

ANALYSIS

The UK Construction Industry Under The Spotlight Again

Marceline Tournier and John Pheasant

Hogan & Hartson

LT Cartels; Collusive tendering; Construction industry; Inspections; Investigations; Public procurement; Statements of objections

Introduction

Once again, the construction industry is under scrutiny as a result of one of the United Kingdom's largest ever Office of Fair Trading (OFT) cartel investigations. The OFT's investigation has uncovered evidence of "endemic" bid-rigging in respect of thousands of tenders with a combined estimated value of near £3 billion. This investigation follows hard 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 (CAT) (*Apex Asphalt and Paving Co Ltd v Office of Fair Trading* [2005] CAT 4 and *Makers UK Ltd v Office of Fair Trading* [2007] CAT 11). 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".

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

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", a term which 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 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 type of practice as a "more serious" form of bid-rigging.

The OFT's investigation has attracted significant media coverage. The companies under investigation are not only active in the private housing, commercial and industrial sectors, but also in the headline-grabbing public sectors including 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 focussed on around 240 alleged infringements committed by the 112 construction companies addressed in the SO.

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 per cent. 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 had 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 those companies implicated in its investigation which had not yet applied for leniency the opportunity for a reduced financial penalty on May 22, 2007. In light of "the extent and quality of evidence obtained by the OFT" at that stage, the OFT would not accept any further leniency applications.

Regardless of individual construction companies' individual 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 anti-competitive 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 anti-competitive activity may also face a court disqualification order of up to 15 years.

OFT on-site visits

During the course of the current investigation, the OFT conducted on-site 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.

The OFT indicated that during the course of the investigation it used, for the first time, digital evidence-gathering and forensic IT 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.

What is the next step?

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 May 30, 2008. The OFT may grant third parties access to a non-confidential version of the SO where the third party is able to materially assist the OFT to test 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 issue its decision after considering the responses to the SO and third party comments and has indicated that this is likely to take place next year.

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

Those construction companies which are ultimately identified in the OFT's final decision to have participated in cartel activities, 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 United Kingdom, 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 CAT 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 that 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 s.47B of the Competition Act 1998 (currently only the consumer association group Which? qualifies) 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 March 17, 2008, the OFT published "A guide for public sector procurers of construction—Making competition work for you".

The guide warns procurers of anti-competitive bidding behaviour, including:

- market sharing agreements, i.e. agreeing to only bid in specified areas;
- bid rotations, i.e. taking turns to submit realistic bids;
- bid suppressions, i.e. agreements not to bid or agreements to withdraw bids; and
- cover pricing, i.e. agreeing to submit a bid which has an unrealistically high price or attaches unrealistic conditions.

The guide also sets forth practical competition risk reduction steps, including:

- 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, such as:
 - simultaneous bids;
 - bids with similar wording;
 - identical prices;
 - likely bidder dropping out;
 - lowest bidder refusing the contract;
 - successful bidder subcontracting to a party who submitted a higher bid;

- expected discounts disappearing;
- last minute changes; or
- no objective justification for high bids;
- conducting due diligence on costs and benchmarking 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 greater awareness on the part of private companies, customers and public authorities; not only of competition law rules, but also of the possibility of seeking damages from companies who 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 it issued 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:

"... [I]t 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.