Fine builders and recruiters

The OFT has hit the construction world twice recently

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On 22 September 2009, the UK Office of Fair Trading announced its decision that 103 construction firms had infringed UK competition law (the Construction Cartel). They were fined a total of £129.5m for engaging in bid-rigging activities, mostly in the form of "cover pricing" – a breach of the Chapter I prohibition of the Competition Act 1998.

Cover pricing is where one or more bidders obtains a cover price from one of their competitors and submit a tender bid in the knowledge that it will be too high and will not win the contract. The rationale is that where a company is not a serious bidder for the contract, it can submit a bid without incurring the cost of producing an estimate. It also avoids any risk that it will be blacklisted for not having submitted a bid. The competition issue is that cover pricing creates the artificial impression of a competitive process. The inference is therefore that the winning bid is unlikely to be reflective of the bid that would have been successful in the absence of collusion between competitors. In some cases, the OFT found that the "willing losers" in the bid for a contract were paid compensation payments of between £2,500 and £60,000, which the OFT found to aggravate the severity of the infringement. (See the facts box below for more background information.)

The OFT was simultaneously conducting an investigation at the recruitment level within the construction industry. On 30 September 2009, the OFT announced that it had fined six recruitment agencies a total of £39.27m for infringing competition law (the Recruitment Cartel). The OFT found that eight companies had formed a cartel and agreed (1) collectively to boycott a new market entrant; and (2) to fix target fee rates for the supply of candidates to intermediaries and certain construction companies in the UK. (See the facts box on p4 for more background information.)

Importance of Construction Cartel investigation

This investigation was noteworthy for several reasons:

(1) As a result of the size of the investigation and the number of parties involved, the OFT adopted a novel approach to leniency by closing the door on leniency applications in March 2007 and offering a fast-track procedure in its place – an approach endorsed by the High Court in the 2009 *Crest Nicholson* (Crest) appeal. The new procedure involved offering parties a reduced financial penalty of up to 25% in return for (a) admissions based on the OFT's allegations contained in the fast-track offer letter; and (b) a commitment to ongoing co-operation in the investigation.

(2) In its investigation, the OFT concentrated only on certain

Facts box: Construction Cartel

- **2004** The OFT initiated its investigation following receipt of a complaint in relation to the building contracts at Nottingham's Queen's Medical Centre (East Midlands). It carried out dawn raids at over 50 companies and employed digital evidence gathering and forensic IT for the first time to search for electronic documents stored on computers.
- **March 2007** The OFT announced the fast-track offer. It explained that it intended to offer reduced financial penalties to companies implicated in the alleged infringements which had not yet applied for leniency, but which were prepared to admit to bid-rigging and co-operate with the OFT's investigation.
- **April 2008** The OFT issued its statement of objections which identified 112 construction companies alleged to have been involved in illegal bid-rigging activities.The charge specifically related to the issue of cover pricing. The OFT also alleged that a minority of companies entered into arrangements whereby the "willing loser" would be paid compensation, usually in the form of false invoices, for entering an unsuccessful bid.
- **22 September 2009** The OFT reached its decision and imposed fines. It found that 103 companies had engaged in illegal bid-rigging on 199 tenders between 2000 and 2006, mainly in the form of cover pricing.

The parties' apparent intention was to stay on the contractor's tender list without having to go to the expense of compiling a full estimate. The OFT found that this gave the contractor the illusion that there was more competition in the market than was in fact the case. The OFT concluded that, in relation to 11 contracts, the lowest bidder faced no genuine competition from other tenderers. This led to an increased risk that the customer paid a higher price than would have been the case in a competitive market.

The OFT found that, in six cases, compensation payments were made by successful bidders to willing losers. The highest individual fine imposed was on Kier Regional Ltd (and its parent, Kier plc) of £17.9m. Total fines amounted to £129.5m, an average of 1.14% of the parties' annual turnover. Under the OFT's leniency policy, 33 parties benefited from discounts on the fine imposed of between 35% and 65%. Under the fast-track procedure, 41 parties received a discount of up to 25%. In the absence of leniency and the associated penalty discounts, the fines would have amounted to £194.4m.

Although fines are usually payable within two months of the OFT's final decision, the OFT offered all parties the option of paying the fine in instalments over three years. The OFT made this offer for two reasons: (1) the current economic climate; and (2) to avoid the OFT having to deal with the large number of expected requests for special payment terms.

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regions in the UK within a specific timeframe of between 2000 and 2006, despite recognising that the practice of cover pricing was endemic throughout the UK construction industry.
(3) It was the largest investigation that the OFT has ever embarked upon and resulted in the largest combined fine to date imposed by the UK watchdog (exceeding the £121.5m individual fine levied on British Airways in 2007 for its role in a passenger fare conspiracy).
(4) The OFT took the economic climate into account by offering parties the option to pay their fine over three years rather than the statutory period of two months from the date of the OFT's final decision. However, the OFT made it clear that the declining economic climate cannot be used as an excuse by companies for participating in anticompetitive activities. This is a move that does not yet appear to have been mirrored by the European Commission.

It will be interesting to see if the OFT adopts the fast-track procedure in future cases and, if so, whether it will produce explanatory guidelines. For instance, it is not fully apparent how the fast-track procedure would operate in comparison to leniency applications: at what juncture would the leniency door shut; and would leniency applicants always be better positioned than a party which accepts the fast-track offer? These questions arise partly because the fast-track procedure offered a relatively high reduction in penalty of up to 25%. The largest reduction applied to the fines imposed in the Recruitment Cartel, as a result of leniency, was 35% (excluding full immunity for the whistleblower) – not much higher than a maximum reduction under the fast-track procedure of 25%. By way of comparison with the OFT's fast-track procedure, the European Commission's settlement procedure only offers a reduction of 10%.

The benefits that the new procedure offered to the OFT in this case are clear: it sped up the investigatory process and reduced the OFT's evidentiary burden. However, the decision whether or not to accept the fast-track offer was perhaps not so clear-cut for the parties concerned, particularly without the benefit of any precedent cases or procedural guidance. On the one hand, while the reduction in any potential fine was less than could be granted based on leniency, it was still significant given that the parties were not necessarily alerting the OFT to new information. On the other hand, the procedure required parties to accept the offer without having had sight of the full extent of the OFT's allegations and evidence contained in its statement of objections (SO) – or even, apparently, as provided in a short-form SO under the European Commission's procedure.

Indeed, Crest argued in its appeal before the High Court that it had not been fairly treated because it had even less information available to it on which to base its decision than other parties. This was because the OFT's allegations concerned a former subsidiary (sold prior to the commencement of the OFT's investigation). While the High Court concluded that the fast-track procedure itself was fair and the OFT was "entitled to adopt the approach it did", it agreed with Crest that it could not have reasonably assessed whether to accept the fast-track offer based on the information available to it. The High Court could not require the OFT to exercise its discretion in relation to any fine it subsequently imposed. But it will be interesting to review the OFT's full decision to assess the extent to which it took the High Court's comments into account when calculating the fine.

Recruitment Cartel investigation

The form of the OFT's investigation in relation to the Recruitment Cartel was procedurally less noteworthy because the scale of it was so much smaller. Nonetheless, the OFT considered that the parties had committed a serious infringement of competition law as reflected in the level of the fines. Indeed, the highest individual fine imposed – £30.4m for Hays Specialist Recruitment Ltd (Hays) (with a 30% reduction for leniency) – was significantly higher than the highest fine imposed in the Construction Cartel (£17.9m on the Kier Group, with no reduction for leniency). The OFT said:

Facts box: Recruitment Cartel

- **December 2005** The OFT received a leniency application from Select Appointments (Holdings) Ltd as the parent company of two recruitment companies who had engaged in the anticompetitive behaviour.
- **July 2006** The OFT announced that it had conducted dawn raids at several business premises as part of an investigation into anticompetitive behaviour in the provision of recruitment services for the construction industry.
- **October 2008** The OFT announced that it had issued a statement of objections to eight construction recruitment agencies alleging breach of the Chapter I prohibition.
- The two whistleblowers received 100% immunity from fines. Three of the remaining four companies applied for leniency and received discounts of between 20% and 35%. The fourth company, which is in administration, was the exception but received a low fine of £3,000.
- **30 September 2009** The OFT announced its decision and imposed fines on six recruitment agencies.

The OFT found that eight recruitment agencies formed a cartel (the Construction Recruitment Forum) in response to market entry in 2003 of Parc UK Ltd (Parc). Parc had entered as an intermediary between construction companies and recruitment agencies for the supply of candidates to construction companies. The OFT considered this to be a "new and innovative" business model. The recruitment agencies were concerned that such intermediaries threatened their margins.

The Construction Recruitment Forum met five times between 2004 and 2006 and engaged in the following anticompetitive conduct: (1) a collective boycott, with the agencies agreeing to withdraw from and/or to refrain from entering into contracts with Parc for the supply of candidates to construction firms in the UK; and (2) price-fixing. The agencies entered into an agreement/concerted practice to fix target fee rates that they would charge to intermediaries such as Parc and certain construction companies for the supply of candidates in the UK.

Hays Specialist Recruitment Ltd received the highest individual fine of £30.4m (including a 30% leniency reduction).

"Cartels such as these can impact on other businesses, in this case construction companies, by distorting competition and driving up staff costs. Ultimately it is the consumer and the wider economy that loses out from such behaviour."

Limited scope of Construction Cartel investigation

The OFT focused its Construction Cartel investigation solely on the East Midlands, Yorkshire, Humberside regions and surrounding areas, although it has said that the practice of cover pricing is endemic in the industry throughout the UK. However, it would be difficult to see how the OFT could have handled an even larger investigation across the entire country within a reasonable timeframe. It had to introduce the fast-track procedure in order to cope with the scale of the investigation based on these regions alone.

At the same time, it is perhaps understandable that the construction companies forming the Construction Cartel might feel aggrieved that companies not active in the targeted regions were left unscathed by the OFT. They have the sympathy of the National Federation of Builders (NFB), which represents 1,500 small to medium-sized construction firms. The Federation said: "it does therefore seem unfair that a small, random sample of companies has been selected by the OFT to be punished as an example to the wider industry". The Competition Appeal Tribunal has already published guidance to companies who intend to lodge an appeal against the OFT's decision (which they must do within two months of receipt of the OFT's decision).

Indeed, the OFT itself appears to have recognised the limitations of the scope of its investigation. At the same time as announcing its decision to fine the construction companies, the OFT released an information note to local authorities and other procuring entities highlighting that the parties named in the OFT's press release could not be assumed to be the only companies who had engaged in anticompetitive behaviour in relation to tenders. The OFT acknowledged that cover pricing was a widespread practice which extended far beyond the limits of its investigation. The OFT stated that it had uncovered evidence affecting over 4,000 tenders involving over 1,000 companies during its investigation but focused on just over 240 suspected infringements in the East Midlands and surrounding areas where the evidence was strongest. The OFT recommended that the 103 companies named in its press release should not be excluded from future tenders or treated more harshly than other companies during tender processes. Additionally, it suggested that those companies are particularly unlikely to engage in future anticompetitive activities, because they are under an obligation to put their houses in order.

Impact of the Construction Cartel investigation

Despite the OFT's acknowledgement and its note to the procuring entities, one must assume that the OFT's investigation has had some impact on the reputation of the companies named in the investigation. The publicity attached to the investigation will also have exposed named companies to the risk of private damages actions. However, while any claimant does not need to prove the infringement (because the OFT has already done this), it must prove that it has suffered loss and the quantum of that loss. This is a heavy burden. Moreover, potential claimants will not be able to launch a claim until any appeals of the OFT's decision have been concluded (thus settling the issue of infringement).

One may speculate whether spotlighting the construction industry was the best use of the OFT's resources. However, it was not a totally surprising course of action, given that the OFT had previously reached decisions condemning cover pricing. Between 2004 and 2006, the OFT took five decisions (in the roofing contractors cases) where it found cover pricing arrangements to be illegal – an approach subsequently endorsed by the CAT in the 2005 *Apex Asphalt and Paving Co Ltd* and *Richard W Price (Roofing Contractors) Ltd* cases. The OFT's message is now shiningly clear: bid-rigging breaks the competition law rules. Indeed, the NFB and the UK Contractors Group have introduced a new code of industry practice in order to reduce the risk of future breaches of competition law within the construction industry. Companies outside the construction industry, where tendering is common, may also be taking a long, hard look at their own compliance procedures in the light of the OFT investigation.

Recruitment cartelists' grievances

Those involved in the Recruitment Cartel have voiced their own grievances. Hays has stated that it is considering an appeal of its fine which, it felt, was "wholly disproportionate with the activities to which it relates, Hays' involvement in those activities and the way in which the OFT has dealt with other cases in the past". Indeed, Hays' fine was the second highest individual fine imposed by the OFT to date for breach of the Chapter I prohibition. The crux of Hays' grievance appears to be its claim that the infringement "related to an isolated matter arising solely from the conduct of a single employee who is no longer with the company and affected only a small part of our UK construction and property business".

It will be interesting to review the full text of the OFT's decision in order to understand how it calculated the fines for each party. Appeals of fines based on discrimination arguments have, in the past, proved successful. For example, in *Nintendo v European Commission* (2009), the Court of First Instance agreed that Nintendo should have been granted the same reduction in its fine (at the relevant stage of its calculation) as John Menzies plc, since both parties co-operated and provided the Commission with information of comparable value.

It will also be instructive to compare the OFT's methodology in setting the Recruitment Cartel fines with that used to set the Construction Cartel fines. In the Construction Cartel, more generous awards of leniency appear to have been made – up to 65%, compared with 35% in the Recruitment Cartel (excluding the parties which received full immunity). However, the CFI pointed out in *Nintendo* that the European Commission's previous decisions could not serve as a legal framework for the imposition of fines in other cases and could only provide an indication of whether there might be discrimination.

Whatever the outcome of any appeals, the resounding conclusion that one must draw from both cartel cases is the paramount importance of compliance training for all staff.

At the time of writing, the Office of Fair Trading had not published its full decision in either case and no appeals relevant to the Construction Cartel had been launched.