Lenny Vulperhorst

Undisclosed Enterprise

Builders, government and the end
of the construction cartel (2001-2005)

[Table of contents, first chapter and summary of Undisclosed Enterprise.
Translation of Verzwegen onderneming, Ondernemers, overheid en het einde van het
Thesis, Leiden University, October 2005]
## Contents

Chapter 1: Introduction 1

1. Personal involvement 1
2. Formulation of the issue 1
3. What this book is not about 2
4. Comparisons 3
5. Chapter organisation 4
6. Research methods 6

Part 1

Chapter 2: “We are going down, down….” 7

1. Prelude 7
2. Revelations, and from denial to some degree of frankness 9
3. Hearings 19
4. Awaiting the inquiry report 19
5. The report of the parliamentary committee of inquiry 21
6. Confusion 24
7. Hardening attitudes 26
8. Temporary reconciliation 29
9. Renewed hardening 30
10. Duplicate books in the homes and offices sector 31
11. Curtains 34
12. Settlement 36

Chapter 3: The world of the building contractors before the *Zembla* broadcast 46

1. What you don't know … 46
2. Business culture of permitting 50
3. Keeping quiet 51
4. Stopping 53
5. Conflicting values 55
6. Group pressure 62

Chapter 4: Entrepreneurs in late 2004 on features of the system 63

1. Approach 63
2. What ought directors to know? 64
3. Permitting 67
4. Keeping quiet goes without saying 68
5. Two worlds 69
6. Stopping is difficult 70
7. Clean break in 2001? 72
8. Stopping the cartel  74
9. Values?  75
10. A man's world  76
11. Between resentment and hope  77
12. Resignation by those responsible  78
13. Competition  80
14. Guilt, but no shame  81

Part 2
Chapter 5: The vulnerability of construction  82
1. Irregularities  82
2. Construction fraud among EU neighbours  84
3. Italy  86
4. New York  90
5. Australia  91
6. Japan  92
7. Vulnerability as structural feature of construction  93

Part 3
Chapter 6: Findings, observations and amazement  97
1. Undisclosed enterprise as natural response  97
2. Internal divisions among building contractors  98
3. The building trade's susceptibility to illegal activities  99
4. Closed industry  100
5. Conflicting values  101
6. The question of stopping  102
7. Amazement  102

Chapter 7: Collusion  104
1. Conspiracy between public and private sides  104
2. Dutch practice  105
3. Secrecy  106
4. Live and let live  107
5. Why 2001?  107

Chapter 8: Crisis  110
1. Parliamentary inquiries  110
2. Crisis  110
3. Institutional Crisis?  111
4. The course of a crisis  112
5. Effect of a crisis  112
6. Crisis in companies  113
7. Effect of company crises  114
8. Restoring reputations in construction  114
6.5 Healthy construction business needs new entrepreneurs  145

Bibliography 149
Footnotes 153
Persons consulted 178
Subject index 179
Chapter 1
Introduction

In 2001, the clandestine self-regulation model in the construction industry gradually began to emerge. What started with a single whistleblower telling his story on the TV programme Zembla on 9 November 2001 grew into a parliamentary inquiry, unprecedented mistrust between the government and the construction industry, and a structural crisis in building companies’ business methods.

While all the pieces have still not been picked up, there is now a widespread awareness that things have to change in the building trade. Putting a stop to the old system, thinking about the new one, investing in a new business model and actually changing: these are the four steps that building contractors have to take to renew their companies and the industry.

1. Personal involvement

I have been working in the building trade as a consultant for years now. I advised the building employers, the Federation of Dutch Contractors’ Organisations (AVBB), during the parliamentary inquiry; I supported and continue to support construction companies who do business (or want to do business) with government customers in different ways (public-private partnerships; new forms of contract) and at the moment I am helping companies to adapt their business models to the new market conditions. I also act as a consultant to public and private customers of the construction industry.

This consultancy work has let me take a look behind the scenes during the current construction crisis, and I am (and have been) privy to the thinking and actions of contractors and public sector customers.

And so that unique circumstance was the immediate occasion for writing this book. That crisis had to be described! But not primarily to point the finger, as journalist do (1) or as I have previously done myself in a series of short essays (2), but with more distance and more appreciation of the specific circumstances, motives and historical background. What I am doing in this book is reordering facts, events, perceptions and judgments. That gives different insights from those I initially had. And of course that is a refreshing re-education for a consultant.

This book records what happened to the construction industry in the Netherlands in the period 2001-2005. I will also try to find explanations why the system of clandestine self-regulation could function undisturbed and why the main players on the private side actually considered it normal. The purpose of this book is to make a contribution to exposing the “mechanisms” behind the existence of the construction cartel and its end.

Together with Marcel Beerman, I once wrote a doctoral thesis on the basic politics of social democracy in the post-war Netherlands. (3) That study was of a historical and politological nature, and was politically and socially important at the time. I hope that the present study will also be characterised in the same way.

2. Formulation of the issue

At the end of 2002 I was speaking to a building contractor who turned out to have been a key figure in one of the building industry cartels over many years. I had worked with his company for years on modernising business practice. The kind of questions we worked on were: How can we respond better, and above all sooner, to our customer’s wishes? How can we provide our customer with more added value than the average building company? What forms of contract can we use to give us more responsibility for building projects?
That discussion took my breath away. How is it possible that contractors I have known for years, who make the impression of being solid citizens, suddenly turn out to have led (or be leading) a kind of double life? And when that “secret” is then rudely exposed, they turn and twist to avoid admitting that “it” was true. “Of course there were companies that ..., but we ...”. “In some sectors, certainly, where...”. “I can’t rule out the possibility that it might have happened in our company”. “It was restricted to a few sectors...”. “It certainly wasn’t true of all works”.

And when finally the game is up and the Dutch Competition Office is swamped with the second sets of books that have been hidden away in henhuts, sheds and the boots of leased cars, they are not even sorry. They just shrug their shoulders and adjust to the new situation.

Asking what kind of people are these building contractors and why did they find clandestine conspiracy so normal? cannot really be called formulating the issue. And yet that simple question gets very close to the central issue of this book, because I deal primarily with how those building contractors behaved during the crisis that arose in the building industry in 2001 and is now, in 2005, being dealt with legally and financially.

Sub-questions that are dealt with in this book in no particular sequence are:

- Why did building contractors go on denying what had already been made public for so long?
- What did directors and managers know about the clandestine self-regulation?
- How did it work to act illegally within legal enterprises or to permit action of that kind?
- How did keeping quiet work? Who did you keep quiet towards, and when?
- What codes did the group use among themselves? How did the group stay closed?
- Why did the contractors not stop (or stop earlier) on their own initiative?
- What values did building contractors actually apply themselves? And how do they think about what was possible and what was not possible?

I have tried to understand the way the contractors behaved in response to the structural crisis that hit the construction industry after the Zembla broadcast. There was a great deal of negative publicity, there were disclosures, the parliamentary enquiry into the construction industry handed down a devastating judgment, the Public Prosecutions Department prosecuted suspected companies and individuals, the Dutch Competition Office punished cartel agreements with heavy fines, the Fiscal Intelligence and Investigation Department wanted settlement for illegal cash flows (pumping round “gingerbread”), and duped government customers were looking for ways to claim back money for mala fide tendering.

3. What this book is not about

This book is not a treatise on market regulation. In its report Taking the Construction Industry out of the Shadows (4) the Vos Committee, the parliamentary inquiry into the construction industry, showed that various different cartels were active in the construction industry at times when projects were being placed. Some were organised by sector, others by region. And occasionally even specifically by customer. These cartel agreements are also described in detail in appendices to the committee’s report. (5) The actual functioning of cartels and forms of contracting are outside the scope of the project, as is an analysis of the effect of economic competition or a testing of the clandestine system against economic game theories. The aim is to show why contractors in the building trade went underground, and why they thought (and continue to think) that this was “normal”. Following from this, it is relevant to analyse how those involved within that system actually operated and justified their behaviour then and
now. In this book, I deal only with the way in which contractors behaved in the project acquisition phase. International research shows that there were also many irregularities in the preparatory, implementation and operational phases, but I do not deal with these. (6)

Nor is this book about tendering in the construction industry. Of course this was how the market and the public sector arrived at contract agreements, but the Vos Committee has written a great deal about that tendering process too. (7) But it is relevant that the cartels were only able to function because the government’s tendering policy and the industry’s own system of market regulation, with its own institutions and “code of conduct” (as it was so inappropriately called), fitted together so seamlessly. Prior to 9 November 2001 the government’s tendering policy and the system of clandestine self-regulation suited each other perfectly. The government placed orders at the lowest price that was offered and the cartel of building contractors ensured that they arranged among themselves who was allowed to offer the lowest price. The company submitting the lowest tender made a payment (known as the calculation fee) to the other companies, and these costs were charged on to the customer. At times the price was further adapted because there was scope to do so within the customer’s estimate price. So “lowest price” was the ideal way to make the clandestine self-regulation run “honestly”. It was the perfect mechanism for controlling the outcomes of tenders, since it was easy to make arrangements on the price that no-one would break.

When the cartel was forced to stop, “lowest price” immediately boomeranged back on the construction industry, with the result that a true price war broke out, making customers more and more convinced by the day that they had been paying too much in the past.

Nor is it my intention to deal with a number of awkward questions that still remain unanswered after the parliamentary inquiry. Questions like “Just how much did the economic detriment to customers amount to?” and “What has happened to all that money anyway?”, while of major social and economic importance, are not central to this book. I am assuming that there has been detriment. And the size of that detriment will either remain guesswork or can be reconstructed from the court rulings on the civil actions brought by aggrieved customers. The same applies to the question what has happened to the money. As the construction industry is a sloppy and badly organised industry, I think it likely that the money has mainly been frittered away.

Another issue I will not deal with is the position and role of supervisory board members. A single observer has expressed sharp criticism of supervisory boards’ supervision of the goings-on within their companies, but only one member of a supervisory board has made any public statement. And while internal supervision is an extremely interesting theme, it falls beyond the scope of this book.

Finally, this book is primarily about the actions of building contractors, and only secondarily about government. So this book is not a critical treatise about the role played by government or about government construction policy. The authorities play only a supporting role in this book.

4. Comparisons

This book does expressly raise the question whether what has now happened in the Netherlands is actually all that unusual. It would be an illusion to think so. The building industry in many Western countries, and also in South-East Asia, is open to all kinds of illegal activities: illegal work and undeclared employment; extortion by trade unions; price-fixing
agreements; corruption; laundering of undeclared money; and so on. So what has been going on in the Netherlands is far from unique. That then raises the interesting question how other countries try to regulate the construction industry in order to deal with illegal activities effectively.

The construction industry has not been investigated systematically in the countries I have covered. My aim has been to give an impressionistic picture of recent minor and major crises in the construction industry in western Europe, the United States, Australia and Japan.

A second comparison considered in this book is the comparison with the culture of illegal enterprises, since even although building companies are legal enterprises they still engaged in part in illegal activities. Hence the book’s title: “undisclosed enterprise”. In Oxford there is a group of academics who are researching what they call “the industry of protection”. (8) By this they mean the activities of the mafia in Sicily and comparable criminal organisations e.g. in Russia and Japan. Descriptions of the behaviour of “entrepreneurs” engaged in illegal (and legal) activities are given a great deal of attention in their publications. I have tried to characterise the illegal business practices of Dutch building contractors with the help of the characteristics they describe.

That does not mean that I am equating Dutch building contractors with mafia-type organisations; not at all. However, I am comparing their illegal business practices with those of the most “reputed” illegal business enterprise. After all, the criminologist V. Ruggiero has pointed out that an analysis should not be based on the perpetrators (white-collar criminals or professional criminals), but on the acts: “corporate and organized crime often share the same illegal know-how and should be jointly analysed irrespective of the social characteristics or background of their perpetrators”. (9)

5. Chapter organisation

This book consists of four parts. (10) The Dutch construction industry crisis is described in part 1, while part 2 describes irregularities in the construction industry in adjacent countries. Part 3 looks for explanations from various perspectives. Part 4 formulates the task for the coming years.

Part 1 consists of three chapters.
The period 2001-2005 is documented and the bewilderment and even amazement of the building contractors (“We’re being treated like criminals! What have we done wrong?”) is reported in chapter 2. I describe the events in a predictable sequence (moving from total denial to total admission, in a very large number of stages). This is done in detail for the period to mid 2004 in chronological sequence in Appendix 1.

Then in chapter 3 I deal with the features of the clandestine self-regulation, mainly using statements made by building contractors before and during the parliamentary inquiry. My intention is to record how building contractors were viewing the crisis in their industry in 2002. Later statements that really belong to the denial phase are also used here.

Chapter 3 is about “knowing” and “not knowing/not wanting to know”, about permitting (illegal practices), and about keeping things quiet and attempts to stop. An interesting question here is whether there is a difference between the principles which determine the thinking and actions of contractors on the one hand and of society and politicians on the other hand. Precisely because building contractors thought and acted on different principles than politicians and society, the structural crisis was not smoothed down or resolved quickly but instead was exacerbated.
Chapter 4 digs down one level deeper. Building contractors lived in their own closed world and were able to carry on undisturbed. And the crucial fact is that collusion was involved: public sector customers and construction firms were both aware of the existence of the clandestine system, and the authorities looked the other way. Even although they knew about it, they didn’t want to know, and that kept the system going knowingly and willingly, even to the extent of repeatedly ignoring all kinds of warning signs. Obviously there were mechanisms that produced that result and the benefits of the illegal system were greater than the drawbacks for both sides.

Once the construction fraud was discovered, there was an inevitable chain reaction. But curiously the people actually involved do not (did not) see it that way. For as long as possible, they ignore warning signs, they put off the move away from the old system, and they repeat detailed arguments for the necessity and advantages of the system over and over again while keeping their fingers crossed that things will suddenly get back to normal. It is only under extreme pressure (in this case, a new scandal early in 2004 that made the Lower House decide that companies that did not put all their cards on the table would be excluded from government contracts) that openness is achieved and the old system is actually abandoned. Additional interviews with directors of major firms were conducted in late 2004 for this chapter. I spoke to them about the features of the closed system in the construction industry. Their (anonymised) views can be found in this chapter.

Part 2 is comparative in nature. Does the building trade also work this way in neighbouring countries? And if so, what are the correspondences and differences with the way the building industry operates in other Western countries? To what extent are “construction scandals” a normal feature of the construction industry? Chapter 5 attempts to answer the question whether the Dutch construction cartel is just a fortuitous form of organisational crime, or a more or less regular form.

Part 3 consists of chapters 6 to 12. In chapter 6 I draw provisional conclusions and ask how I am to interpret them. The next five chapters then deal with different perspectives from which the main questions of the study can be answered. These perspectives are the collusion approach of the Maastricht criminologist G. van den Heuvel, the crisis approach of the Leiden management expert U. Rosenthal, the school of the Italian criminologist D. Gambetta (“industry of protection”), the approach that argues from facts (M. Douglas, H. van Gunsteren, F. Varese) and finally the sociological approach of denial (S. Cohen). Each of the perspectives (no matter how different they are) proves to have explanatory value for a specific episode of the construction industry crisis or for specific features of it, so in that sense the approaches are complementary.

Part 4 looks forward. In chapter 13 I formulate the changes that are desirable and I make recommendations. I also develop the Business to Public (B2P) concept further. B2P is a concept introduced by me that argues that contractors are trained at business schools in business concepts that are unserviceable for doing business with government customers. Business to Consumers has little to do with the construction market, where only a modest part of the turnover is carried out directly for consumers. Business to Business is itself probably part of the explanation of the system of clandestine self-regulation. After all, it is quite rational for companies to wheel and deal when doing business with each other, but when a company is doing business with the government that model simply ends in tears. B2P assumes that doing business with the government has to proceed in a different way from doing business with other businesses or with consumers; it demands that companies should
underwrite the rules in the public domain and do business out of a sense of social involvement.

6. Research methods

For chapters 2 and 3 I have based my research largely on the enquiry into the building industry, collections of newspaper cuttings (the AVBB’s collection on this subject is complete from November 2001 on), research conducted for the parliamentary inquiry, and excellent books on the inquiry by journalists from *NRC Handelsblad* and *De Volkskrant*. All this information is available to the public. I have also conducted interviews with building contractors and consulted documents held by employers’ organisations in the construction industry. And finally I have conducted interviews with a number of members of the Lower House and with senior officials of government bodies who were involved in dealing with the inquiry.

Chapters 4, 5, 7, 8, 9, 10, 11 and 12 are based on literature research, analysis of current discussions on the building trade in a number of countries and additional interviews with directors of large construction firms.

Chapter 13 further develops insights by academic experts, builders and consultants on the future of the construction industry in the Netherlands.

Appendix 1 is based on a detailed survey of construction companies on culture change and the updating of the building trade’s business model. That survey was conducted in April 2004 among contractors employed in 100 major construction firms. The response to the survey was sufficient to give a picture of building contractors’ thinking on culture change. It is particularly important that replies were received from all the larger firms, as they represent the lion’s share of the construction turnover in the Netherlands. There was also a sufficient spread across the various sectors of the construction industry.

As well as public information, I have also made use of confidential information that was available to me as a consultant in the period 2001-2004. I made no attempt to switch off my memory, but of course since in this book I have based my treatment only on information that is also available to others and because I wish to avoid my selectivity proving decisive for the outcomes of this book, I cannot draw on that confidential information. At the same time, thanks to what I know I am able to ask rather more pointed questions and follow up on issues, although again this only works as long as the answers are supported by sources that can be consulted by the reader.
Summary

In a television programme on 9 November 2001, a former director of the Koop Tjuchem construction company revealed that construction companies were guilty of price-fixing agreements and bribery. He substantiated his story by showing the shadow bookkeeping used at the company where he worked. Politicians and other media reacted strongly. The ‘building fraud scandal’ was born, and a parliamentary inquiry ensued. The Public Prosecutor raided companies and proceeded to litigate. The Dutch competition watchdog NMa became active and fined the industry hundreds of millions of euros. And aggrieved customers claimed reimbursement, assuming that contractors had overcharged them. Initially, contractors denied any involvement in wrongdoing, but after disclosures and public hearings they were slowly forced to admit that large-scale illegal price-fixing agreements had been made throughout the construction industry.

The book details the development of the crisis in the construction industry, from the disclosures in November 2001 to mid-2005. Extra attention is devoted to how contractors ‘denied’ in 2002 that the industry was guilty of foul play. The contractors responded as all offenders respond: “I didn’t know”, “Everyone’s doing it”, “We didn’t cheat anyone”. “We thought that the government allowed it”. It was also argued that the illegalities only took place in part of the construction industry. This is the classic defence of the white-collar criminal who considers the ‘illegal’ as a (minor) aberration to an otherwise normal existence.

Internationally, the construction industry seems to be susceptible to irregularities. Many countries have experienced similar construction scandals and repeated major and minor scandals. The leitmotif in the contractors’ behaviour is clandestine self-regulation: contractor collusion in influencing prices and dividing up the market. Moreover, bribing public officials is almost a normal business activity in many countries. Exposure and punishment temporarily disrupt the clandestine self-regulation. Government regulation (e.g. blacklisting ‘illegally operating’ companies) and stringent supervision of competition and corruption are designed to prevent structural irregularities in the construction industry. With varying success.

The construction crisis is analysed from various perspectives to ascertain why contractors blatantly ignored the law until November 2001. The close relationships between politicians, civil servants and contractors prior to 2001 ensured that no one lost any sleep about cartel agreements prior to 2002. The specific style of customer relationship management (attending football matches, the theatre, restaurants at the contractor’s expense, etc; offering luxury gifts) was also considered to be normal behaviour in soliciting work for the construction industry. This collusion between the public and private sector ensured that there could be no correction for irregularities: after all, everyone was to blame.

Another perspective is to look at crises. How are crises created, what damage do they cause and what can you do to control their effects? It is striking that no one in the building fraud scandal appears to have been prepared. Politicians, civil servants and contractors all improvised. The contractors manoeuvred themselves into a corner so that they could only ‘deny’ their wrongdoing. They were repeatedly overtaken by new developments. Lawyers recommended that they use a damage control strategy of keeping quiet as long as possible and doing nothing to weaken their legal position. Contractors differ from criminal entrepreneurs. Contractors engage in legal business activity while criminal entrepreneurs practice illegal business activity. Nevertheless, when contractors conduct illegal business, their actions appear to be very similar to criminal entrepreneurs:
mutual trust, silence, their own language and codes, etc. An important distinction, however, is that (threat of) force was not necessary for effective clandestine self-regulation in the Netherlands: mutual trust ensured sufficient cohesion within the cartel. How group behaviour maintains itself is a fourth approach. Prior to 2001, contractors had their own ‘cultural facts’. They lived in a fairly closed world with their own ethics and values. They were also convinced that ‘they were forced to participate’. Individual accountability was subordinate to collective behaviour. Even contractors who did not participate in the cartel kept quiet about their colleagues’ behaviour. Finally, the ‘denial’ is analysed. In scores of cases, denying criminal acts appears to be the way to continue without shame. Denial however appears to recur via the same patterns and reasoning. The contractors’ denial was stereotypical behaviour for offenders. It is difficult to understand why contractors were not ashamed of their criminal acts (at the time).

The book concludes with an appeal to conduct a new style of business with the government. Contractors can only win back the trust of government customers when they understand what social added value provides, when they conduct business honestly and transparently, and when they assume the position of service providers instead of capacity suppliers. Public authorities should provide a healthy investment climate and offer room for reform. Ultimately it all revolves around professional customers and new, inspiring contractors.