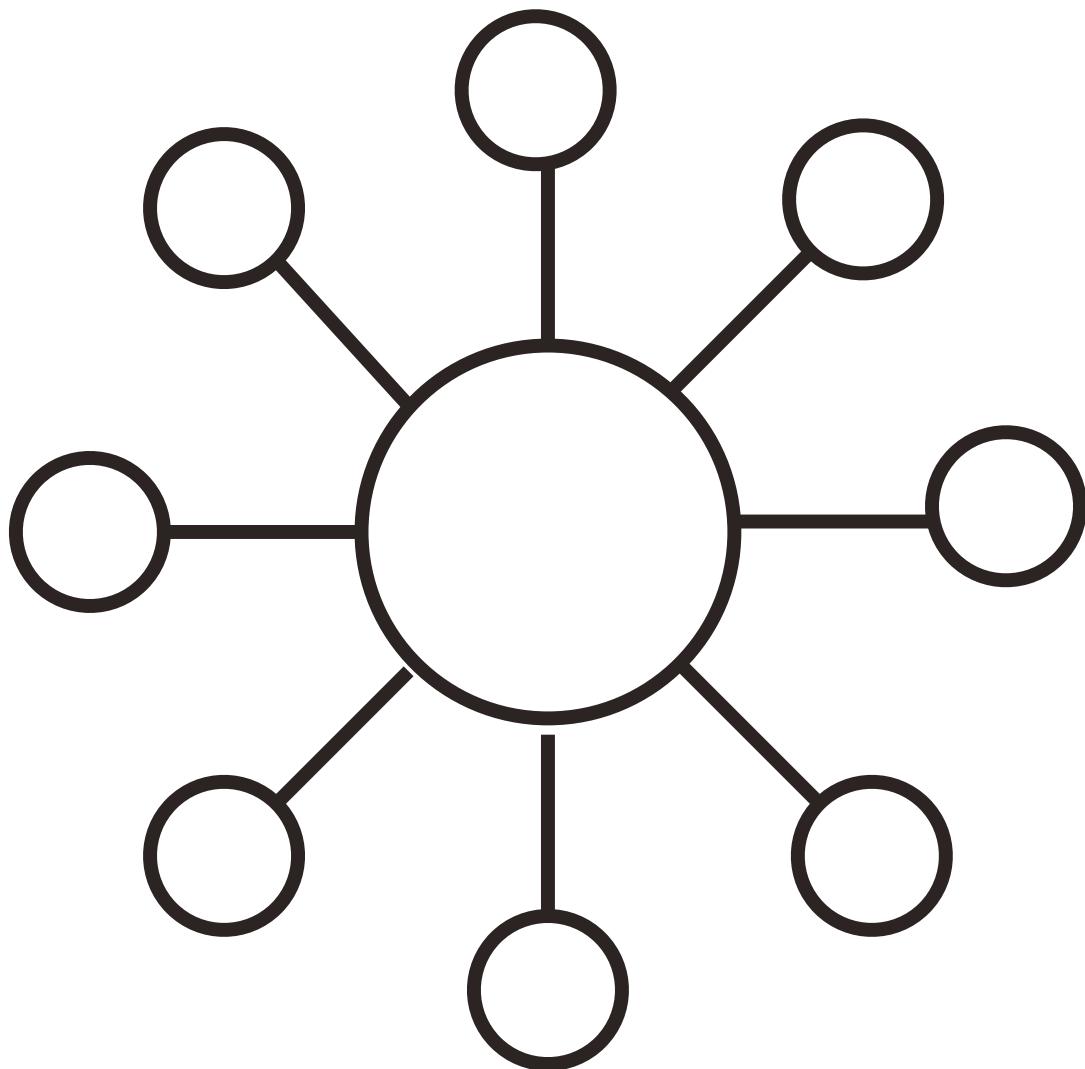


HUB AND SPOKE CARTELS AND BID RIGGING IN BRAZIL: CURRENT LANDSCAPE AND FORWARD-LOOKING CONSIDERATIONS



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This article aims at providing an overview of the current status of Brazilian antitrust landscape and particularly CADE's case law pertaining to hub and spoke cartels under the perspective of bid rigging. Initially, an overview of bid rigging is laid out. Then, hub and spoke cartels as a potential framework for procurement collusion is presented especially considering CADE's major hub and spoke cartel precedent, which was a bid rigging case. After that, an analysis is carried out of recent references that CADE's Tribunal has made to the hub and spoke cartel features in the context of a general bid rigging case. It is argued that CADE's case law evolution on the issue at stake remains to be seen, although the precedent and quick references made by the Tribunal in other cases already play an important role in terms of legal certainty and predictability. Finally, some risk mitigation measures for the day-to-day business activities of economic agents engaging in supply, distribution or resale of products are laid out in view of the current views of local antitrust authorities on the subject.

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I. INTRODUCTION

Bid rigging is a form of collusion whereby companies conspire to raise prices or lower the quality of goods or services during a bidding process. Such collusive behavior in public tenders is particularly damaging to competition and the public interest, as it jeopardizes the outcome and integrity of public procurement procedures and negatively impacts public services.²

In Brazil, bid rigging is deemed to be grave anticompetitive conduct, exposing participants to civil and criminal liability under antitrust and/or public procurement law.³ Brazil's antitrust agency ("CADE") has recognized that companies operating a bid rigging scheme could potentially use various strategies to achieve their objectives, such as fixing the prices to be submitted to a tendering party, presenting proposals without the intention of winning the bid (cover bids), reducing the number of companies bidding in tenders (bid suppression), allocating markets and geographic areas for bidding purposes (market allocation or market division), or alternating the submission of competitive proposals in different bids (bid rotation).⁴

Given the anticompetitive nature of such conduct, CADE has frequently treated bid-rigging arrangements as hardcore cartels. Illustrative bid rigging cases ruled on by CADE include, for instance, the subway cartel case⁵ and many cases prosecuted in the context of the so-called Car Wash Operation.⁶

Recently, for example, CADE tackled a specific type of cartel behavior which first appeared in CADE's case law within a bid rigging case, as described below. This was a so-called "hub-and-spoke cartel," a concept which is not new to international antitrust authorities, especially in the United States and the United Kingdom.⁷

Although not all bid-rigging cases are necessarily characterized as hub-and-spoke cartels, such cases can be characterized as a form of collusion that is increasingly found in bid rigging cases – especially in digital or remote competitive procedures – considering the frequently found hardcore contours of the practice, which ends up demanding a higher degree of care and compliance from companies and economic agents in general when it comes to distribution and resale policies and practices. This article will focus on hub-and-spoke cartels given their importance and practical relevance in the context of bid rigging cases.

II. OVERVIEW OF THE HUB-AND-SPOKE CARTEL THEORY IN BRAZIL

As laid out in CADE's case law further detailed below, and in line with international theory and practice,⁸ a hub-and-spoke cartel violation entails an indirect alignment of prices and/or other commercial variables between competitors, made possible by a commercial partner common to all of them who operates in a non-competing (usually vertically related) market. Generally, the commercial partner is a supplier (hub) that has a supply contract with several distributors/resellers (spokes) that compete with each other.

By contrast with a classic cartel structure, in which direct competitors align themselves on prices or other competitively sensitive variables to curtail competition, in a hub-and-spoke cartel, alignment among competitors is made indirectly, by means of a vertically-related participant in the structure. Such a vertically related entity takes advantage of its position (usually as a common supplier of the spokes) and, as a type of "intermediary," collects competitively sensitive information. The "hub" not only functions as a type of "channel" for information flow, but

² OECD (2021), Fighting Bid Rigging in Brazil: A Review of Federal Public Procurement <https://www.oecd.org/competition/fighting-bid-rigging-in-brazil-a-review-of-federal-publicprocurement.htm>, p. 15.

³ CADE. Guia - Combate a Cartéis em Licitação (2019) https://cdn.cade.gov.br/Portal/Not%C3%ADcias/2019/Cade%20publica%20Guia%20de%20Combate%20a%20Cart%C3%A9is%20em%20Licitac%C3%A7%C3%A3o__guia-de-combate-a-cartel-em-licitacao-versao-final-1.pdf, 19 – 24.

⁴ CADE, Combate a Cartéis em Licitações – Guia Prático para Agentes de Contratação (2019) <https://cdn.cade.gov.br/Portal/centrais-de-conteudo/publicacoes/guia-combate-a-cartel-em-licitacoes/Guia-Combate-a-Cartel-em-Licitacoes.pdf>, p. 2. See also CADE, Administrative Proceeding No. 08700.004617/2013-41, Technical Note No. 81 from the General Superintendence, 9.

⁵ CADE. Administrative Proceeding No. 08700.004617/2013-41.

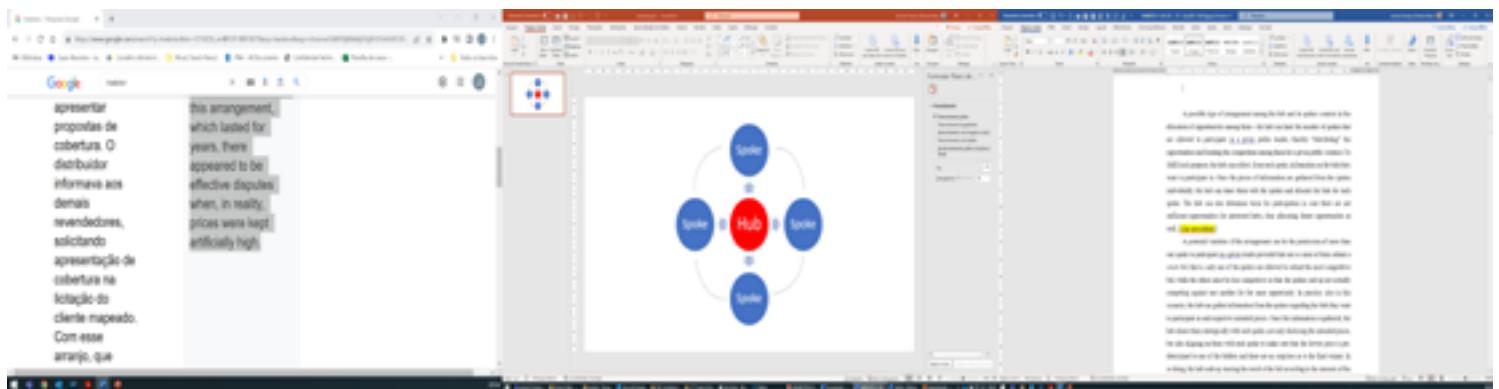
⁶ CADE. Administrative Proceeding No. 08700.001836/2016-11, for instance.

⁷ Ishihara, Júlia Namie, *Analysis parameters of the hub-and-spoke cartel in Brazilian law*, Revista de Defesa da Concorrência, V 8 No. 2, 177 (2020).

⁸ Ishihara, Júlia Namie, op. cit., 190.

also as a “coordinator” of the alignment among the spokes. In sharing sensitive information, it directs the behavior of the information recipient according to its interests within the scheme.

Figure 1 – Basic Structure of a Hub-And-Spoke Cartel



An example of a possible arrangement among the hub and its spokes could consist of a “hub”, only permitting a given spoke to participate in a given tender. The others are less competitive, such that the spokes end up not actually competing against one another for the same opportunity (that is, the non-winning spokes submit a *cover bid*).

In practice, the hub can gather information from the spokes regarding the bids they want to participate in, and their respective intended prices. Once the information is gathered, the hub shares them strategically with each spoke, not only disclosing the intended prices, but also aligning on them with each spoke to make sure that the lowest price is pre-determined for one of the bidders, and there are no surprises as to the final winner. In so doing, the hub ends up steering the result of the bid, according to the interests of the scheme. Needless to say, this can be highly detrimental to public entities expecting real competition on prices and conditions for given tenders.

The conduct can also involve a limitation on the number of spokes that are allowed to participate in a given public tender, so that the hub ends up “distributing” the opportunities among the spokes for different tenders. To do so the hub might collect, from each spoke, information on the bids they want to participate in. Once the requisite information is gathered from the spokes individually, the hub can share them with the spokes and, in effect, allocate the bids to each spoke.

As cartel violations, hub-and-spoke cartels constitute an illicit form of conduct by object (that is, they are punishable regardless of their effects)⁹ and expose perpetrators to heavy fines in Brazil.

Under the Brazilian Antitrust Act (Law No. 12,529/11), companies participating in such a cartel are subject to administrative fines applied by CADE, which can vary from 0.1 to 20 percent of revenue in the field of activity in which the violation occurred, in addition to other penalties, such as publication of the decision in a mass-circulation newspaper, along with prohibitions on contracting with official financial institutions, participating in public tenders, or spinning off assets. Individuals involved in such conduct are also potentially subject to fines from CADE, which can vary from R\$ 50,000.00 to R\$ 2,000,000,000.00. In the case of administrators directly or indirectly responsible for the violation, the applicable fine ranges from 1 to 20 percent of that applied to the company.

In addition to being administratively penalized by CADE, cartels in Brazil are also subject to criminal prosecution: the crime of participating in a cartel exposes individuals involved to imprisonment from two to five years, plus a fine, under the terms of the Economic Order Crimes Act (Law No. 8,137/90).

Finally, participants in a cartel are also subject, in the civil sphere, to damages lawsuits that can be filed by any victim, and to public civil actions filed by the Public Prosecutor’s Office or other interested parties.¹⁰

As it will be further analyzed below, at the time of writing, the only conviction for a hub-and-spoke cartel practice ended up in fines being imposed on the spokes corresponding to 15 percent of their gross revenues in the year preceding the CADE investigation (a high percentage

⁹ CADE, Administrative Proceeding No. 08012.007043/2010-79, Technical Note No. 56/2020 from the General Superintendence, 66.

¹⁰ Laws No. 12,529/11 (Brazilian Competition Act) and 7,347/85 (Public Civil Action Act).

applicable only to hardcore cartels). CADE even imposed an 18 percent surcharge on the hub, in response to the particularly serious role it played in the scheme.¹¹

III. HUB-AND-SPOKE CARTELS IN CADE'S BID RIGGING CASE LAW

A. Brazil's Leading Hub-and-Spoke Cartel Case to Date

At the time of writing, CADE has ruled on only one hub-and-spoke case. The agency convicted 18 companies and 20 individuals of bid rigging (in public and private procurements) in the sale of interactive whiteboards and projectors.¹² CADE's Tribunal ruled on this case on April 12, 2023. The case resulted from a formal investigation (administrative proceeding) launched in 2012. The anti-competitive behavior was found to have occurred from 2009 to 2011 and affected various Brazilian regions. The evidence pointed to an anti-competitive agreement among resellers of interactive whiteboards and projectors of the "Smart Board" brand taking place in three stages.

- First, a reseller would identify a potential customer (among schools, universities and companies in different sectors) interested in purchasing whiteboards and screen projectors. Then, the reseller would inform the supplier (a company called Conesul) who that customer was, and also indicate a reference price which the reseller would submit in the tender, asking for "customer protection" from the other resellers that could be potentially interested in the same customer.
- Second, Conesul would then ask the other resellers of the requested price and ask them to submit prices above such reference price (cover bids).
- Third, all involved parties would actively behave to restrain competition in public and private tenders by submitting fake proposals (cover bids). Evidence, which involved e-mail communications, also indicated that all involved parties were aware that the practice was anticompetitive, and that they actively collaborated to map out potential customers and execute the bid rigging scheme.

By means of this arrangement, which lasted for years, competition among several resellers for the same customer was only a façade, while the result was pre-determined. Due to the lack of true competition, prices were kept artificially high.

As mentioned above, CADE treated the conduct to be anticompetitive by object, and imposed fines on the participants amounting to approximately R\$ 7.9 million.

B. Other Helpful References by CADE's Tribunal to Hub-and-Spoke Cartels

As detailed below, CADE has been investigating several potential hub-and-spoke cartels, and it remains to be seen how the case law on such anticompetitive practices will evolve. The conduct is increasingly raising interest from the antitrust community in Brazil, and CADE's Tribunal has been testing the hub-and-spoke cartel theory in other cases. This will bring about more legal certainty and predictability to the case law.

During CADE's Trial Session No. 217, on August 2, 2023, while a cartel involving gas stations in the countryside of Brazil (in Santa Catarina State) was being reviewed in the plenary session,¹³ Commissioner Gustavo Augusto explained why, in his opinion, such an arrangement should be interpreted as a hard-core cartel and not a hub-and-spoke cartel.

In his view, a hub-and-spoke cartel is characterized by the presence of an economic agent who is not in the market at issue (the hub), and that agent organizes the cartel of spokes – which are competitors in the same horizontal market. Therefore, he pointed out, there is no direct communication between the different (horizontal) competitors: there are "competitor A" and "competitor C" who are in the same horizontal market and don't communicate directly among each other; rather, they communicate with "B," who is another entity that can be vertically integrated to the spokes and that carries out an "ABC"-type of communication.

11 CADE, Administrative Proceeding No. 08012.007043/2010-79, Opinion of the Reporting Commissioner Luiz Hoffman, 130 and 131.

12 CADE, Administrative Proceeding No. 08012.007043/2010-79.

13 Administrative Proceeding No. 08700.005639/2020-58.

Gustavo Augusto added that an essential requirement of the hub-and-spoke cartel configuration, based on foreign doctrine, is such “ABC” communication, that is, communication from a competitor to the external (vertically related) agent, and from the external agent to the other competitor. This would be an essential element that must be demonstrated in the concrete case.

Having laid out the test above, Gustavo Augusto concurred with the Reporting Commissioner (Luis Bertolino Braido) and determined that there were only two horizontal competitors communicating with each other in a classic, hardcore cartel structure, and not in a hub-and-spoke scheme. Although the evidence indicated references to third parties (especially a fuel distributor called Maxsul), CADE's Tribunal determined that the dialogues among cartelists did not evidence that the alignment was being made on behalf of any third party.

Although the case was not classified by CADE as a hub-and-spoke cartel, the opinions of the Commissioners including Gustavo Augusto's helped to revisit and eventually confirm the characteristics of the conduct as laid out in the whiteboards case, thus affirming the legal certainty associated with how CADE is expected to address the practice at issue.

IV. RISK MITIGATION MEASURES

To prevent and detect hub-and-spoke cartel practices, it is paramount that companies address the issue in antitrust compliance programs and trainings, spotting and tackling risky situations for the company's operations either in the hub (vertically related) position or in the spoke (resellers/competitor) position.

Companies are advised to create, maintain, and periodically review and revise commercial policies involving the supply/distribution/resale of products and services in order to avoid falling into the trap of engaging in communications with vertically related parties which can be used to structure any type of collusive scheme which could be characterized as a hub-and-spoke cartel.

Any policies involving the resale of goods by distributors and/or resellers in different territories must comply with Brazilian law and be set forth in a clear and transparent manner, as those policies could be presented to CADE in an investigation of alleged anticompetitive conduct.

V. CONCLUSION

Hub-and-spoke cartel behavior is highly detrimental to competition and is increasingly drawing CADE's attention.

It is expected that the agency will refine its techniques to detect those types of practices. CADE has been focusing on improving its cartel and bid-rigging enforcement broadly – for instance, through its well-known “Projeto Cérebro,”¹⁴ which is aimed at monitoring publicly available information on pricing and procurement processes. It does so by employing data analysis tools to identify potentially collusive patterns and associated behaviors.

It is also expected that, as more hub-and-spoke cartel cases are investigated, CADE's jurisprudence on the matter will be refined and will evolve to shed more light on the types of conduct engaged in and the level of exposure of economic agents in their day-to-day business activities.

14 Roquete, Felipe Leitão Valadares et al., *Organização de Dados: Projeto Cérebro* (2018), <https://www.gov.br/casacivil/pt-br/assuntos/governanca/regulacao/eventos/2018/organizacao-de-centro-de-dados-cade/organizacao-de-dados-cade/organizacao-de-dados-cade-projeto-cerebro-cade.pdf>.

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