

CPI's Asia Column Presents:

KANSEI-DANGO and Antimonopoly Law in Japan
– The Characteristics of Collusion in the Japan's
Public Procurement –

Shuya Hayashi

Nagoya University Graduate School of Law

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Introduction

To promote free and fair competition, public tendering system is a measure generally used by national, local, and regional government bodies as well as public organizations in Japan. Bid-rigging (a voluntary restriction of competition by prearranged activities among bidders) erodes the integrity of the entire bidding system and violates the Japanese *Anti-Monopoly Act* (hereinafter AMA).¹

National and local government officials have sometimes been found to be involved as participants in bid-rigging.² For example, a government official in charge of the bidding process may call a meeting with representatives from the business sector in order to provide yearly targets of order volume allocated to each enterprise. This officer may instruct business entities to coordinate in achieving such targets. In addition, in response to requests from businesses entrepreneurs, the official may designate the winner of the bid by suggesting a prospective name or even leaking the planned ceiling price, which is confidential and could not be disclosed. In Japan, bid-rigging is generally called *kansei-dango* (government-assisted or -facilitated bid-rigging). Other seminal cases of *kansei-dango* in Japan include disclosure of confidential information from the state officials to the chosen bidders, nomination of the bid winner etc.

In order to design an efficient public procurement system that promotes market competition among suppliers *without kansei-dango*, it is essential to understand the reasons why Japanese bureaucrats collude with suppliers. On the basis of an examination from the testimony of corrupt officials in some seminal cases of *kansei-dango*, the Japan Fair Trade Commission (JFTC) examines that public officials may be motivated to collude for the following reasons (JFTC, 2015, p.68):

1. Bureaucrats generally aim at the growth of regional economy and boosting the ability of the their own regional suppliers is thus necessary to achieve the set goal. Bureaucrats are thereby unavoidably to do things in favor of them.
2. In order to maintain the quality of procured goods, bureaucrats may wish to delegate their procurements to suppliers with good reputation.
3. In actual procurements, public officials may have an extra request upon a successful bidder (e.g. in the case of emergency or unexpected urgent circumstances). Bureaucrats may be in favor of the firms satisfying their requests in the past.
4. Corrupt officials may respond positively to the potential supplier's approach in order to make collusion easier.
5. In practice, public procurement rules are frequently revised in detail To avoid any confusion, bureaucrats may be in favor of suppliers with outstanding positive experiences in public procurement activities.
6. Bureaucrats may be in favor of specific firms to guarantee their jobs after retirement.

* Shuya Hayashi, L.L.D., is a Professor, Nagoya University Graduate School of Law. His research interests are in law and policy of competition, telecommunications/media, and public procurement.

According to six motivations mentioned above, (4) and (6) are simply for the personal gains of the state officials which is the simple form of corruption, whilst, in (1), (3) and (5), corruption is motivated by bureaucrats' favoritism.

, On the other hand, (2) seems to interestingly focus more on public officials' "negative" motivation to avoid the risk of unsuccessful procurement. In response to this, the *Law on the Promotion of Quality Assurance in Public Works* was enacted in Japan in 2005.³ According to this law, scoring auctions should be properly implemented in specific auctions of public works. In a scoring auction, it is necessary that public procurers know the quality of procured goods and/or services involved in the auctioned work and thus the quality of public procurement needs to be verified. Although some studies discuss other economic forces leading to corruption among bureaucrats and suppliers, there is no study that links factor (2) to this type of corruption.

The purpose of this article is mainly to show that "the motivation to avoid unsuccessful procurement" constitutes one of the main reasons for corruption in Japanese public procurements. By focusing on *kansei-dango*, we clarify that the risk of unsuccessful procurement resulting from the nature of the procured goods may facilitate corruption in Japanese context. "Unsuccessful procurement" means procurement in which the quality of work cannot be verified until the procurement object is put into use. The quality thereby largely depends on the technical capabilities of the contractors.

Regulatory framework of *kansei-dango* in public procurements

The first attempt to revise the laws regarding *kansei-dango* was prompted by the JFTC's issue of a cease and desist order in May 2000 to combat bid-rigging case in a local government project.⁴ In that case, evidence was found that the project owner had an intention to nominate the winner of the bid, and the JFTC therefore issued a request to the local government to provide a remedy. As a result of this incident, government officials' involvement in bid rigging, known as *kansei-dango*, began to draw strong criticism from society. During that time, business enterprises involved in bid-rigging were subjected to the penalty; however, no applicable law could be imposed upon the state officials involving in collusion. This imbalance lead to the issue of unfairness among service contractors.

For this reason, the *Act Concerning Elimination and Prevention of Involvement in Bid-Rigging* was eventually promulgated in January 2003 as a measure to prevent government officials engaging in bid-rigging.

Based on this law, the JFTC may require heads of organizations offering bids to take corrective measures to eliminate the involvement of government officials. After receiving a request from the JFTC, the heads of relevant ministries and other government organizations have to investigate whether there is evidence substantiating disciplinary action against officials involving in bid-rigging. Cooperation and coordination among relevant administrative organizations are also required by law.

This Act essentially provides the more rigid measures to eliminate and prevent bid-rigging in public procurement on the part of government personnel under the criteria of the Fair Trade Commission. The newly-imposed measures includes (i) a measure to eliminate involvement in bid-rigging by state officials, (ii) a measure to claim damages over bid-rigging cases involving officials, (iii) an investigation process to allow action to be taken against government officials

involved in collusion, (iv) a measure to support coordination among administrative institutions, and (v) a measure to punish state officials engaging in collusion, which harmfully distorts the fairness of public tendering process. In accordance with this Act, the term “bid-rigging” in this paper means any act by which local governments or specified agencies (hereinafter referred to as “government”) unlawfully agree with a counterparty on a sale/purchase, lease, or contract via an auction or other competitive means (hereinafter referred to as “bidding”). Nomination of the winner (either by agreement among the potential bidders or as assigned by the Trade Association) and collusive agreement on bid price are prohibited under article 3 and article 8, paragraph 1, of the AMA (Act No. 54; 1947). The term “involvement in bid-rigging” in this Act means involvement by local or national officials, as well as directors or employees of specified corporations (hereafter, “the employees”). This involvement may include activities as the following examples.

- I. Involvement in bid-rigging activities by entrepreneurs or the Trade Association.
- II. Nomination of one bidder as the winner of the contract.
- III. Disclosure of confidential information by the official that may lead to bid-rigging.
- IV. Any involvement by officials solely for the purpose of facilitating collusive bidding.

Given the negative effects of bid-rigging for the fairness of the tendering process, the Japanese National *Penal Code* (Act No. 45; as of April 24th, 1907) sets out a provision in article 96-3(1) stipulating that any person using fraudulent means or committing an act which distorts the fairness of public auction or bid shall be imprisoned up to 2 years or shall be subjected to punitive fine up to 2,500,000 yen (approximately US\$22,750). When collusion is detected, the JFTC may officially ask the chief of the ministry or agency in question to find measures to deter or prevent bid-rigging in the public tender process. After the investigation stage, police or a public prosecutor may prosecute criminal charge against person engaging in *kansei-dango* at any time.

These amendments took effect on January 4th, 2016 with an increase in the rate of surcharge imposing on violators of the Act and applying the higher rate to entrepreneurs with a repeated history of violations as well as introducing the new criminal investigation powers. Those amendments aim to regulate AMA violations more actively in the stricter manner. On the other hand, the amendments provide a motivation to terminate violations at the earliest opportunity. For example, after taking into account the models of the United States, the European Union, and other developed countries, a leniency program was introduced. Under this program, any business corporations reporting their own violations to the JFTC are able to be granted full statutory immunity or reduction of imposed surcharges. This new system is expected to deter AMA violations effectively and adequately. Japanese government has emphasized its competition policy both the AMA and the state-imposed or -facilitated constraints to boost economy and promote consumer welfare with free and fair competition.⁵

Characteristics of *Kansei-Dango*

As described in the previous subsection, the *Act Concerning Elimination and Prevention of Involvement in Bid-Rigging* allows the JFTC to expose *kansei-dango* and requires the public procurer (the head of the organization whose official is involved in the corruption) to take adequate corrective measures to eliminate this sort of corruption. There have been 13

corruption cases since the implementation of this law that the JFTC has exposed, and required the procurer to take reform measures.

At the same time, police can also prosecute corruption between a public official and a supplier based on the *Penal Code*. The JFTC collects data on corruption cases prosecuted by police, and has published a summary thereof, JFTC (2015, pp.53-54). Police pay more attention to illegal actions over the implementation of public tendering, while the JFTC concentrates more on cases related to collusion between tendering firms. Due to their different respective focuses, the number of cases prosecuted by police is relatively large compared to that by the JFTC.

Case Study in the Application of the Act Concerning Elimination and Prevention of Involvement in Bid-Rigging

Here is an example of an application of *the Act Concerning Elimination and Prevention of Involvement in Bid-Rigging*. This is a recent case regarding bidding for snow-melting equipment for the Hokuriku Shinkansen bullet train operated by the Transportation and Technology Agency (JRTT) – a Japan Railway Construction– which is wholly financed by the government.⁶

Outline of the Case

The JFTC issued cease-and-desist orders and surcharge payment orders to the 11 companies that had participated in bidding for snow-melting equipment ordered by JRTT. On September 14th, 2011, the 11 companies had substantially restrained competition in the field of snow-melting equipment works for Hokuriku Shinkansen by nominating successful bidders. In this case, 11 companies violates the article 3 of the AMA (concerning prohibition of an unreasonable restraint of trade). The total amount of the surcharge was approximately 1.03 billion yen (approximately US\$11,793,500). At the hearing, the JFTC firstly notified 11 companies with the content of the proposed orders in writing, provided them with opportunities to view and copy the evidence that had become a basis for the orders and finally ask them to submit their opinions and evidences to the JFTC. After the JFTC took opinions and evidence submitted by the companies into consideration, the orders were finalized.. One recipient was unsatisfied with the JFTC's orders and thus appealed to the Tokyo District Court.⁷

An Essence of the Case

These allegations over bid-rigging on Shinkansen-related engineering project meant that competitive bidding on infrastructure improvement projects is essential for the safety of bullet train services was derailed through a collusive relationship between entities in the public and private sectors. The cost of the projects was covered by resources from national government subsidies and contributions from involved local governments.. The corporations involved in the scheme essentially take unlawful profits from the state revenue by using an exorbitant bidding price.

It will be particularly disconcerting if a case like this one is found to involve collusive bidding at the initiative of a government-affiliated institution (e.g. the case of JRTT). Various cases of public procurement projects show the (99% or more) similarity between JRTT estimated cost and the price offered by the bid winner. This inevitably shows that the confidential information is secretly disclosed to the contractors for the purpose of winning the bid.

Another probable factor behind this case is that JR TT wanted to avoid unsuccessful procurement (e.g. an unsmooth progress on the bidding process) so that it could complete the construction projects in time to open the Nagano–Kanazawa route. If there is no bidder winning in the first tendering, it may take approximately two months to organize the second one. JR TT’s projects are inevitably delayed by this time-consuming processes. According to this case, it can be seen that JR TT takes its own interest by involving in the collusion to nominate the bid winner. This substantially distorts the competitiveness among bidders as well as reduce public’s trust in public procurements.

In December 2006, the *Public Sector Bid-Rigging Prevention Law* was revised to impose criminal penalties on public service employees and others involving in bid-rigging. Employees at JR TT involving in the collusion in the construction projects of new Shinkansen lines in Hokkaido and Kyushu and the Hokuriku Shinkansen will be subjected to the punishment under the newly amended law. Under the law, timely measures need to be taken to determine whether there is any suspicion about the bidding for projects on these lines. The aforementioned case is explicitly illustrated the widespread collusion in the engineering projects (e.g. the snow melting equipment industry). In 2006, action was taken in a case involving an order placed by the (now-defunct) Defense Facilities Administration Agency for air-conditioning equipment installation work.⁸ This 2006 case of bid collusion is inspired by a desire to obtain private-sector posts for retired senior bureaucrats (this practice called *amakudari*). It is necessary to strengthen the measures recently taken by ministries to address conflicts of interest created by the *amakudari* system, which includes prohibiting senior officials from accepting job offers at firms receiving contracts from the ministry for five years after retirement as well as extending this prohibition or a similar one to all officials of ministries and related organizations.

Concluding Remarks

This article has suggested that the risk of unsuccessful procurement resulting from the “experience goods” nature of procured goods in public works projects may facilitate *kansei-dango* in Japanese public procurement. In particular, the quality of the goods procured through public works cannot be predicted *ex ante* by the procurer, as we discussed above. Therefore, as the above discussion shows us, procuring this type of goods tends to lead to *kansei-dango* in order to avoid the risk of unsuccessful procurement.

Thus, inability to confirm the quality of goods *ex ante* causes this type of *kansei-dango*. To eliminate corruption between public officials and suppliers, it is necessary to take measures to overcome this disability. One approach should be stricter inspection of the quality of goods by a third party, which may reduce the risk of unsuccessful procurement by the public procurer and consequently reduce *kansei-dango*.

However, if this hindrance cannot be overcome by strict inspection, we should implement auction types that correspond to the nature of the procured goods. Taking the most recent case mentioned in the former section as an example, the traditional price auction may lead to unsuccessful procurement and lead to the leak of social benefits, while the non-competitive procurement method is possibly more useful. However, in Japan, non-competitive auctions are rarely adopted in practice because many collusion and corruption cases have been uncovered since the 1990s. The investigation analyzed in this article may urge us to reconsider the possibility of adopting non-competitive auction in such cases.

Besides, it can be clearly seen that *kansei-dango* is generally supported by collusion among suppliers or market imperfection. It is very important for government officials and the public to take measures to eliminate government-assisted bid-rigging and restore the fairness of public auctions to increase awareness of business corporations. Enhancing the transparency of demands issued by the JFTC to central government agencies, public corporations, or local governments is also very significant as the measures aim at reducing and preventing the recurrence of government-assisted bid-rigging.

From the perspective of competition/competitiveness policy, the JFTC has been implementing competition law with an emphasis on supporting a competitive business environment to promote the vitalization of an economy based on free and fair competition as well as to raise awareness and public interest. In order to create a competitive business environment, it is necessary to remove and replace anti-competitive regulations and other state-imposed or -facilitated restraints.

Notes

1. *Act on Prohibition of Private Monopolization and Maintenance of Fair Trade* (Act No. 54 of April 14, 1947).
2. A case against bidders for construction work in Iwamizawa City. On January 30th, 2003, the JFTC issued a recommendation to eliminate the conduct for violation of Section 3 (on the prohibition of unreasonable restraint of trade) of the *Antimonopoly Act*. (Decision issued on March 11th, 2003.) In this case, the JFTC found that some city officials with consent or complicity from support staff had fixed the target amount for annual order placements allocated among companies before putting a contract to tender, designated potential bid-winners for each construction contract, almost ensured the target amount for annual order placements, and communicated the name of the expected bidder as well as the rough amount of the contract to the board members of relevant trade associations, who then transferred the tip-off to each expected bidder.
3. *The Law on Promoting Quality Assurance in Public Works* (Act No. 18 of March 31st, 2005) states that the quality of public works must be secured by selecting tendering and contracting methods appropriate to the nature of the works and the conditions in the area, while reflecting the capabilities and purpose of the commissioning entity. This covers, for example, excluding construction business operators that are not qualified as contractors; securing the transparency of the tendering and contracting process and the content of the contract, and fairness in tender which thoroughly abolishes official involvement or other improper actions (e.g. bid-rigging or tendering bid-rigging, preventing the conclusion of contracts for public works whose proper implementation cannot be expected given the contract fee, and implementing contracted public works in an effective way etc.).

4. *JFTC Recommendation Against Suppliers of Agricultural Construction Works Procured by Hokkaido Prefecture*, May 15th, 2000.
5. For a comparative study of the EU and Japan, including discussion of *kansei-dango* regulation, see Kameoka (2014).
6. The JFTC-Issued Cease-and-Desist Orders and Surcharge Payment Orders to the Participants in Bidding for Snow-Melting Equipment Works for Hokuriku Shinkansen Ordered by the Japan Railway Construction, Transportation and Technology Agency. October 9th, 2015.
7. “JFTC Files Criminal Accusation on Bid-Rigging Concerning Snow-Melting Equipment Engineering Works for Hokuriku Shinkansen Ordered by Japan Railway Construction, Transport and Technology Agency.” March 4th, 2014. ([Online] Available at www.jftc.go.jp/en/pressreleases/yearly-2014/March/140304.html).
8. JFTC Bridge Construction Bid-Rigging Case to Public Prosecutors Office for Criminal Indictment, 23rd May 2005, JFTC Criminal Indictment

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