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Bid Depositories under the Sherman Act

Bruce Ducker

BID DEPOSITORIES UNDER THE SHERMAN ACT

BY BRUCE DUCKER*

The organization of bid depositories by large groups of specialized subcontractors in order to eliminate or at least substantially to curtail the underhanded practices of bid peddling by subcontractors and bid shopping by prime contractors — practices ultimately destructive of free and open competition — has come under attack from the Justice Department as being a restraint on trade and violative of the Sherman Act. Mr. Ducker explains the bid depository practice and its rationale, discusses the antitrust cases in point, and concludes that such depositories are valuable deterrents to the aforementioned deleterious practices and, therefore, their reasonableness under the Sherman Act should take into account this effect.

THE general construction industry — and in particular, the mechanical specialty trades — have long been plagued by the practices of "bid peddling" and "bid shopping." That is, once the prime contract has been awarded, subcontracts under it are often renegotiated for prices lower than those quoted in the original bids. Where an ambitious subcontractor takes the initiative, he is "peddling" his bid; where the prime contractor seeks adjustment, he is "shopping." Either practice, when carried to extremes, can undermine the industry price structure and lead to chaotic competitive conditions.[1] The immediate results may be several profitable jobs for prime contractors; the eventual result must be the attrition of those craftsmen who cannot afford to compete without a reasonable profit margin.

Bid depositories have proven to be an effective method of controlling these practices. While a depository can conceivably serve several trades, in practice each has functioned in one geographic area for one specialty, traditionally for electrical, plumbing, air-conditioning, and sheet metal subcontractors.

A depository is simply a service, run by a trade association, a bank, or an independent agency, for the purpose of collecting all subcontract bids on a particular job and distributing them to interested general contractors. This service has no fixed procedure or form. It can be varied by the terms of its agreement to meet the needs of its creators. Nevertheless, most bid depositories develop operating patterns similar to other like depositories. The advertisement of a

* Associate, Seawell, Cohen & Seawell, Denver, Colorado; A.B., Dartmouth College, 1960; M.A. 1963, LL.B. 1964, Columbia University.

[1] *See* Report of the Federal Trade Commission, May 20, 1952, in *Hearings on S. 2907 Before a Subcomm. of the Senate Comm. on the Judiciary*, 82d Cong., 2d Sess. 274-75 (1952); *see generally* H.R. REP. No. 434 (to accompany H.R. 7168), 85th Cong., 1st Sess., at 5 (1957).

construction job in a trade journal will often contain a notice of bids for the several component trades. Through trade usage or perhaps by a depository advertisement, the contractors in each specialty learn that their depository will receive bids for that particular construction job until a specified time prior to the closing of bids on the prime contract. The depository then holds these subcontract bids in confidence, immediately opening or distributing them to interested prime contractors.[2] The prime contractors who wish to bid on the principal job then simply "plug in" the successful component bid and recompute their own bid. The prime contractor thus cannot circulate among interested subcontractors, trading one bid against another. Similarly, the depository has recorded the amount and nature of each bid submitted and, if its rules permit, can take action against any bidder who later peddles that bid to land the job.

Since a depository by its nature regulates bidding practices, it is subject to the broad proscriptions of sections one and two of the Sherman Act.[3] The Act itself does not mention bidding practices; nevertheless, bidding practices and bidding pools have been attacked and altered by antitrust litigation. A bid depository operating for the purpose of dividing profits is, not surprisingly, illegal.[4] Similarly prohibited are the comparing of bids,[5] fixing bid prices,[6] group boycotts, and customer or market allocations.[7] These activities among competitors constitute *per se* antitrust violations; they are neither more nor less tolerable when performed through a bid pool.[8]

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[2] To the extent that the differences can be cost justified, depositories may allow one subcontractor to submit bids of varying amounts to different prime contractors. For, as every experienced estimator knows, certain prime contractors are easier to work with, and therefore more profitable to work for. An estimating engineer may add as much as an additional 10 percent "coordinating coefficient" to a job if it is to be performed under a particularly obdurate contractor.

[3] 15 U.S.C. §§ 1 & 2 (1964), in pertinent part, declare:

> Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is hereby declared to be illegal . . . .
>
> Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a misdemeanor . . . .

For an excellent discussion of bid depositories in general see Schueller, *Bid Depositories,* 58 MICH. L. REV. 497 (1960).

[4] United States v. Brooker Eng'r Co., 1940-43 Trade Cas. ¶ 56,183 (E.D. Mich. 1942).

[5] United States v. Engineering Survey and Audit Co., Inc., 1940-43 Trade Cas. ¶ 56,019 (E.D. La. 1940).

[6] United States v. Associated Nevada Dairymen, Inc., 1955 Trade Cas. ¶ 68,172 (D. Nev. 1955); United States v. American Lead Pencil Co., 1954 Trade Cas. ¶ 67,676 (D.N.J. 1954).

[7] Las Vegas Merchant Plumbers Ass'n v. United States, 210 F.2d 732 (9th Cir.), *cert. denied,* 348 U.S. 817 (1954).

[8] Indeed, these activities are more easily proved illegal, as the very existence of a bid pool evidences some concert among competitors. Therefore, participants in a depository must proceed with both caution and counselling. *See* G. LAMB & S. KITTELE, TRADE ASSOCIATION LAW AND PRACTICE § 2.7 (1956).

In short, whenever a bid depository unreasonably inhibits competitive bidding, it is a combination in restraint of trade and violative of the Sherman Act. The qualification of unreasonableness, however, should be the basis for any judicial inquiry into a questionable depository practice. Depositories patently control otherwise free and rampant bidding. The critical issue is whether the extent of that inhibition is justified — that is, reasonable — in the face of the alternative: open and possibly destructive competition.[9]

It is notable that until recently most courts, upon finding illegality, have abolished the entire depository, rather than merely its offending aspects. In a case from the lumber industry,[10] for example, the depository itself was guiltless of any wrongdoing; its members, however, had compared and rigged bids before submitting them. A broad consent decree swept away the service along with the illegal practices committed during its existence, but not necessarily under its aegis. Again, in *United States v. Detroit Sheet Metal & Roofing Contractors Ass'n, Inc.*,[11] roofing contractors and their trade association were prohibited, by consent decree, from entering into any understanding with any other person for the following purposes: (1) Collecting, disseminating, or exchanging information regarding bids prior to their final submission to the awarding authority; (2) fixing or maintaining any rules in computing bids; (3) affecting the award of any contract for the construction or installation of roofing; (4) influencing or interfering with the free choice of a contract by any awarding authority; (5) restricting any contractor from doing business with, or submitting any bid to, any awarding authority; or (6) refraining from bidding or competing in the sale or installment of built-up roofing. Thus, the court banned not only the *per se* violations but also such defensible practices as uniformity in bid terminology and disclosure of bonding capacity. More lamentably, the court published no consideration of possible competitive justification or permissible depository practices.

Two recent cases yield some guidelines on pooling methods which may be used to combat bid shopping and peddling. In *United States v. Bakersfield Associated Plumbing Contractors, Inc.*,[12] a California depository agreement came under attack for three of its rules: First, subcontractors were required to submit separate bids for plumbing, heating, and ventilating portions of any construction contract;

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[9] The Sherman Act has, since earliest construction, been applied with a "rule of reason" under which only unreasonable restraints of trade are illegal. *See e.g.*, Standard Oil Co. of N.J. v. United States, 221 U.S. 1 (1911).

[10] United States v. W.C. Bell Serv., Inc., 1940-43 Trade Cas. ¶ 56,171 (D. Colo. 1941).

[11] 116 F. Supp. 81 (E.D. Mich. 1953).

[12] 1958 Trade Cas. ¶ 69,087 (S.D. Cal.), *modified*, 1959 Trade Cas. ¶ 69,266 (S.D. Cal. 1958).

second, the successful bidder paid a fee directly to the depository; and third, any bidder was able to withdraw his bid, upon the payment of a withdrawal fee, between the opening of bids by the depository and their submittal to the general contractor.

The district court found all three of these practices unreasonably restrictive of free and competitive bidding. The separate bid system on its face limited the bidder's ability to offer any particular service at the lowest possible price. If a subcontractor can save supply costs by combining services, he should be allowed to bid in such a manner that this saving is passed on to the builder, and eventually to the owner.

The depository fee was also found to be a restraint on trade. The proof showed that the fees collected under the rule produced substantially more revenue than required for the ordinary operation and maintenance of the depository. Since the fee had occasionally been included by subcontractors as an element of their cost and consequently passed on to the general contractor, the court apparently felt that use of the depository unreasonably raised the price of doing business without a commensurate benefit to the trade or to the consuming public.

Finally, the withdrawal privilege had been abused. Evidence was adduced that at least on two occasions, the successful bidder had reimbursed the withdrawing bidder in the amount of the withdrawal fee. The court appropriately found collusion among competitors, constituting an unreasonable restraint on trade.

Nevertheless, with the exception of these three rules, the court found that the bid depository agreement was not a *per se* violation of the Sherman Act. In its analysis, the court noted that certain restraints upon interstate commerce were designed to, and did in fact, eliminate harmful bid peddling.[13] This is the first judicial acknowledgement of the possibility that depository restraints may be economically more reasonable than free bidding.

The second case, *Mechanical Contractors Bid Depository v. Christiansen*,[14] contains more stringent boundaries of antitrust legality. Depository rules against bid splitting and late bids were overturned in

[13] 1958 Trade Cas. ¶ 69,087, at 74,305:

> The rules of the bid depository, other than Rules 6, 8, and 12 B, imposed only reasonable restraints upon interstate commerce in that they were designed to and did eliminate the practice of bid peddling. The defendants established the bid depository primarily to eliminate bid peddling and, except as hereinbefore stated to the contrary, their purpose was not to place unreasonable restraints upon interstate commerce.
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> . . . .
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> The effects, if any, on interstate commerce as a result of the enforcement of the rules of the bid depository, other than Rules 6, 8, and 12 B, are speculative and inconsequential.

[14] 352 F.2d 817 (10th Cir. 1965), *cert. denied*, 384 U.S. 918 (1966).

Christiansen upon a rationale identical with that in *Bakersfield*. But the thrust of the opinion dealt with a rule under which those general contractors who elected to take bids from the depository were required to award the subcontract to one of the depository bidders. Since only members could submit bids through the depository, the rule divided the market into depository members and nonmembers. The proof at the trial showed that those general contractors who violated the rule were boycotted by the member subcontractors. The Tenth Circuit affirmed the lower court's holding that this rule, considered with the others "and *as implemented by the acts and practices of the depository,*"[15] was a violation of sections one and two of the Sherman Act.

The italicized qualification above cannot be overemphasized, for it suggests those principles within which depositories may operate. If depositories are to combat bid shopping and peddling, they must be able to prohibit post-award negotiation between general contractors and subcontractors. Of course, no prohibition is effective unless it also includes a sanction, and the only commercially feasible sanction which a group of subcontractors might hold over the prime contractor is the requirement that if he solicits the depository bids, he must use one of them. *Christiansen* does not interdict this sanction, but when the sanction is combined with closed membership and black-listing, it then becomes prohibited. Conceivably, a bid depository whose rules include neither of these two additional sanctions, or perhaps only one of them, would be tolerated in the Tenth Circuit.[16] Unless a depository can demand this commitment to accept one of its own bids from general contractors, and unless it can enforce the commitment by fine or suspension, it will not be able to lessen destructive bid shopping or peddling. Any other purposes it might serve — bid advertising, uniformity, cost analysis — have little competitive value by comparison.

Exclusivity of use by the contractor is not the only "gray" area of depository antitrust law. Whether the depository can be mandatory upon members and whether it may require bonding capacity information on the bid are both debatable propositions. Admittedly, the former would tend to controvert the principle of *Addyston Pipe* that the crucial antitrust consideration is "the effect of the combination in limiting and restricting the right of each of the members to transact business in the ordinary way . . . ." [17] The latter

[15] *Id.* at 819 (emphasis added).

[16] The modified *Bakersfield* decision approved a bid depository agreement with the following language: "[N]o bid shall be delivered to a general contractor until said contractor has agreed in writing to accept the bid if it is the low bid accepted through the depository." United States v. Bakersfield Associated Plumbing Contractors, Inc., 1959 Trade Cas. ¶ 69,266, at 75,039 (S.D. Cal. 1958).

[17] Addyston Pipe & Steel Co. v. United States, 175 U.S. 211, 245 (1899).

would tend to prejudice a contractor, albeit with possible justification, against subcontractors without the necessary financial history to secure a bonding commitment.

There are other unresolved questions. A depository fee in excess of that needed for simple administration may be economically warranted if the depository were distinct from the industry and therefore entitled to generate its own profits, or if it were rendering additional services of compiling, analyzing, and publishing bids. A standard form specifying that every component of the bid is included unless otherwise noted would eliminate the practice of "breaking out" items, *i.e.,* altering the elements of one's bid after bid opening, as an alternative method of bid peddling.

The reasonableness of bid depositories under the Sherman Act, then, should depend upon the exigencies of the market place. An industry riven by bid shopping must be allowed the competitive tools necessary to unify itself. The applicable criteria for those tools can be derived from neither static principle nor vagrant precedent; like any antitrust guidelines, they must be sufficiently malleable to adjust to the economics of the situation.

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