

The results of reforms of the public procurement system in Russia provide a good example for how the modernization of the regulatory framework can improve competition, reduce corruption and generate budgetary savings.

In 2005, the Russian Federation adopted Law No. 94-FZ “On the Placement of Orders to Supply Goods, Carry Out Works and Render Services for Meeting State and Municipal Needs”, a modern law on public procurement, which was consecutively amended in 2009 and 2010. The procurement law is complemented by the Federal Law No. 135-FZ “On Protection of Competition”, which in its Article 11 provides for a *per se* prohibition of bid-rigging. Moreover, since the amendments made to Article 178 of the Criminal Code of the Russian Federation in 2009, bid-rigging is sanctioned by imprisonment for up to three years.

Law No. 94-FZ has established a uniform procurement system for all state and municipal procurement entities in the Russian Federation and universally introduced tender and auction procedures for public procurement in the Russian Federation. The amendments in 2009 and 2010 led to the creation of a single Russian Federation-wide internet portal for public procurement placement in 2011 and the introduction of compulsory electronic.

It is estimated that the reform of the Russian system in the five year period from 2006 to 2010 has resulted in budgetary savings of more than EUR 26.5 billion. Furthermore, a stark increase in participants per auction was observed. It is reported that in 2008, the average number of suppliers taking part in open procurement auctions was 26, versus nine participants per auction when the auction form of procurement was implemented. It is esteemed that the new government measures, which transform many state and municipal procurements that previously were directly awarded into competitive auctions, have raised the probability that businesses will participate in transparent and honest auctions.

Challenge and Reform, Cambridge University Press 2011.

<sup>3</sup> Sources: OECD Global Forum on Competition, Collusion and Corruption in Public Procurement, Contribution from Russia, DAF/COMP/GF/WD (2010)43; Improvement of competition principles in the Public Procurement System in the Russian Federation, Presentation dated 28 October 2011 by Andrey V. Yunak, Federal Antimonopoly Service of the Russian Federation; Procurement Reform in Russia: Implications for the Fight Against Corruption by Dina V. Krylova and Alexander Settles, June 2011.

9. In the member states of the European Union the reform process was mainly driven by the adoption of legislation at the European level<sup>4</sup> which obliged EU member states (for procurement projects above specific thresholds) to open their procurement markets, to comply with procurement procedures based on the principles of transparency, competition and sound procedural management and to introduce a national review system that allows for rapid and effective redress in cases where bidders consider that contracts have been awarded unfairly.

10. Acknowledging the importance of well-functioning public procurement systems for the delivery of development aid, strengthening public procurement systems and capacities<sup>5</sup> has also become an essential aspect in many development programmes and thus triggered related reforms in developing countries. In 2003, a partnership between the OECD Development Assistance Committee and the World Bank led to the creation of the so-called Procurement Roundtable, a partnership that quickly grew to include interested bilateral donor organizations, multilateral development banks, United Nations organizations and importantly representatives from beneficiary countries served by these organizations.<sup>6</sup> In one of the fundamental documents resulting from this initiative, a sound public procurement system is described as a system the overriding objectives of which are to “deliver economy and efficiency in the use of public funds while adhering to the fundamental principles of non-discrimination and equal treatment, due process, access to information and transparency.”<sup>7</sup> As to the procurement methods, the statement of a clear preference for open and competitive procurement is required.<sup>8</sup>

11. In this context, the 2011 UNCITRAL Model Law on Public Procurement 2011 also merits to be mentioned, which offers guidance for countries that are reforming their procurement law.<sup>9</sup> It clearly advocates procurement procedures based on the principle of competition. In fact, the preamble of the UNCITRAL Model Law lists “Promoting competition among suppliers and contractors for the supply of the subject matter of the procurement” as one of the main objectives of public procurement.

## 2. Public tendering: the main form of competitive procurement methods

12. The 2011 UNCITRAL Model Law on Public Procurement further provides guidance on how to translate the objective to promote competition for public contracts into the design of procurement methods. While its Article 27 lists a whole array of different procurement methods, Article 28 (1) clearly gives priority to procurement by means of open tendering:

“Except as otherwise provided for in articles 29 to 31 of this Law, a procuring entity shall conduct procurement by means of open tendering.”

<sup>4</sup> An overview of currently applicable EU directives on public procurement is available at: [http://ec.europa.eu/internal\\_market/publicprocurement/rules/current/index\\_en.htm](http://ec.europa.eu/internal_market/publicprocurement/rules/current/index_en.htm).

<sup>5</sup> The United Nations Procurement Capacity Centre, is a specialized United Nations body engaging in this field.

<sup>6</sup> Strengthening Country Procurement Systems: Results and Opportunities, 4<sup>th</sup> High Level Forum on Aid Effectiveness, 29 Nov–1 Dec 2011, Busan, Korea available at: <http://www.unpcdc.org/media/352128/strengthening-country-procurement-systems-oecd-dac-hlf4-2011.pdf>, page 8.

<sup>7</sup> Volume 3 of the DAC Guidelines and Reference Series on Harmonising Donor Practices for Effective Aid Delivery, available at <http://www.oecd.org/dataoecd/12/14/34336126.pdf>, page 59.

<sup>8</sup> Ibid, page 61.

<sup>9</sup> [http://www.uncitral.org/pdf/english/texts/procurement/ml-procurement-2011/ML\\_Public\\_Procurement\\_A\\_66\\_17\\_E.pdf](http://www.uncitral.org/pdf/english/texts/procurement/ml-procurement-2011/ML_Public_Procurement_A_66_17_E.pdf).

13. The procedure for carrying out an open tender is detailed in Chapter III of the UNCITRAL 2011 Model Law. Similarly, the EU Directive 2004/18 on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts<sup>10</sup> favours public tender procedures as primary procurement method. The favoured methods comprise so-called “open procedures” whereby any interested economic operator may submit a tender, and so-called “restricted procedures” whereby any economic operator may request to participate and whereby only those economic operators invited by the contracting authority may submit a tender. A further procurement method called “competitive dialogue” is only allowed under specific circumstances (see Article 29 of the Directive).

14. While public tenders are considered to be the favoured procurement method in order to achieve best value for money, there is also the concern that specific features of public tender processes, in particular the great level of transparency that they involve, may facilitate collusion among bidders which eliminates competition and thereby compromises the results of the procurement procedure. To address this dilemma, it is suggested to pay due attention to stimulate and safeguard competition when designing public tenders, which will be explored in more detail in the third part of this paper.

### **3. Scope of application of public procurement laws**

15. Procurement laws sometimes exclude specific public entities, such as state-owned enterprises, or procurement for specific purposes (e.g. for military purposes) from their scope of application. However, it is evident that from a competition perspective a broad scope of application without exceptions is desirable. An expressive reference to state owned enterprises, such as in the Ghanaian public procurement law proves a useful tool to dispel any doubts about the scope of application. The respective provision reads as follows: “this Act applies to .... (e) state owned enterprises to the extent that they utilize public funds; ...”<sup>11</sup>

### **4. A clear prohibition of bid-rigging to complement public procurement laws**

16. With respect to the regulatory framework for public procurement, it has furthermore to be pointed out that a clear prohibition of bid rigging, that is to say the prohibition of collusion between bidders (potential bidders) in a public tender needs to complement the rules governing public procurement. In countries with a competition law, bid rigging would fall under a general prohibition of anti-competitive agreements, if not expressly prohibited as *per se* anti-competitive. Moreover, while anti-competitive agreements are not sanctioned criminally in most countries, several countries have opted for a penal interdiction of bid-rigging given its egregious effects on the public budget.<sup>12</sup>

### **5. Review of public procurement decisions**

17. Allowing frustrated bidders to appeal against public procurement decisions and irregularities of the procurement procedure is a further tool to protect competition in public procurement. The procuring entities are incentivized to comply with the procedure and

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<sup>10</sup> Available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2004:134:0114:0240:en:PDF>.

<sup>11</sup> See Public Procurement Act, 2003, Section 14 (II) e, available at <http://www.ppbghana.org/documents/Public%20Procurement%20Act%202003%20Act%20663.pdf>.

<sup>12</sup> For an overview of sanctions for competition law infringements, see the UNCTAD background note “Appropriate Sanctions and Remedies” TD/RBP/Conf.7/5 pages 4 to 6, available at [http://www.unctad.org/en/docs/trbpconf7d5\\_en.pdf](http://www.unctad.org/en/docs/trbpconf7d5_en.pdf).

select the “best” offer in order not to see their decisions challenged by frustrated bidders and face delays in the procurement process caused by an appeal process. If, for instance, an omission to announce a public tender in the legally prescribed manner, may lead to the annulment of a procurement decision, the procuring entity will have a strong incentive to respect the legal publication requirements. Given that these requirements aim at ensuring competition for public contracts, appeal and review procedures not only benefit the individual frustrated bidder, but also aim at ensuring that procuring entities comply with the legal framework for government procurement and thereby help to protect and stimulate competition. It thus appears only consequential that for instance the 2011 UNCITRAL Model Law on Public Procurement includes a chapter on appeals (Chapter VIII. Challenge Proceedings).

18. In certain countries, competition agencies were actually assigned the jurisdiction to review public procurement decisions. For instance, in Germany, on federal level three specialized public procurement tribunals were integrated into the Federal Cartel Office. They remain however completely independent in their decision making. In addition, contracts attributable to the “*Länder*” are reviewed by the public procurement tribunals of the relevant “*Land*.” In Sweden, there a specific department for public procurement law enforcement with several subdivisions within the competition authority. While Germany and Sweden made good experiences with this approach, experiences in Mongolia were rather mixed. After the approval of the new Law on Competition, in 2010, the Mongolian authority for competition and consumer protection (AFCCP) was set in charge of reviewing public procurement decisions in addition to competition and consumer protection matters. While the new legal framework empowered the AFCCP in multiple and interconnected areas of works, it was not provided with additional staff and resources, hence compromising its performance and effectiveness.<sup>13</sup>

## **B. Ensuring competition through the design of the institutional framework for public procurement: Centralized versus decentralized procurement systems**

19. While a sound legal framework for public procurement which is based on the principle of competition is the starting point for achieving best value for money in public procurement, it also needs an efficient and integer administration of this framework in order to achieve the desired outcome. In this context, centralized versus decentralizes procurement systems are being discussed.

The OECD tool box for public procurement lists the following key arguments for both approaches:<sup>14</sup>

### *Key arguments for centralized procurement:*

- better value-for-money (price and quality) of procured supplies, services and works through increased purchasing power of the centralized agency, including through reduced government overheads
- increased concentration of procurement expertise, better delivery of training and more focused performance management of procurement staff and

<sup>13</sup> UNCTAD, 2012. Voluntary Peer Review of Competition Law and Policy: Mongolia (forthcoming).

<sup>14</sup> See [http://www.oecd.org/document/40/0,3746,en\\_21571361\\_44258691\\_44978216\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/40/0,3746,en_21571361_44258691_44978216_1_1_1_1,00.html)

- greater standardization of technical requirements, procurement contracts and transactions, management controls and reporting to support greater transparency of government operations

*Key arguments for decentralized procurement:*

- reduced scope for large scale corruption and mistakes through affecting large volume purchases that result in overspending
- closer matching of supplies, services and works delivered to the requirements of end-users (both government agencies and citizens) and
- greater possibility for small and medium enterprises to successfully compete for government tenders.

20. In addition to the arguments outlined above, centralized procurement systems enhance the procurement agency's understanding and knowledge of specific markets, which may enable it to uncover and fight collusive behaviour more effectively. A recent case from Germany illustrates this aspect very well.<sup>15</sup> In 2011, the German competition authority successfully prosecuted a price fixing and market sharing cartel of fire-engine producers who divided more than 1,000 tenders for the procurement of fire engines among themselves. This cartel was detected by way of an anonymous notification and additional information provided by the central purchasing entities for fire engines in Northern Germany.<sup>16</sup> In fact, whereas in the Southern parts of Germany, fire engines are procured by individual municipalities, there is a centralized procurement system in one of the Northern regions. Given the larger volume of fire engines procured by this central procurement entity, procurement officers of the latter had developed a very good market overview and became suspicious of price increases that were implemented on a regular basis just after fire engine producers had met at trade fairs for fire engines. Furthermore, suspicious exchange of staff between competing fire engine producers was observed as well. The initial information and suspicions allowed the German competition authority to start an investigation including dawn raids, which confirmed the existence and the dimension of the suspected bid rigging.

### C. Broadening the circle of potential bidders

21. As mentioned previously, the outcome of public procurement procedures strongly depends on the level of competition for public contracts. Thus, the level of competition in respective markets is of crucial importance to achieve best value for money in public procurement. For this reason, it is worth looking at strategies to broaden the circle of potential bidders and thereby increase competition for public contracts. Such strategies include facilitating country wide participation of bidders in public procurement procedures, as well as facilitating the participation of small and medium sized enterprises (SMEs) and liberalizing public procurement markets.

<sup>15</sup> See Press Release of the German Federal Cartel Office dated 10 February 2011 available at [http://www.bundeskartellamt.de/wEnglisch/download/pdf/Presse/2011/110211\\_PM\\_Feuerwehrfahrzeugehersteller-E2.pdf](http://www.bundeskartellamt.de/wEnglisch/download/pdf/Presse/2011/110211_PM_Feuerwehrfahrzeugehersteller-E2.pdf).

<sup>16</sup> See presentation "Bid rigging – Outreach, Awareness, Cooperation with Procurement Authorities, A German Perspective" by Katharina Krauss, 11 October 2011, held at the 2011 ICN Cartels Workshop.



## 1. Facilitating country wide participation of bidders

22. Facilitating country wide participation of bidders in public tenders requires first of all the publication of the respective invitations to tender in media that are country-wide accessible. In this respect, good experiences have been made with a central platform for the publication of invitations to tender, which allows its users to assess relevant business opportunities by searching a uniform space instead of visiting individual publication instruments of regional and municipal procurement entities. For example, in 2011, Russia introduced an official procurement website ([www.zakupki.gov.ru](http://www.zakupki.gov.ru)) that allows anyone to view information on national-level bids, as well as on government purchases for regions and municipalities (previously, local and municipal authorities had been entitled to publish the respective information on their own websites).<sup>17</sup> In this context, it is reported that many participants from the Far East, Siberia, the Ural Mountains, and the North Caucasus would now participate in the regional procurement markets for Moscow and St. Petersburg.<sup>18</sup>

23. Similarly, in Chile, a centralized purchasing service<sup>19</sup> was implemented in August 2003. Among other duties the service administers an on-line platform for public tenders ([www.mercadopublico.cl](http://www.mercadopublico.cl)) currently used by about 900 public institutions and over 100.000 companies. Amongst other virtues of the system, evidence suggests that it has expanded opportunities for small and mid size enterprises, particularly those from outside the metropolitan area.<sup>20</sup>

24. It also appears that the use of standardized e-procurement systems reduce the burden of preparing bids and thereby facilitate broader participation of bidders in public procurement. In the case of Russia, the introduction of compulsory e-auctions has significantly increased the level of participation in public tenders (see box on the reform of the public procurement system in Russia since 2005). Similarly, according to a recent study carried out in the EU, 23 per cent of small and medium sized companies and large companies alike consider increased competition from e-procurement solutions to constitute an important problem for them, which should however benefit procurers and the taxpayer.<sup>21</sup>

25. While e-procurement and a centralized, internet-based publication of public tenders appear very favourable in order to increase the participation in public procurement, it needs to be taken into consideration that this only holds true if potential bidders actually dispose of the required information technology infrastructure and capacity. It is pointed out that failure to balancing the introduction of new procurement tools like e-procurement and the capacity of local sellers to absorb the required changes will restrict public procurement opportunities to relatively few firms and thereby limit competition.<sup>22</sup>

<sup>17</sup> See the chapter on Russia by Kamil Karibov and Olga Chaykovskaya in *Getting the Deal Through – Public Procurement 2011*, page 194.

<sup>18</sup> *Procurement Reform in Russia: Implications for the Fight Against Corruption* by Dina V. Krylova and Alexander Settles, June 2011 available at <http://www.cipe.org/publications/fs/pdf/063011.pdf>.

<sup>19</sup> Dirección Chilecompra [www.chilecompra.cl](http://www.chilecompra.cl).

<sup>20</sup> Informe MIPE Chilecompra 2006 – 2007 (Spanish), available at: [http://www.chilecompra.cl/index.php?option=com\\_phocadownload&view=category&download=37%3AInforme-mipe-chilecompra-2006-2007&id=9%3AInvestigacin-y-estudios&Itemid=154&lang=es](http://www.chilecompra.cl/index.php?option=com_phocadownload&view=category&download=37%3AInforme-mipe-chilecompra-2006-2007&id=9%3AInvestigacin-y-estudios&Itemid=154&lang=es).

<sup>21</sup> Evaluation of SME's access to public procurement markets in the EU, DG Enterprise and Industry, Executive Summary, September 2010, page 9 available at [http://ec.europa.eu/enterprise/policies/sme/business-environment/files/smes\\_access\\_to\\_public\\_procurement\\_final\\_report\\_executive\\_summary\\_2010\\_en.pdf](http://ec.europa.eu/enterprise/policies/sme/business-environment/files/smes_access_to_public_procurement_final_report_executive_summary_2010_en.pdf).

<sup>22</sup> Public procurement in developing countries: market opportunities through electronic commerce, Wayne A Witting, available at [http://www.unpcdc.org/media/2382/public%20procurement%20in%20developing%20countries%20\(copy\).pdf](http://www.unpcdc.org/media/2382/public%20procurement%20in%20developing%20countries%20(copy).pdf).

## 2. Facilitating participation of SMEs

26. Small and sometimes medium-sized enterprises may face the challenge that their capacity does not allow participating in public tenders of larger volumes. A study carried out in the European Union in 2010 shows that the large size of contracts is probably the most important barrier for SMEs accessing public procurement.<sup>23</sup> Therefore, strategies aiming at facilitating the participation of SMEs in public tenders aim also at broadening the number of potential bidders and thereby stimulating competition. In this context, breaking down large tenders into lots is viewed as one of the most important means of helping SMEs.<sup>24</sup> Furthermore, in cases where SMEs do not have the capacities to submit individual bids, allowing to form a bidder consortium also creates opportunities for SMEs. However, joint bidding shall not be allowed for enterprises that are in a position to participate individually in a public tender, since this would significantly reduce the level of competition. Further strategies to facilitate participation of SMEs in public procurement include simplifying tendering procedures and reducing administrative burdens, and improving the availability and quality of information on public procurement opportunities.

## 3. Liberalizing procurement markets

27. Opening procurement markets or selected procurement markets for foreign bidders constitutes a further strategy to broaden the circle of potential bidders. Allowing and attracting foreign bidders to participate in public procurement can be done on a unilateral basis where a state wants to retain certain discretion in this respect or plurilaterally through accession to the WTO Agreement on Government Procurement (GPA).<sup>25</sup> The GPA obliges its members to open procurement procedures for public contracts above specific thresholds to bidders from other members to the GPA through the application of the principles of national treatment and non-discrimination contained in Article 3 GPA. While membership in the GPA lays the ground for increased foreign competition in domestic public procurement, it also offers domestic firms the opportunity to participate in public procurement of other GPA members.<sup>26</sup>

## D. Balancing competition with other objectives of public procurement<sup>27</sup>

28. Based on an increased awareness of the power of public procurement to shape supply and to thereby influence a whole array of further factors, public procurement is more and more considered to be a policy instrument rather than a mere tool to purchase required goods and services. Fostering innovation, contributing to a greener economy and society, as well as contributing to economic and social development are some of the objectives pursued more recently by public procurement in addition to achieving best value for money. Just to give a few examples: under the title “green public procurement”, the

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<sup>23</sup> Evaluation of SME’s access to public procurement markets in the EU, DG Enterprise and Industry, Executive Summary, September 2010, page 5 available at: [http://ec.europa.eu/enterprise/policies/sme/business-environment/files/smes\\_access\\_to\\_public\\_procurement\\_final\\_report\\_executive\\_summary\\_2010\\_en.pdf](http://ec.europa.eu/enterprise/policies/sme/business-environment/files/smes_access_to_public_procurement_final_report_executive_summary_2010_en.pdf).

<sup>24</sup> Ibid.

<sup>25</sup> Currently, 42 members have voluntarily joined the GPA. The scope of the agreement was importantly enhanced in December 2011.

<sup>26</sup> Initiatives to facilitate international integration should also consider the effect of non-tariff barriers and measures that impose a high cost on potential bidders from other countries.

<sup>27</sup> On the related topic of policy coherence, see “The importance of coherence between competition policies and government policies” Note by the UNCTAD secretariat, available at [http://www.unctad.org/en/docs/ciclpd9\\_en.pdf](http://www.unctad.org/en/docs/ciclpd9_en.pdf).

European Union promotes public procurement for a better environment as “a process whereby public authorities seek to procure goods, services and works with a reduced environmental impact throughout their life cycle when compared to goods, services and works with the same primary function that would otherwise be procured.”<sup>28</sup> With support from the Swiss government, Ghana launched a task force to introduce sustainable public procurement at all levels of state purchasing.<sup>29</sup> In South Africa, based on the Preferential Procurement Policy Framework Act, public procurement has been used to address legacies of the apartheid system, such as skewed racial ownership patterns, and to provide economic opportunity to those previously excluded from the economy. It is reported that this framework requires that South Africa’s preferential procurement policy be implemented solely by means of tender adjudication criteria and as such excludes all other forms of preferential treatment e.g. set asides, qualification criteria, preferences at the short listing stage or offering back,<sup>30</sup> thus providing a means by which bidders can compete on a balance between price and social objectives.

29. The South African example highlights that policy objectives of public procurement other than promoting competition can potentially conflict the latter and thus due attention needs to be paid to the question how best to balance the pursued policy objectives. In the case of green procurement, technical specifications of the goods and services to be procured constitute an important tool for attracting environmentally-friendly offers. In order not to restrict competition, it appears imperative to formulate these specifications in a way that allows for a maximum number of firms to compete on the parameters of environmentally friendliness and price. With respect to other policy objectives, such as development of local industries, which may be promoted through margins of preferences for local producers and suppliers, it appears to be more challenging to safeguard competition, given that they are discriminatory by nature.

## II. Prevention, detection and prosecution of bid-rigging

30. For the reasons outlined in the first part of this paper, public tenders are a common method for implementing public procurement. In principle, they allow for a transparent allocation of public contracts while allowing the State to make good use of public resources by taking advantage of competitive offers.

31. Regrettably, public procurement markets are not always competitive by default. Often, cultural habits and uses of commerce lead to collusive practices and even to the social acceptance of them as the normal way of running businesses. In the case of public procurement markets, where the ultimate interest of the counterpart is perhaps more distant than in the case of private customers, engaging in collusive practices can be considered as a “nice” way of behaving towards colleague entities or eventual competitors. Fighting bid

<sup>28</sup> Communication from the European Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions “Public Procurement for a better Environment”, COM 2008/400 final, available at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2008:0400:FIN:EN:PDF>.

<sup>29</sup> See press release of the Government Procurement Authority of Ghana dated 12 January 2010 available at [http://www.ppbghana.org/story\\_detail.asp?story\\_id=79](http://www.ppbghana.org/story_detail.asp?story_id=79).

<sup>30</sup> South Africa, Country Procurement Assessment Report, Refining the Public Procurement System, Volume 2, February 2003, Report No. 25751-SA by the World Bank, Africa Region, Operational Quality and Knowledge Services, page 39 available at [http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2003/05/13/000094946\\_03042504054635/Rendered/PDF/multi0page.pdf](http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2003/05/13/000094946_03042504054635/Rendered/PDF/multi0page.pdf).

rigging often implies a cultural change. If bid rigging is socially tolerated, procurement entities may have difficulties to address it as a serious infringement.

32. In addition, public procurers face a complex set of priorities and objectives that compete for their attention and resources. Procurers may detect signs of illicit conducts but may lack of sufficient understanding or tools to deal with them. Also they may find it impracticable or inconvenient to proceed with a formal complaint, particularly if they perceive that taking action may trigger a situation in which they will be at risk of failing in the procurement of specific goods or services.

33. A better understanding of the effects of bid rigging practices on societies has however placed its deterrence as one of the top priorities for competition enforcers around the world. Experiences though are diverse, both in terms of implemented solutions and of achieved outcomes.

34. Today, a number of factors to deter bid-rigging have been identified in a number of publications including competition forums and those produced by competition authorities around the world.<sup>31</sup> The current availability of guidance material and the diversity of experiences across member States suggest the convenience of applied discussions and the interchange of experiences and learnt lessons, on actual initiatives and efforts to deter collusive tendering. To organize the discussion we propose reviewing some insights on prevention, detection and prosecution of bid rigging offences, to then identify some topics on the role of policies and institutional coordination, with reference to country experiences provided by member States.

## **A. Prevention of bid rigging**

35. There are three essential elements to consider on the mechanics of the formation of a successful collusive agreement. First, firms need to know who the other potential bidders are. Second, they need to communicate with each other. Third, they need to reach an agreement that all participants consider to be their optimal choice. In this light, let us now discuss how a collusive agreement can be effectively prevented.

### **Element 1.**

#### **Information on who are the other potential bidders.**

36. The first requirement for a collusive agreement to take place is that competitors are able to identify the firms that may participate in a specific tender (or a set of tenders in a specific relevant market). The likelihood of an agreement is therefore lowered by measures that maintain a level of “healthy” uncertainty for every bidder, on who else could be participating in the tender. At the extreme, if bidders do not know who the others are, they have no chance to establish communication, and the possibility of bid rigging would be ruled out.

37. Contrarily, uncertainty on who are the actual participants is reduced when the number of potential bidders is low, with products with a high degree of specialization, with tenders that are repeated over time and the information on who are the actual bidders disclosed, and when providers are restricted to a particular domain.

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<sup>31</sup> See an index on relevant works at the ICN website:  
<http://www.internationalcompetitionnetwork.org/working-groups/current/cartel/awareness/procurement.aspx>.

38. Therefore, procurement policy should aim at reducing the chances for bidders to learn about who the other potential bidders are, by facilitating access to as many potential bidders as possible, by not specifying requirements that are unnecessary restrictive and by reducing as much as possible the complexities associated to the preparation of a bid. Instances for interested bidders to meet and know each other during the preparation of a tender should expressly be avoided.

### **Element 2.**

#### **Communication between potential bidders**

39. To establish a collusive agreement, potential competitors need to communicate with each other with the specific purpose. It is hard to prevent communications between competitors as these are not illicit per se. In fact, trade associations are normal instances of meeting and coordination in regard to a number of legitimate matters in relation with firms' common activities and interests.

40. Communications between competitors should be kept at the minimum. Procurement policies can provide strong disincentives for inappropriate communication. One way of doing so is, for instance, by requesting a formal declaration of independent bidding, and a statement of declaration of communications that may have taken place. This tool may act as a dissuasive device, and facilitates prosecution of eventual infringements by means of additional legal elements that arise should the declaration is proven to be false. Indeed, if competition authorities prove inappropriate communication then firms may face important legal consequences (particularly if they have signed the independent bidding declaration). This is an example on how combined policies may reinforce each other to provide a strong disincentive for communications to take place. Disincentives to engage in inappropriate communication will be strong if penalties imposed are high and if competition authorities keep a high profile in detecting these infringements.

### **Element 3.**

#### **Engagement in collusive agreements**

41. If potential bidders know each other and there is room for inappropriate communication, then they will have the possibility to engage in collusive agreements. But will they have incentives for doing so?

42. Industrial economists have long discussed on factors that may affect the likelihood of collusion. Yet a simple principle is that for a cartel to take place and to be maintained over time, all members must consider that their optimal choice is engaging and complying with the agreement.

43. The question for policy design is, therefore, how to introduce incentives for individual firms not to find it optimal to engage in collusive agreements, or to comply with them if they already are in place.

44. With this in mind, procurement authorities may consider some experiences in the design of tender processes that distribute contracts in a way that is difficult to be evenly split within an eventual agreement. An interesting case took place in Chile in 2004, in a public tender on the supply of oxygen for public health institutions. In this case there were only four possible providers and the tender was designed in a way that only three of them would obtain a contract.<sup>32</sup> Besides, the three contracts were unevenly distributed, where one contract was much bigger than the other two. This tender resulted in huge savings for the

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<sup>32</sup> Future competition was not compromised because there were other big clients in the market of oxygen, as for example mining companies.

public health system. The behaviour of the four firms during the tender process gave rise to allegations of previous collusion and the case was pursued by competition authorities, yet it was dismissed by the Supreme Court on the basis of lack of hard evidence of an explicit agreement and the absence of harm (given the successful outcome of the tender).<sup>33</sup>

45. Indeed, much can be done by public procurement policies and authorities to prevent bid rigging in public tenders. The OECD 2009 guidelines for fighting bid rigging<sup>34</sup> set a landmark for guidance on this field. They include two checklists, one for the prevention and one for the detection of bid rigging in public procurement, which principles have been applied by several procurement and competition authorities around the world, to campaign and to develop specific policies in this regard. The first checklist contains a first series of six points to be considered while designing a public tender:

Being informed on specific market characteristics, available products and prices before designing a tender. Consider the likelihood of collusion in the specific market;

- (a) Designing the tender process such as to encourage participation of potential bidders;
- (b) Defining requirements clearly and avoiding predictability of future contracts;
- (c) Reducing the chances of communication among bidders;
- (d) Considering the impact of selection criteria on current and future competition; and
- (e) Raising staff awareness on bid rigging matters.<sup>35</sup>

46. Following this guidance is expected to improve the chances of attracting a “good number” of bidders to a specific tender or series of tenders on a specific area or market. Following point i), procurement authorities would be better positioned to design tenders in accordance with actual market conditions, point ii) is a straightforward reminder of using such knowledge to specify tenders in order to maximize the number of credible bidders, and point v) emphasizes on an important and challenging element: to consider ways of promoting and preserving competition in the future.

47. On the other hand, points iii) and iv) relate to the behavioural element, aiming at ensuring that bids are independent from each other (competitive). In terms of the three elements discussed above, (information on who are the other potential bidders, communication between potential bidders, engagement in collusive agreements), point iii) of the OECD checklist helps introducing a healthy dose of uncertainty on who will participate in a specific tender (element 1), point iv) directly addresses the issue of communication (element 2), and the combination of i) and iii) may be regarded as related to the introduction of disincentives for firms to engage in collusive agreements (element 3).<sup>36</sup>

48. Dealing with bid rigging matters is costly and requires developing in house expertise and coordination with competition authorities. Likewise, competition authorities need to develop the necessary capacities, resources, and the decision to play their supportive role.

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<sup>33</sup> The sentences are available (in Spanish) at:

<http://www.tdcl.cl/Portal.Base/Web/VerContenido.aspx?ID=780&GUID=>

<sup>34</sup> OECD (2009). Guidelines for fighting bid rigging in public procurement: Helping governments to obtain best value for money.

<sup>35</sup> This point underlines the previous five. Yet, it will also have an important impact on institutional capacities for detection.

<sup>36</sup> This is the case, for instance, when careful tender design makes it harder to divide benefits amongst market players, or introduces any other feature that would make it more difficult to organise and maintain an agreement.

Competition policy may also alter the incentives for firms to engage in collusive agreements, by developing an adequate and balanced set of instruments to prosecute cartels (see below).

## **B. Detection of bid rigging**

49. As discussed in the previous subsection, a high probability of detection reduces the incentive to establish communications and to engage in collusive tendering. In fact, prevention and detection have a two-way influence.

50. The already mentioned OECD guideline contains a second checklist, for detecting bid rigging in public procurement.<sup>37</sup> This checklist is aimed at facilitating the role of public procurement agents in the detection of clues and signs of bid rigging, by focusing on:<sup>38</sup>

- (a) Warning signs and patterns in the submission of bids;
- (b) Warning signs in all documents submitted;
- (c) Warning signs and patterns in prices;
- (d) Suspicious statements;
- (e) Suspicious behaviours.

51. Since resources are always limited, it is advisable to concentrate efforts for detecting these clues and signs on the basis of the following three areas:

### **Area 1.**

#### **Understanding of actual behaviours**

Based on available information and existing knowledge of the markets involved, it is worth focusing on those markets where authorities have developed an understanding that collusion is likely to take place. It is therefore important to develop this knowledge on a systematic basis and improve it on a continuous basis. Screening methodologies may help selecting relevant in an objective way.<sup>39</sup>

### **Area 2.**

#### **Analysis of incentives**

Carefully analyze the incentives that firms may have to collude during the specific process/ tender. In this respect, market characteristics play an important role.

### **Area 3.**

#### **Revision of how information has been managed**

Analyze how information has been managed before, during and after a specific tender, and its likely implications on the behaviour of bidders.

52. Procurement authorities have primary access to the information that is necessary to analyse these three elements. Therefore, procurement officials need to build up in-house

<sup>37</sup> OECD (2009). Op. cit.

<sup>38</sup> The OECD checklist includes two points (not listed here) to recommend on considering possible indications and evidences in a cautious way, not as unambiguous proof of infringements, and to recommend procurers on how to proceed if bid rigging is suspected.

<sup>39</sup> See for instance Harrington (2009) at [http://www.econ2.jhu.edu/People/Harrington/Harrington\\_SACC\\_9.09.pdf](http://www.econ2.jhu.edu/People/Harrington/Harrington_SACC_9.09.pdf).

capacities for the preliminary analysis or ask for expert advice in order to do so. Competition authorities should perform a more thorough analysis of cases in which meaningful indications of collusion have been found. Therefore, a case detected by procurement officers should be discussed with or handed to the relevant competition authority as soon as the procurement authority concludes that there are strong indications and the relevant documentation has been collected. This is a critical step for effective detection and illustrates the importance of cooperation between procurement and competition authorities.

53. A vital element to build a fruitful and collaborative relationship between procurement and competition authorities is to generate clear mutual understanding on which are the signals that should be considered, on the way to document a suspected case of bid rigging and what to expect once the case has been handed to a competition authority, in terms of further collaboration and feedback. Procurement authorities have to invest a good deal of effort in order to submit a case, and misunderstandings with competition authorities may lead to disappointment and discouragement to work on and submit new cases. On the other hand, additional loads of work resulting from investigations of bid rigging cases and the eventual disruptions to procurements processes may also discourage the detection and submission of cases, giving that procurers have other urgencies and other priorities. Again, being a practical issue it will be worth examining which solutions for these coordination challenges have actually worked in different countries.

### **C. Enforcement – Prosecution of bid rigging**

54. Effective enforcement requires the concurrence of competition authorities, public procurement agencies and other prosecuting instances to combine their powers and resources. For instance, the competition authority of Armenia (SCPEC) has developed over time a fruitful cooperative relationship with the Treasury’s public procurement, including the formation of a joint SCPEC/Treasury working group on procurement policy.<sup>40</sup> Similarly, the Japan Fair Trade Commission has engaged various procurement entities in surveys and study meetings to promote competition in public procurement. Instead, in Indonesia the competition authority has developed a closer relationship with a special court for corruption cases.<sup>41</sup> Other competition systems including in Canada and Brazil work closely with public prosecutors, whereas in several other countries this relationship raises major coordination issues.

55. Both legal and institutional frameworks play a role. In particular, dealing with public procurement matters requires a great deal of understanding and coordination between competition and public procurement authorities, which may require several years of joint work, mutual collaboration and reciprocal training. In many countries competition and public procurement authorities commence to build up this necessary coordination, as they intensify efforts to ensure competition in public procurement processes. A recent noteworthy initiative is the signing of a memorandum of understanding between the OECD and the Mexican Institute for Social Security (IMSS) – to implement the “Guidelines for Fighting Bid Rigging in Public Procurement” which followed a close cooperation between the IMSS and the Mexican Federal Competition Commission (CFC).<sup>42</sup>

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<sup>40</sup> See peer review of Armenia at <http://www.unctad.org/Templates/Download.asp?docid=14078&lang=1&intItemID=4163>.

<sup>41</sup> See peer review of Indonesia at <http://www.unctad.org/Templates/Download.asp?docid=11641&lang=1&intItemID=4163>.

<sup>42</sup> Submission by Mexico.



***Alliance to fight bid rigging in the Mexican Health Care System***

The IMSS is the third largest public buyer of goods and services in Mexico, concentrating 9 per cent of government procurement expenditure, and the single largest purchaser of pharmaceutical products and other medical supplies.

In 2002, the IMSS audit office informed the CFC of possible collusive practices in the supply of surgical sutures and X-ray materials and chemicals. In the following, the CFC investigated and punished three firms for bid rigging with a US\$1.3 million fine.

In 2006, following a presentation by the CFC on bid rigging, the IMSS requested recommendations to improve procurement procedures and granted CFC with access to its databases. This allowed the CFC, in 2010, to prosecute a cartel in the provision of insulin and electrolyte solutions, punishing six pharmaceutical companies with a US\$12.5m fine.

The close cooperation between the CFC and the IMSS recently led to the signing of a Memorandum of Understanding between the OECD and the IMSS to implement the "Guidelines for Fighting Bid Rigging in Public Procurement" with assistance of the CFC. The initiative is the first of its type. Given the sensitivity of the IMSS' services for the population, potential savings and benefits are expected to have an enormous social impact.

Source: Submission by Mexico

56. Indeed, prosecution of bid rigging cases by competition authorities is strengthening over time, following legal and institutional developments that allow for enhanced effectiveness. For instance, in November 2007, the Swiss Competition Commission (COMCO)<sup>43</sup> stopped a cartel of road asphalters in Tessin, operated by 17 companies that met each week to decide on tender allocations and prices. This cartel was detrimental for private customers, public authorities and taxpayers, but since it dissolved before the end of the grace period envisaged by the legislator, participating companies escaped sanctions envisaged by the revised law. Later on, in July 2009, COMCO imposed fines for bid rigging to Bernese electric fitters, by a total of CHF 1.24 millions. The case was denounced by a whistleblower, i.e. a third party not taking part in the cartel. The investigation was opened with raids, and all parties collaborated within the framework of the leniency program, which made it possible to discover the existence of several agreements on tenders of large projects of electric installations in the area of Bern between 2006 and 2008. Afterwards, COMCO has effectively prosecuted several other cases, particularly on the construction market and related sector, which they have set as one of the commission's priorities.

57. A number of recent cases of interest also illustrate the increasing prosecution of bid rigging cases around the world. In July 2011 the Italian Competition Authority (ICA) sanctioned four suppliers of magnetic resonance equipment with fines totalling € 5.5 millions for a collusive tendering in the region of Campania, reasoning that the exchange of sensitive information and the reaching of an agreement among the involved companies made the bidders commercial strategies no longer independent from each other.<sup>44</sup> In Spain, the national competition authority fined 46 construction companies €47 million in October 2011.<sup>45</sup> In Australia, the national competition and consumer protection authority charged

<sup>43</sup> Submission by Switzerland.

<sup>44</sup> See press release at <http://www.agcm.it/en/newsroom/press-releases/1963-i729-healthcare-antitrust-over-55-million-in-fines-for-competition-distorting-agreement-among-4-suppliers-of-magnetic-resonance-equipment.html>.

<sup>45</sup> See decision (in Spanish) at:

fining for A\$ 1.3 million to three construction companies in November 2011, for engaging in a conduct known in the construction industry as “cover pricing”, while two executive managers were also fined and made liable for their companies’ legal costs.<sup>46</sup> In the area of private procurement, Japan’s JFTC issued in January 2012 cease and desist orders and surcharge payments orders to participants of a bid rigging conspiracy for automotive wire harnesses and related products that affected five major automobile manufacturers.<sup>47</sup>

### **III. Conclusion and issues for further discussion**

58. In summary, the paper focused on two important areas to ensure that public procurement benefits from the maximum level of competition for public contracts:

#### **A. Promotion of competition through the design of the public procurement system and individual tenders**

59. The ideal case is that public procurers have access to a sufficient number of competitive offers. This is why it is important to establish a procurement system based on and promoting the principle of competition, and to design tenders in a way that attracts bidders from a sufficiently ample spectrum of potential providers. In this context, substantive and institutional aspects of public procurement systems were discussed, as well as strategies to broaden the circle of potential bidders. The importance to expand the frontiers of procurement markets by eliminating unnecessary requirements to participate in public tenders, facilitating country-wide participation of all interested companies including SMEs and liberalizing procurement markets was noted. E-procurement, as a modern means of public procurement, was discussed as well as balancing competition and other objectives of public procurement, such as green or sustainable procurement and development objectives.

60. Competition authorities can play an important role in advising the legislature and public procurement entities on the competition issues in the area of public procurement that have been presented in this paper.

#### **B. Use of policy tools to make competitive behaviour the optimal choice for potential bidders, in other words: “How to fight bid rigging effectively?”**

61. Bid rigging poses a serious threat to competition in public procurement markets. Therefore, it is important to make use of the available instruments to incentive competitive behaviours and fight bid rigging. In this context, it was highlighted that the design of procurement processes that take market characteristics into consideration, together with the likelihood of collusive behaviour, can do much to prevent bid rigging. Advice by competition authorities on ways of turning agreements less likely is very useful for procurement entities.

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[http://www.cncompetencia.es/Inicio/GestionDocumental/tabid/76/Default.aspx?EntryId=125677&Command=Core\\_Download&Method=attachment](http://www.cncompetencia.es/Inicio/GestionDocumental/tabid/76/Default.aspx?EntryId=125677&Command=Core_Download&Method=attachment).

<sup>46</sup> See press release at:

<http://www.accc.gov.au/content/index.phtml/itemId/1015335/fromItemId/966100>.

<sup>47</sup> Submission by Japan.

62. Competition policy may also change the expected profits of a firm participating in a collusive agreement, by imposing high penalties on infringers and by increasing the probability of detection. Active enforcement by competition authorities may lead to extremely high costs for companies. Besides the associated penalties and liabilities there are other –perhaps higher- costs that a firm prosecuted for bid rigging must bear, such as the costs of litigation, costs in public image and even the internal conflicts that a judicial process may generate are a cost that firms will carefully weigh against the cost of complying with the law.

63. Every firm will weigh the expected costs and benefits of engaging and complying with a collusive agreement. Therefore, good detection tools are particularly important for this pondering process by firms, and once again, coordination and cooperation between procurement and competition authorities is essential. Furthermore, in a context of credibility on the authorities' capacity to detect cases of bid rigging, there is an enhanced role for leniency programmes, which in turns will reinforce firms' perception that bid rigging cases are likely to be detected and prosecuted.

### **C. Issues for further discussion**

64. The following issues are suggested for further discussion during the Twelfth Session of the Intergovernmental Group of Experts on Competition Law and Policy in 2012:

- (a) Which steps have competition and procurement authorities taken to systematize their knowledge on specific procurement markets?
  - (b) Has the analysis of incentives for collusion lead to any specific law or policy adjustment in your jurisdiction?
  - (c) Does transparency of bidding processes actually undermine competition?
  - (d) Which advocacy actions by competition authorities have proven to be more effective to enhance competition in public procurement?
  - (e) Which remedies have been used after bid rigging cases to enhance competition in bidding markets? Is blacklisting effective to deter collusive practices?
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