

Building a cartel

The UK construction industry is under the spotlight again

by *Marceline Tournier and John Pheasant**

Once again, the construction industry is under scrutiny as a result of one of the largest- ever Office of Fair Trading cartel investigations. The OFT's inquiry has uncovered evidence of "endemic" bid-rigging in respect of thousands of tenders with a combined estimated value of near £3bn.

This investigation follows on the heels of five separate OFT decisions concerning bid-rigging in the roofing sector in England and Scotland between 2004 and 2006. Two of these decisions were appealed to the Competition Appeal Tribunal (*Apex Asphalt and Paving Co Ltd v OFT* and *Makers UK Ltd v OFT*). The CAT upheld the OFT's decisions in each of these cases in 2005 and 2007, confirming the illegality of collusive tendering and particularly cover pricing. ("Cover pricing" describes the practice of bidders colluding with one another during the tender procedure to submit one or more bids which are too high to win the contract.)

The OFT issued a Statement of Objections (SO) on 17 March 2008 against 112 construction firms in England, including large construction groups such as Balfour Beatty, Carillion and Kier Group.

Statement of objections

The SO alleges that the 112 companies engaged in bid-rigging, which is illegal under the Competition Act 1998.

The alleged bid-rigging includes cover pricing. The intention of agreeing on the submission of unrealistic bids is to create the false impression that the winning bid won the contract by competing successfully against the unrealistic bids. The inference is that the winning bid is inflated and would have been lower had all competing bidders engaged in genuine competition and submitted realistic bids.

The SO also alleges that a smaller number of these companies agreed to pay losing bidders compensation payments, usually by issuing false invoices. The OFT has characterised this as a "more serious" form of bid-rigging.

OFT investigation

The OFT's inquiry has attracted significant media coverage. The companies under investigation are not only active in the private housing, commercial and industrial sectors, but also in headline-grabbing public sectors such as schools, hospitals and universities.

The OFT's current investigation originated from a particular complaint submitted to the OFT in 2004 concerning the East Midlands and the investigation was subsequently extended to Yorkshire, Humberside and elsewhere in England.

The OFT has stated that it has evidence of cover pricing affecting "thousands of tender processes", but has focused on around 240 alleged infringements committed by the 112 construction companies addressed in the SO.

Leniency applications

The OFT received 37 leniency applications in connection with its investigation. Leniency applicants will have approached the OFT in a bid for total immunity from fines or reductions in fines of up to 50%. Immunity from fines is generally available to the first cartel member who provides evidence of a cartel to the OFT. In this case, the OFT will have discretion as to whether it grants any party full immunity if, at the time of the immunity application, it already has sufficient evidence to initiate the investigation. Given that the OFT's investigation originated from a specific complaint, this is likely to be the case.

In addition, 40 other companies admitted to bid-rigging activities after the OFT offered the chance for a reduced financial penalty on 22 May 2007 to those companies implicated in its investigation but who had not yet applied for leniency. In the light of "the extent and quality of evidence obtained by the OFT" at that stage, the OFT would not accept any further leniency applications.

Liabilities and penalties

Regardless of individual construction companies' co-operation with the OFT, they will remain equally vulnerable to claims for damages. Any application for leniency or admission to the OFT does not confer any protection from claims for damages.

The OFT's press release is silent on whether it is considering any criminal offences under the Enterprise Act 2002. The OFT can prosecute individuals for dishonestly entering into a seriously anticompetitive agreement, including bid-rigging. This is known as the "cartel offence" and prosecution could lead to a prison sentence of up to five years and/or an unlimited personal fine. Directors of construction companies found guilty of anticompetitive activity may also face a court disqualification order of up to 15 years.

OFT onsite visits

During the current investigation, the OFT conducted onsite visits at the premises of 57 construction companies.

OFT visits can be made without any notice, and this is common procedure to prevent the removal or destruction of evidence which might take place if the business in question were to receive prior notice. The OFT may also enter and search domestic premises with a warrant. In order to do so, the OFT need not actually suspect the individual of participating in cartel activities.

For the first time in an investigation, the OFT used digital evidence gathering and forensic IT in order to search for electronic documents stored on computers. The OFT also employed forensic techniques to discover and analyse documents where steps may have been taken to hide evidence.

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What's next?

The 112 addressees of the SO have the opportunity to respond to the allegations in writing and orally by the deadline set by the OFT, which typically will be approximately two months after the OFT issues the SO.

The SO is not a published document. Interested third parties, such as complainants, had the opportunity to request a non-confidential version of the SO by 30 May 2008. The OFT may grant third parties access to a non-confidential version of the SO in cases where the third party is able to assist the OFT materially in testing its factual, legal and/or economic arguments. Typically the OFT will provide the non-confidential version to those third parties who were extensively involved in the OFT investigation and provided the OFT with significant information before the issue of the SO.

The OFT will give its decision after considering the responses to the SO and third-party comments and has indicated this is likely to take place next year.

Under the Competition Act 1998, the OFT can fine members of a cartel up to 10% of worldwide turnover, subject to any fine reduction for leniency or admission.

Those construction companies which are ultimately identified to have participated in cartel activities in the OFT's final decision, including the leniency applicants, are likely to be targeted by parties who believe they have suffered loss as a result of the bid-rigging behaviour.

In the UK, where the OFT has issued a decision finding an infringement of the Competition Act 1998 (or EC competition law), claimants may bring an action for damages (or an action for relief) in front of the Competition Appeal Tribunal in connection with the offending behaviour established in the OFT decision. This is known as a "follow-on" action.

The attractiveness of this type of action is that the claimant need not prove that the cartel activity took place, as it has already been established in the OFT decision. The claimant need only prove it has suffered loss as a result of that cartel activity.

However, the CAT may stay actions for damages where the OFT decision in question is under appeal, significantly delaying such actions.

Claimants need not wait for the OFT decision (or the outcome of any appeal) to bring a High Court claim against construction companies. This litigation route is less attractive as the claimant will first need to prove the illegal cartel behaviour before demonstrating loss.

Claimants could include competitors who were excluded from bids, and private companies and local authorities who paid more as a result of bid-rigging. Consumer representative bodies which are designated as a "specified body" under section 47B of the Competition Act 1998 (currently, only the consumer association group Which?) may also bring a claim for damages in front of the CAT on behalf of a group of named consumers – for example, a group of specified home owners who paid inflated prices for construction or repair work as a result of bid-rigging.

OFT guidance to public authorities

Following the high-profile reporting of the OFT investigation, the construction sector should expect to remain

under legal scrutiny in the foreseeable future.

On 17 March 2008, the OFT published *A guide for public sector procurers of construction – Making competition work for you*. The guide warns procurers of anticompetitive bidding behaviour, including the following:

- market sharing agreements (ie agreeing only to bid in specified areas);
- bid rotations (ie taking turns to submit realistic bids);
- bid suppressions (ie agreements not to bid or agreements to withdraw bids); and
- cover pricing.

It also sets out practical competition-risk reduction steps, including the following:

- insisting on non-collusion clauses;
- requiring certificates attesting to the independence of bids;
- ensuring a sufficient number of credible bidders;
- regularly reviewing evaluation criteria;
- seeking objective justifications for any failure to bid;
- staying alert for suspicious bidding behaviour;
- conducting due diligence on costs and benchmark bids;
- documenting all discussions with bidders;
- considering the pros and cons of aggregating contracts (which might encourage new entry) versus disaggregating contracts (to exert competitive pressures on suppliers by linking performance on contracts);
- clearly defining selection criteria; and
- collaborating with other procurers.

In respect of this last point, the guide warns that any collaboration between procurers must comply with competition law.

The guide also covers practical steps relevant to the EU procurement regime.

Heightened public awareness

A lasting outcome of the OFT investigations into the building sector will be a greater awareness on the part of private companies, customers and public authorities of not only competition law rules, but also the possibility of seeking damages from companies that have engaged in cartel activity.

Bid-rigging will expose companies not only to potential financial loss but also reputational damage which could affect the chances of being invited to tender in future bids.

On the same day of issuing the press release on the current investigation, the OFT published an information note to local authorities and other procuring entities.

The OFT explains that its investigation "could not pursue every firm against which [the OFT] received allegations or evidence of cover pricing" and that "it is not safe to assume that the addressees of the SO (or ultimately, of the final decision) are the only companies that may have engaged in cover pricing. Moreover, companies that have applied to the OFT for leniency are under an obligation to put their house in order as part of their leniency agreement with the OFT and are therefore unlikely to be now engaging in cover pricing or other forms of bid-rigging".

This is a clear warning that construction companies which are not listed in the OFT's SO should not seek any comfort from this omission and should be prepared for potential competition law investigations and/or claims.