



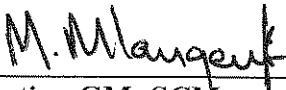
PROVINCE OF KWAZULU-NATAL

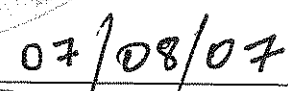
MEMORANDUM

TO : Ms Pam Zulu, SGM : Financial Management  
FROM : Mr Mondli Mlangeni: Acting GM : SCM  
DATE : 06<sup>th</sup> August 2007  
SUBJECT : Guidelines for the Prevention of Cover Quoting

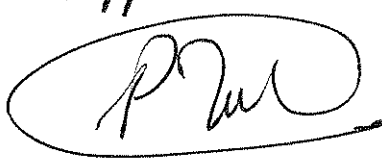
1. The aforementioned refers.
2. Please find attached hereto a copy of the aforementioned document developed for issuance in the Province.
3. It should be noted that the guideline was developed in response to numerous incidents of cover quoting reported to the SCM compliance and Monitoring Unit. We do acknowledge that the guideline will not serve to stop cover quoting, however we are of the opinion that it will provide various official with additional insight on how to identify and hence combat cover quoting.
4. In addition, with the imminent adoption of the KZN BEE Strategy, the guideline would play a significant role in ensuring the full implementation of the Strategy.

Kind Regards

  
Acting GM: SCM  
Mr Mondli Mlangeni  
Provincial Treasury

  
Date

Approved for distribution



13/08/2007



**KWAZULU NATAL  
PROVINCIAL GOVERNMENT**

**GUIDELINES FOR THE  
PREVENTION OF COVER  
QUOTING**

**PROVINCIAL TREASURY**

**2007**

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## 1. INTRODUCTION

Cover quoting, sometimes referred to as "shadow quoting", or "bid rigging" is an offense which represents both corruption and acquisition fraud. It undermines the fair determination of a supplier, corruptly eliminating free and open competition. This operation of collusion involves departmental official(s) and suppliers themselves. This manipulation of the acquisition process is pre-meditated and intentional by the parties involved and therefore undermines the process of acquiring goods and services in a manner that promotes fairness, equitability, transparency, competitiveness and cost-effectiveness, as regulated by the Constitution of the Republic of South Africa.

Cover Quoting may without limitations, be evident where there is a generally corrupt relationship between a Departmental official and a supplier or amongst suppliers themselves

Cover quoting poses a threat to the Province and Departments and for this reason, this Guide has been developed, to assist departments in the combating thereof.

## 2. GENERAL EFFECTS OF COVER QUOTING

The effects (results) of cover quoting are:

- Corruption.
- Goods and services are procured at an inflated price.
- The fraud risks are exponentially increased.
- The integrity of the entire procurement process is compromised.
- Undue preference is artificially and corruptly granted to specific suppliers.
- The controls to prevent unnecessary items being included in the quotation/ bid process are rendered useless.
- The end-user or the department suffers significant financial prejudice.
- BEE targets are compromised.

### 3. BASIC SCHEMES OF COVER QUOTING AMONGST SUPPLIERS

It is normally an agreement amongst suppliers as to who will render the lowest price in respect of a bid or quotation. Suppliers will concur to submit their quotations or bids in a manner prearranged by them. Supplier/s will threaten another supplier in an attempt to have that other supplier submit a quotation or bid in a particular manner or that supplier will be offered an inducement in an attempt to have that supplier comply. There are five basic schemes involved in most cover-quoting instances:

**3.1 Quotation or Bid Suppression:** Occurs where some of the suppliers agree not to submit a quotation or bid so that another supplier can successfully win a contract. In this type of scheme, one or more suppliers agree not to quote / bid, or withdraw a previously submitted quote/ bid, so that a designated supplier will win. In return, the supplier who did not submit a quote/bid or who withdraws may receive a subcontract or payoff.

**3.2 Complementary Quoting or Bidding:** Occurs where some of the suppliers quote or bid an amount knowing that it is either too high or contains conditions that are unacceptable to the client department. In this scheme, co-conspirators submit token quotations or bids which are intentionally high or which deliberately fail to meet all the quotation or bid requirements in order to lose a contract.

This practice is designed to give the appearance of fair and legitimate competition. Suppliers that agree to lose a contract are given some compensation by the successful supplier. The compensation can take several forms, which includes the following:

- The losers will be promised that they can win another contract at a later stage. This is the most common payback.
- The winning contractor subcontracts a portion of the contract to one or more colluding suppliers. There may be a direct payoff in the form of goods, cash, or cheque, normally disguised as a legitimate payment.

**3.3 Quotation or Bid Rotation:** Occurs where the suppliers take turns at being the designated successful supplier. In quotation or bid rotation, all co-conspirators submit quotations or bids, but by agreement, take turns at being the lowest bidder/s on a series of contracts. In this way each supplier will acquire contracts for an equal market value over a period of time or win an equal number of contracts over a period of time.

**3.4 Customer or Market Allocation:** This occurs where suppliers allocate or apportion markets, products, customers or geographic territories among themselves, so that each will get a "fair share" of the total business, without truly competing with other suppliers. In this scheme, co-conspirators agree to divide the contract with respective clients or geographic areas. In this instance co-conspirators will not quote/ bid but will only submit complementary quotations or bids when a solicitation for quotations or bids is made by a Departmental official in an area not assigned to them.

This scheme is most commonly found in the service sector and may involve quoted prices for services as opposed to quotations or bids. Normally a particular supplier will win an account closest to its headquarters. Also, these suppliers divide contract by type of customers, such as one supplier focusing on a certain department (s).

**3.5 Price Fixing:** is an agreement between colluding suppliers selling the same product or rendering the same service. Essentially, it is an agreement intended to ultimately push the price of a product as high as possible or as low as possible. Price-fixing can also involve any agreement to fix, peg, discount or stabilize prices. The principal feature is any agreement on price, whether expressed or implied.

Price fixing includes selling at a common target price, setting a common "minimum" price, adhering to a price book or price list, standardizing financial credit terms offered to purchasers, using uniform allowance, limiting discounts, discounting a free service or fixing the price of one component of an overall service and or purposefully sharing markets, territories or customers using price.

These forms of cover quoting are not mutually exclusive of one another, and two or more of these practices could occur at the same time. All forms of cover quoting have one thing in common, an agreement among some or all of the suppliers which predetermines the winning supplier and limits competition amongst conspiring suppliers, thereby prejudicing the department.

#### **4. BASIC SCHEME OF COVER QUOTING BY A DEPARTMENTAL OFFICIAL**

- 4.1** In this instance a Departmental official contacts a supplier and requests that supplier to submit multiple quotations under the pretext of different titles, as independent quotations. The supplier would then submit multiple quotes using different titles, letterheads of existing or fictitious titles which he/she manages or has fabricated. This could lead to an inflated price as he/she is assured that whichever "supplier" is awarded the contract, it is controlled by him/ her. In this regard the supplier's quote is the lowest regardless of the exorbitance of the quoted prices.
- 4.2** A Departmental official will receive quotations from various suppliers, and before or after the closing time of quotation will inform the colluding supplier to submit the quotation with the lowest price. The colluding supplier will have the advantage of knowing the price of competing suppliers through the departmental official and in most instances be successful.
- 4.3** A Departmental official will inform a colluding supplier of the budget and or cost estimate for the goods and services to be acquired. This will assist the colluding supplier in quoting within the limit of the budget and prescribed cost estimate.

## 5. GENERAL INDICATORS OF SUSPICIOUS BEHAVIOUR

- Identical quotations or bids from different suppliers either, with respect to individual line items, or lump sum quotations or bids
- Quotations or bids are above the departmental cost estimate for the value of a contract or way above comparable quotations or bids by the same companies in other areas.
- A winning supplier subcontracts part of the business to one or more losing suppliers.
- There is indication of physical alteration to quotations or bids, particularly at the last minute.
- Particular line items for some suppliers are much higher than that of others.
- The range of quotations or bids shows a clear gap between the winning supplier and others who submitted quotations or bids.
- The quotations or bids received from suppliers are suspiciously similar in value. This would appear to indicate that suppliers may have known each other's prices.
- The same increment between the quotations or bids of each supplier is noticed.
- All suppliers submit high quotations when work is known to be scarce.
- The supplier provides different quotations or bids for the same line item on different contracts within a short space of time.
- The suppliers appear to have engineered a split on the contract through each supplier bidding lower on particular aspects of the contract and inexplicably higher on other parts of the contract.
- There is physical evidence of collusion, such as different companies submitting bids with the same handwriting, or in the same envelopes, or with the same mathematical or spelling errors, or from the same fax number.
- Qualified suppliers do not submit quotations or bids, especially where the supplier initially took steps to quote or bid.
- If a contract is a re-quote or re-bid because all quotations or bids were unacceptable, the suppliers return in the same order or some suppliers fail to re-submit.
- There are significant increases by most suppliers with respect to previous prices when there have been no real or substantial market cost increases.
- Prices mysteriously drop when a new supplier is requested to quote or bid.



- Suppliers are seen meeting shortly before or after the quotations are submitted.
- Quotations or bids submitted are vague, lacking codes and full descriptions of the items
- Any kind of territorial pattern (draw out the area each supplier serves on a map).
- A supplier always quotes or bids for a contract but never wins it or conversely always wins it. That is, Supplier A is always the cheapest and Supplier B almost always the highest.
- All of the suppliers in the group win an equal volume of business over time.
- All of the suppliers win an equal number of contracts over time.
- Evidence of payback pattern (many are possible).
- A supplier will always be the last to submit a quote or bid.

## **6. CUSTOMER OR MARKET ALLOCATION INDICATORS**

The same suppliers appear to get business over and over again from particular departments and the competitors never seem to provide meaningful quotes or bids. Officials may attempt to procure quotes or bids from others who appear uninterested and may refuse to submit a quote or bid. Where a quote or bid is submitted, it may be ridiculously high, thereby discouraging you from changing suppliers. This becomes further evident when suppliers that should be desiring to engage in business with government decline to do so, particularly with SMMEs and other emerging contractors.

## **7. PRICE FIXING INDICATORS**

Price fixing has severe impacts when acquired through purchase order or direct purchase. In this way, suppliers may agree to raise or fix prices which will be charged for their goods and services. Suppliers may adopt a strategy of limiting prices. This strategy is adopted in order to "limit" the ability of new suppliers to enter the market and take advantage of the economies of scale particularly where costs are low enough for them to become competitive. On the other hand, they may set a minimum price below which there are no sales, or reduce or eliminate discounts. Normal indicators are as follows:

- (i) Suppliers always announce their price increases at the same time for the same amount or have staggered price increase with a specific pattern. The supplier may appear to take turns at going first in increasing prices.
- (ii) Suppliers reducing or eliminating discounts almost simultaneously.
- (iii) Prices seem to be uniform and all suppliers refuse to negotiate quoted prices.

Whilst the above mentioned indicators may arouse suspicion of collusion, they are not proof of collusion and may indicate the following circumstances:

- Quotations or bids that come in well above the estimate may indicate collusion or simply an incorrect estimate from the side of supplier (s).
- A supplier (s) can lawfully submit an intentionally high quotation or bid that it does not think will be successful for its own independent business reasons, such as being too busy to handle the work but wanting to stay on the department's supplier database.

Thus, indicators of collusion merely call for investigation and departments are urged to contact the Compliance and Monitoring Unit at the SCM Centre of Excellence, situated at Provincial Treasury, should collusion be suspected.

## **8. INDICATORS OF A CORRUPT DEPARTMENTAL OFFICIALS**

- An official shows signs of spending more than he/she is earning.
- An official is always showing interest in the award of a contract or particular contracts.
- An official is seen meeting with supplier (s) before or after the closing of quotations and or bids.
- An official is receiving gifts from a supplier (s) that is normally awarded a contract.
- An official is always present at work, and is reluctant to take leave.
- An official defends a particular supplier (s) where there is a query.
- An official has an increased interest in certain quotations or bids over others.

- An official makes the same mistake when verifying information on certain supplier (s) quotation or bid.
- An official is being friendly to a particular supplier (s) representative (s).
- An official continues requesting quotes from the same supplier (s).
- An official shows extreme discontentment when other officials use his/her works station.

## 9. CONDITIONS FAVOURABLE TO COVER QUOTING/COLLUSION

While cover quoting or collusion can occur in almost every industry, it is more likely to occur in some industries than in others. The following are conditions favourable to cover quoting:

- (i) Cover quoting or collusion is more likely to occur if there are fewer suppliers. The fewer the number of suppliers, the easier it is for collusion to occur amongst suppliers with respect to prices, quotations, bids, customers, or territories. Cover quoting may also occur when the number of manufacturers is large, and the remainder are "fringe" suppliers who control only a small fraction of the market.
- (ii) Repetitive acquisitioning may increase the chances of collusion, as the suppliers may become familiar with the other suppliers and future contracts provide the opportunity for suppliers to share the work.
- (iii) Cover quoting is more likely where suppliers know each other well, through social connections, trade associations and/ or legitimate business contacts.
- (iv) Suppliers, who congregate in the same building or town to submit their quotations or bids, have an easy opportunity for last-minute communications.

## 10. HOW TO DISCOURAGE COVER QUOTING

An official of the department may discourage cover quoting by taking several steps which include the following:

- (i) Expand the enquiry of quotes or bids to make it more difficult for suppliers to collude. Departmental officials should solicit quotes or bids from as many suppliers as economically possible. As the numbers of suppliers increases, the probability of successful collusive quoting or bidding decreases. While there is no magic number of suppliers above which no collusion occurs, experience suggests that collusion is more likely to arise where there are fewer competitors.
- (ii) Quotation enquiries or bid documents should require suppliers to sign and submit a non-collusive affidavit stating that the supplier has not colluded and informing suppliers of the penalties both for violating the Competition Act and for signing a false non-collusive affidavit.
- (iii) Ensure that all departmental officials, especially those responsible for the awarding of contracts are familiar with the indicators of cover quoting, price fixing, and other types of collusion.
- (iv) Maintain contract award records, for example, suppliers list, and abstracts and quotations or bids so that when collusion is suspected, it becomes simple for auditing to review the acquisition history of a product to determine if a pattern of quotation or bid allocation or rotation is present.
- (v) If the quotation or bid price submitted does not make sense, an official must request suppliers who submitted such prices to explain and justify their prices. A Departmental official may be provided with a reasonable explanation or suspicions may be heightened by a bogus answer.
- (vi) A Departmental official must know and understand the dynamics of markets in which major acquisitions are made. A knowledgeable departmental official may correctly suspect collusion from the market

behavior that may not be evident to an uninformed department official.

- (vii) A departmental official must report suspicions of collusion through appropriate channels.
- (viii) Departments must endeavor to identify suitable cost estimates before receiving quotations or bids.

## 11. USEFUL TOOLS TO PREVENT COVER QUOTING

The prevention of cover quoting is critical to the Province as it compromises transparency, fairness and equity. Departments can prevent cover quoting using the following methods:

- Formulate suitable Policies, Guidelines and Procedures.
- Continuously review policies to correct shortcomings.
- Identification of suitable compliance officers.
- Do not delegate unlimited and uncontrolled powers to a single departmental official.
- Communicate policies through training.
- Take disciplinary action against offenders.
- React appropriately to incidents.
- Achieve compliance through reporting and audits.
- Use vetted suppliers only as per the Provincial Suppliers Database.
- Appropriate procurement delegations.
- Standard conditions in quote / bid document.
- Impose segregation of duties.
- Restriction of suppliers found guilty of cover quoting.