Bid-Rigging Schemes in Securities Markets

Bid-rigging is an illegal agreement among conspirators in an auction to predetermine the winning bidder. Bid-rigging schemes have been uncovered in many markets including the securities markets.

The U.S. Department of Justice (DOJ) and the U.S. Securities and Exchange Commission (SEC) are currently investigating bid-rigging in the municipal securities markets.

Bid-Rigging Schemes are Illegal

A bid-rigging scheme is a *per se* violation of the Sherman Act, and therefore, subject to criminal prosecution by the DOJ. Sherman Act violations are punishable by fine and/or imprisonment.

A bid-rigging scheme that manipulates the price of a security is a violation of the antifraud provisions of the Securities Exchange Act of 1934. The SEC may revoke or suspend registration of a regulated entity caught bid-rigging. The SEC often seeks disgorgement of the conspirators' ill-gotten gains and civil money penalties related to the harm caused by their actions.

Bid-Rigging Schemes Harm Issuers

Bid-rigging schemes cause direct and measurable harm to the issuer of securities involved the bidding process in the form of lower issuing proceeds. These lower proceeds can be reflected as either lower offering prices or higher offering yields.

A simple measure of harm to the issuer is the difference between the actual proceeds that the issuer received and the proceeds that the issuer would have received in the absence of the bid-rigging scheme.

Conspirators Use a Few Basic Strategies

The simplest bid-rigging strategy is ***bid suppression***. In a bid suppression scheme, some of the conspirators agree not to submit bids, or withdraw previously submitted bids, so that a designated conspirator will be the successful bidder. Bid suppression schemes are the easiest to detect as the absence, or withdrawal, of a bid from a competitor who otherwise would be expected to bid can be very conspicuous.

A more common and less detectable bid-rigging strategy is ***cover bidding***. In a cover bidding scheme, some conspirators agree to submit non-competitive bids, or "shade down" competitive bids to non-competitive levels, so that a designated conspirator will be the successful bidder. The purpose of cover bids is to give the appearance of a competitive bidding process.

Bid-rigging conspirators can share the spoils by engaging in ***bid rotation*** and/or ***sub-contract arrangements***. In a bid rotation arrangement, conspirators collude to take turns being the designated successful bidder. In a subcontracting arrangement, the designated conspirator agrees to share the ill-gotten gains by awarding a subcontract to the other conspirators.

Consider the competitive sale of newly issued municipal securities. These securities are awarded to an underwriting syndicate that presents the best bid according to specific criteria set forth in the official notice of sale. Conspiring bidders with a subcontracting arrangement can agree to let the designated conspirator submit the winning bid and the designated successful bidder can agree to re-offer the securities to the other conspirators in the aftermarket at a predetermined price.

Conclusion

News of illegal bid-rigging schemes in the municipal securities market should not come as a surprise. Bid-rigging conspirators in variety of markets have used the same basic strategies to generate illicit profits for decades. Their actions cause measurable harm to the issuers of the securities involved.

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