

The CAT's *Construction* judgments: an overview

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Introduction

1. Between 11 March and 27 April 2011 the CAT handed down nine judgments on 25 appeals against the OFT's *Bid rigging in the construction industry in England* decision ("the construction decision")¹ and one judgment on three appeals against the OFT's *Construction Recruitment Forum* decision ("the CRF decision").²
2. The judgments cast light on a great number of interesting issues, mainly concerning the OFT's approach to the setting of penalties for breaches of the prohibitions, but also touching upon interesting liability issues. Arguably the key issue was the approach adopted by the OFT in seeking to ensure that the penalties imposed had a sufficient deterrent effect: as will be explained below, whilst this was a legitimate consideration, the OFT's approach had the effect of leading to excessive fines in every appeal.

The contested decisions

3. The construction decision was the culmination of by far the largest investigation ever undertaken by the OFT. The investigation lasted for some 5½ years, and by the autumn of 2006 it had evidence of cover pricing involving more than 1,000 companies and more than 4,000 suspect tenders. In the light of resource constraints, the OFT decided to narrow the scope of its investigation to 122 companies and a maximum of five suspect tenders per party, with the aim of objecting to a maximum of three alleged infringements for each party who had not applied for leniency. In March 2007 the OFT closed the door to new leniency applications (having already received 37 such applications) and issued

¹ *Kier Group and Others v OFT* [2011] CAT 3 (*Kier*); *Durkan Holdings and Others v OFT* [2011] CAT 6 (*Durkan*); *GF Tomlinson and Others v OFT* [2011] CAT 7 (*Tomlinson*); *Barrett Estate Services and Others v OFT* [2011] CAT 9 (*Barrett*); *Crest Nicholson v OFT* [2011] CAT 10 (*Crest Nicholson*); *Quarmby Construction Company v OFT* [2011] CAT 11 (*Quarmby*); *GMI Construction Holdings and Others v OFT* [2011] CAT 12 (*GMI*); *AH Willis v OFT* [2011] CAT 13 (*Willis*); *North Midland Construction v OFT* [2011] CAT 14 (*North Midland*)

² *Eden Brown and Others v OFT* [2011] CAT 8 (*Eden Brown*)

a “fast track offer” (“FTO”) to the 85 firms who had not applied for leniency pursuant to which, in return for admissions of liability for specific infringements and cooperation with the OFT in other ways, the OFT guaranteed a 25% reduction in penalty³. 45 of the 79 non-lenience parties to whom the SO was subsequently issued took advantage of the FTO.

4. In the construction decision, the OFT found that in the period 2000-2006 103 undertakings had committed between 1 and 3 infringements of the Chapter I prohibition. Most of those infringements were cases of “simple” cover pricing. The CAT described “simple” cover pricing as an arrangement:

“where one of those invited to tender for a construction contract (Company A) does not wish to win the contract, but does not want to indicate its lack of interest to the client, for whose work it may wish to be invited to tender in the future. Company A therefore seeks a cover price from another company which is tendering for that contract (Company B). Company B will be seeking to win the contract and will have reached a view as to its own tender price. Indeed it may already have submitted its own tender to the client. The cover price which it provides to Company A will be at a level sufficiently high to ensure that Company A does not win. This price is submitted to the client by Company A as though it is a genuine tender. It should be noted that Company B does not reveal its own tender price to Company A – the cover price is an inflated price.”⁴

5. Six of the infringements involved “compensation” payments. Four of these involved payments being made by the company providing the cover price to the company receiving it in the event that the former won the tender to which the cover price related. In the other two cases the firms agreed that the winner would pay the loser a specific sum for the cost of tendering even though no cover price may have been provided and each of the companies prepared and submitted competitive bids.
6. The OFT considered the infringements involving compensation payments to be more serious than those involving “simple” cover pricing, meriting a higher starting point for the calculation of the penalty.

³ See press release 49/07 (22.3.07) at <http://www.offt.gov.uk/news-and-updates/press/2007/49-07>. See also *Crest Nicholson v OFT* [2009] EWHC 1875 (Admin), in which the Court confirmed the lawfulness of the use of the FTO generally but found that the OFT had breached the principles of equal treatment and fairness in its application of the FTO to the claimant.

⁴ E.g. *Kier Group and Other v OFT* [2011] CAT 3, para 3.

7. The OFT imposed penalties amounting in aggregate to just under £130 million in respect of 199 infringements. The individual fines ranged from £173 to nearly £18 million. The penalties were said by the OFT to have been calculated applying its penalty guidance⁵:

(1) at step 1, the OFT took each undertaking's "relevant turnover", namely its turnover in the product and geographic market affected by the infringement⁶, in the last business year prior to the decision, i.e. 2008. It then took 5% or 7% of that turnover figure⁷ to arrive at a starting point for the penalty for each infringement.

(2) no adjustment was made for duration at step 2: although the infringements lasted for less than a year, the effects of the cover pricing were irreversible in respect of the affected tender, and there could be a continuing adverse impact on future tender processes.⁸

(3) at step 3, which provides for the penalty figure to be adjusted to achieve the twin policy objectives of punishment (having regard to the seriousness of the infringement) and deterrence, the OFT was concerned that in some cases the penalty arrived at by step 2 was small compared to the undertaking's total worldwide turnover. So as to achieve deterrence having regard to the economic size of the undertaking, the OFT increased the penalty, where necessary, to a level equivalent to a specific proportion – 0.75% or 1.05% – of the undertaking's worldwide turnover in the year prior to the decision. This was the so-called "minimum deterrence threshold" ("MDT").

(4) The figures of 0.75% (for simple cover pricing) and 1.05% (for infringements involving compensation payments) were arrived at by assuming that the undertaking's turnover in the relevant market

⁵ OFT 423 (Dec 2004). See paras 32-67 of *Kier* for a summary of the guidance and of its application by the OFT in the cases to which the appeals related.

⁶ The product markets were defined "very narrowly indeed", rendering the step 1 penalties "lower and more "hit and miss" than might have been the case if the markets had been more broadly defined"; *Kier*, para 34.

⁷ Depending on whether the infringement was a case of simple cover pricing or one involving a compensation payment.

⁸ No challenges were brought against this aspect of the construction decision.

represented at least 15% of its total worldwide turnover. The OFT then applied the relevant Step 1 starting point percentage (5% or 7%, as the case might be) to this assumed 15%, resulting in the 0.75% or 1.05% figures. In other words, as the CAT noted, the OFT considered that for each infringer one of the penalties should be at least a sum representing 5% (or 7%) of an *assumed* (not actual) relevant turnover. Thus, where the MDT was applied the penalty for the particular infringement ceased to be related to actual relevant turnover and became instead related to total worldwide turnover” (*Kier*, para 47). The OFT took into account the ignorance of the unlawfulness of cover pricing when fixing MDT, maintaining it at the same level as in previous decisions relating to flat roofing⁹. In cases of multiple infringements, the MDT was applied to the infringement which produced the largest penalty after step 2 but not to the others.

- (5) At step 3 the OFT also considered the position where the MDT did not apply and where the relevant turnover was zero (thereby leading to a zero penalty after step 2). In such cases the OFT used a proxy figure of 0.14% of the undertaking’s most recent total worldwide turnover, which was said to be the median percentage for all infringements in the decision.
- (6) Where an undertaking had two or three infringements in the same relevant market and the aggregate penalties amounted to more than 4.5% of the undertaking’s total worldwide turnover, the OFT made a downward adjustment at step 3 so as to bring it within the range of penalties imposed on other undertakings.
- (7) The OFT also took account of financial hardship at step 3, so long as the evidence, taken in the round, indicated that payment of the full penalty (even when spread over 3 years) would seriously threaten the undertaking’s financial viability.

⁹ See in particular the OFT’s decision in CA98/01/2006 *Collusive tendering for flat roof and car park surfacing contracts in England and Scotland* and the related appeal *Makers v OFT* [2007] CAT 11, discussed below.

- (8) at step 4, the OFT made upward and/or downward adjustments to reflect aggravating and/or mitigating factors.
- (9) at step 5, the OFT ensured that the statutory maximum fine of 10% of worldwide turnover¹⁰ was not exceeded in any particular case.
8. The *CRF* decision was the culmination of a 3½ year investigation into several undertakings engaged in the supply of recruitment services to the construction industry in the UK. The OFT found that the recruitment agencies had formed a cartel in response to entry on the market by another company which was perceived as a threat to their margins. The infringement, which lasted for 12 to 15 months, took the form of a collective boycott of the new entrant and an agreement/concerted practice to fix certain target fee rates. The OFT imposed fines ranging from just over £3,000 to just over £30 million. The successful immunity applicant, Randstad, stood to be fined more than £115 million but for the 100% reduction on account of its application for immunity. The OFT's penalty calculation followed a similar pattern to that in the construction decision, save that a 9% multiplier for seriousness and a 1.25 multiplier for duration were used at steps 1 and 2 respectively; these were also applied to the figure representing 15% of total turnover for MDT purposes¹¹.

The issues on appeal

9. The appeals raised a wide range of issues; the principal issues are set out below.
10. Six appeals against the construction decision challenged findings of liability. Five appellants flatly denied that they had participated certain or all instances of cover pricing alleged by the OFT. They claimed that the OFT had not discharged the burden of proof¹². One of those appellants also contended that the OFT had not shown that an agreement to which it was party had an appreciable effect on either competition or trade within the UK¹³. Another of those appellants claimed that, in relation to one finding of infringement, the agreement had been entered into by an independent service provider; as such,

¹⁰ s 36(8) of the 1998 Act.

¹¹ *Eden Brown*, para 85.

¹² *Durkan; GMI; Quarmby; North Midland; Willis*.

¹³ *North Midland*

the infringement had not been committed by, and could not be attributed to, it¹⁴. Yet another contended that it did not exercise “decisive influence” over its subsidiary, which had been party to an infringement, and so should not be held liable for it¹⁵.

11. All of the appeals put in issue the amount of the penalty imposed by the OFT. Challenges were made to:

(1) The use of turnover in the undertaking’s last business year prior to the contested decision for the purposes of establishing the “relevant turnover” for the purposes of Step 1 of the OFT’s guidance. Some of the appellants claimed that the appropriate year was the year preceding the termination of the infringement.

(2) The percentage levels adopted by the OFT of 5% and 7% for simple covering pricing and infringements involving compensation payments respectively.

(3) The deterrence uplifts applied by the OFT at step 3, caused in particular by use of the MDT.

(4) The approach to mitigating and aggravating factors at step 4.

Liability

12. Although, to a large extent, the liability issues are overshadowed by the very large reductions made by the CAT to the fines in these cases, they nonetheless raise some very interesting and important points of law and practice.

Factual disputes

13. Perhaps the most important is the OFT’s approach to witness evidence. In none of the appeals where liability was contested, and where such liability involved factual dispute rather than a question of law, did the OFT adduce witness evidence in support of its case. Instead, it relied on the transcripts of interviews it conducted at the investigative stage. This was despite the facts that such

¹⁴ *Willis*

¹⁵ *Durkan*

documentary evidence as existed was often ambiguous or at least capable of bearing more than one meaning and that the account given by interviewees was directly contested by the appellants' own witnesses in most cases where liability was disputed.

14. In *Durkan*, for example, the OFT relied on evidence provided by a leniency applicant, Mansell, and on an interview conducted with a Mansell employee for the purposes of establishing one of the infringements it found to have been committed by Durkan. The documentary evidence consisted of one Mansell report on which the name of a Durkan employee was written in manuscript and next to it a figure which was slightly less than the cover price ultimately submitted by Mansell. The interview was not with the Mansell employee who had written the manuscript notes but with a colleague.
15. Durkan adduced evidence from four witnesses and tendered them for cross-examination. The OFT, by contrast, did not adduce any witness evidence. Understandably, the CAT was not impressed:

“108. ...The OFT’s decision not to lodge witness statements in support of its case caused us some concern, as we made clear at the outset of the hearing in this appeal. The OFT was asking us to uphold a finding of infringement – for which it had imposed a fine of over £3 million – on the basis of a transcript of an interview with a person who was apparently not the person who had written the notes on the key contemporaneous document. ...

109. ...The significance of the failure to produce a witness statement is two-fold. First, Mr Goodbun [of Mansell] has not been pressed about any of his answers – his comments in the interview in 2007 appear to have been simply taken at face value throughout the investigation and this appeal. If, once the appeal had been lodged, the OFT had gone back to Mr Goodbun to take a witness statement they may well have filled in many of the gaps that currently exist in the account of what happened. Faced with only the transcript of the interview, we do not know, for example, whether Mr Goodbun’s evidence was based on what Mr Hart [his colleague who had made the manuscript notes] had told him had actually happened or whether he was simply inferring from the marks on the document the same “facts” as any person familiar with what went on generally in the industry could infer. We do not know what Mr Goodbun’s reaction would have been had he been told that Mr Sharpe vehemently denied that he had given a cover price. Mr Goodbun was not asked whether there might be an alternative explanation for the marks on the Report.

The second disadvantage of relying on an interview transcript is that Mr Goodbun's evidence has not been tested by cross-examination, a process which might also have generated a better understanding of the strength of the case against Durkan Limited. We reject the OFT's suggestion, made both at the hearing and in their letter of 6 August 2010, that because it was open to Durkan Limited to call Mr Goodbun as a witness for the purposes of cross-examining him and they decided not to do so, that Durkan is somehow restricted in the extent to which it can challenge what is recorded in the transcript of his interview. It is not the task of the Appellant to supplement the evidence relied on by the OFT. Similarly, we reject the suggestion that because the Tribunal did not exercise its powers on its own initiative to call Mr Goodbun, his "evidence" is somehow immune from criticism."

16. The CAT accepted the evidence given by Durkan witnesses, including the Durkan employee, Mr Sharpe, whose name appeared on the Mansell report, that it was Durkan's policy not to give or seek cover prices and that doing so would lead to dismissal. In that light, little was left of the OFT's case. Although Mansell had clearly decided to seek a cover price, and someone at Mansell was told that Mr Sharpe was the Durkan employee with responsibility for that project, what was still unknown was whether Mansell tried to contact Mr Sharpe or what happened if he tried to do so. The OFT had failed to establish the necessary link between the writing of Mr Sharpe's name on the report and the writing of the figure next to it. It had therefore failed to establish Durkan's participation in the infringement.
17. Similar conclusions were drawn, albeit on different facts, in *GMI, North Midland* and *Willis*. In *GMI* the CAT referred to the OFT's "flagrantly leading questions" during an interview it had conducted with a leniency applicant (para 54) which – although not mentioned as such by the CAT – will doubtless have diminished the little weight the CAT was prepared to place on it. Indeed, in *GMI, North Midland* and *Willis* the CAT included a "postscript" concerning the OFT's evidence, which reads in materially identical fashion in all three cases. Taking *GMI* as an example:

"Difficult and important questions arise in relation to the "evidence" adduced by the OFT. There is no indication that the transcripts of Mr Nelson's and Mr Miller's interviews with the OFT were reviewed by and attested to by them. Certainly they did not endorse the transcripts with a statement of truth or even sign them.

More fundamentally, we do not consider that material contained in transcripts of interview – even if reviewed and attested – is a satisfactory means of evidencing alleged infringements in cases of this kind, particularly where important facts are in dispute. It is one thing to use a transcript of interview as evidence of relevant admissions by the interviewee; it is quite another thing to attempt to use it as evidence against a third party. In paragraph 81 of the Tribunal’s decision in *Argos Limited v The Office of Fair Trading* [2003] CAT 16, the Tribunal observed that “notes of interview are not, in our view, satisfactory substitutes for witness statements”. We agree. A witness statement will set out the relevant facts, will be attested to by the witness by way of a statement of truth, and will enable the witness to be exposed to cross-examination should the accuracy and/or truth of those facts be disputed. This is not to say that relevant interview transcripts cannot or should not be put before the Tribunal in support of a witness statement. It is simply that they are not a substitute for it.

We do not therefore agree with the suggestion in numbered paragraph 2 of the OFT’s letter to the Tribunal dated 6 August 2010, and referenced to *inter alia* this appeal, that the preparation of a witness statement in circumstances such as the present would be “a complete triumph of form over substance”. (An extract from the letter is quoted at paragraph 54 of the Tribunal’s judgment in *AH Willis & Sons Ltd v OFT* [2011] CAT 13.) Where crucial facts are disputed it may in certain cases, and depending upon what if any other evidence is available, be very difficult to resolve the issues in the absence of evidence from a witness who has been deposed in the ordinary way and whose assertions are available to be tested in cross-examination by those who dispute them. Where central issues of fact cannot be resolved, the outcome may have to turn on the burden of proof. It is therefore all the more important from the OFT’s perspective that there should be probative evidence before the Tribunal. Thus, even if the OFT has not obtained witness statements in order to fortify its own decision-making process, once it becomes clear that there is a material dispute as to the facts on which its decision was based, the OFT should consider to what extent such statements are necessary or desirable in order to support those facts in an appeal, subject always to the provisions of rule 22 of the Competition Appeal Tribunal Rules 2003 (SI 2003 No. 1372). It is, of course, not normally the role of the Tribunal to decide whether and if so which witnesses should be deposed or called to give evidence by any party. We should add in regard to these matters that we are in entire agreement with the comments of the Tribunal at paragraphs 108 to 110 of its judgment in *Durkan ...*”

Appreciability under the 1998 Act

18. One appeal, *North Midland*, raised the interesting issue of the role of the concept of “appreciability” in cases involving infringements by “object” under s 2 of the 1998 Act. The role of appreciability is twofold in EU competition law: first, to ensure that only agreements which have more than minor distorting effects on competition are censured (appreciable effect on competition); and

secondly, to serve as a jurisdictional dividing line between EU and national law (appreciable effect on trade between Member States). It will be recalled that in *Aberdeen Journals (No 2)*¹⁶ the CAT considered that the latter concept had no role to play in purely domestic proceedings. This view was, however, criticised by the Chancellor of the High Court in *P&S Amusements v Valley House Lesiure*,¹⁷ who found it hard to square with the language of the 1998 Act itself.¹⁸

19. In *North Midland* it was common ground that the two concepts of appreciability would stand or fall together (para 51), so the CAT did not have to wade into the debate in the case law. The CAT dismissed the appellant's argument that the OFT had not shown that one-off cover pricing, relating to a single tender, amounted to an appreciable restriction of competition. Whilst the CAT accepted that an agreement having as its object the restriction of competition "could nevertheless be so trifling as to fail the appreciability test", it may on the other hand "also be the case that the nature of the specific collusive conduct is such that, given the individual circumstances, the potential effects on competition of the conduct in question are inherently likely to be significant" (para 53). In that latter case, establishing appreciability may be more easily done.
20. The CAT then rehearsed the potential negative effects of cover pricing, first enunciated in *Apex Asphalt*¹⁹ and elucidated in *Kier*, which explained that "the potential effects of cover pricing extend beyond the confines of the specific contract being tendered and into similar exercises to be conducted in future" (para 56). It then considered the facts of the cover pricing at issue, finding that the potential effects clearly satisfied the appreciability requirement (paras 56-58).
21. Although the CAT does not rule out the possibility of "object" agreements whose actual or potential effects are so "trifling" that they would fail the

¹⁶ [2003] CAT 11, paras 459-460.

¹⁷ [2006] EWHC 1510, para 22.

¹⁸ On the role of appreciability in UK competition law, see Bailey "(Appreciable) Effect on Trade within the United Kingdom" [2009] ECLR 353.

¹⁹ [2005] CAT 4

appreciability test, it is difficult to think of examples. It may be that this becomes the last word on this subject, at least in the context of “object” infringements.

The concept of an “undertaking”: freelance contractors

22. In *Willis*, the question was whether a freelance estimator engaged by Willis, who assisted Willis in bidding for a contract but who also (unknown to Willis) provided a cover price to a competitor, was acting as part of the same “undertaking” as Willis in carrying out that latter act. The OFT found that it was, but the CAT disagreed. It adopted a functional approach, stating (at para 35) that there were two separate questions: whether the estimator was part of the Willis undertaking for the purposes of preparing the tender (answer: yes); and whether he was part of the undertaking for the purposes of supplying a cover price to Willis’ competitor (answer: no). At para 37 the CAT held:

“The question is whether (looking objectively at all the factual circumstances and the economic realities of the situation) Mr Elbourn’s provision of a cover price to Mansell amounted to the wrongful performance of a function that Mr Elbourn was performing for Willis, or whether it was in fact a discrete function altogether. In our view, it was the latter. In this case, Mr Elbourn was serving two masters. He was providing estimation services (as well as submitting the bid documentation) for Willis, but he was also providing “some figures for Mansell’s use” (to quote from Decision/IV.6259 (p1520)). In this latter respect, *if* (were we obliged to decide the point, which we are not) Mr Elbourn was acting as part of any undertaking other than that comprised in his own estimating business, it was Mansell, and his conduct is to be attributed to Mansell. The main point is that he was not acting as part of the Willis undertaking. The fact that this conduct almost certainly involved a breach of Mr Elbourn’s duties to Willis does not alter this conclusion. Nor is it altered because it was as a result of the estimating work which he had already carried out for Willis that he was in a position to provide, without much additional labour on his part, the cover price that Mansell required.”

Imputation of liability to a parent company: decisive influence

23. In *Durkan*, it was argued that a parent company which owned 51% of the shares of its subsidiary did not exercise decisive influence over it and so should not be held jointly and severally liable with it to pay the fine.

24. Having cited the ECJ's judgment in *Akzo Nobel*,²⁰ the CAT summarised the principles as follows:

“(a) The fact that the parent owns all the shares in the subsidiary means that it has the ability to exert influence; this does not automatically mean that it actually exerts that influence but it creates a rebuttable presumption that influence was actually exercised.

(b) The exercise of influence can be indirect and may be established even if the parent does not interfere in the day to day business of the subsidiary and even if the influence is not reflected in instructions or guidelines emanating from the parent to the subsidiary.

(c) It is not necessary to show that any influence was actually exercised as regards the infringement in question: one must look generally at the relationship between the two entities.

(d) The factors to which the court may have regard, when considering the issue of decisive influence, are not limited to commercial conduct but cover a wide range as described by the Advocate General and the General Court.”²¹

25. In the event, nothing turned on the fact that the parent company owned only 51% of the shares in its infringing subsidiary; in particular, the CAT did not have to opine on whether a rebuttable presumption of decisive influence arises in that situation, too (*Durkan*, para 23). That was because, on the evidence, the parent did exercise such influence. The CAT considered three “indicators” of the existence of control: first, the parent’s influence over strategic direction; secondly, how far the subsidiary was incorporated into the parent’s corporate structure and treated as part of the group of companies; and thirdly, how far the parent, through its representatives on the subsidiary’s board, was involved in its running (para 31). As to the first indicator, the CAT found that:

(1) The parent determined the scope of the subsidiary’s business when the company was first founded, making it clear to the individuals with day-to-day responsibility for the subsidiary that their business must not encroach on that of a sister company controlled by the parent.

(2) The parent monitored growth, margin and rate of return targets and gave clear guidance to its subsidiary as to the mark ups it should pursue.

²⁰ Case C-97/08P *Akzo Nobel and Others v Commission* [2009] ECR I-8237.

²¹ The reference to the General Court is to the judgment of that Court in Case T-112/05 *Akzo Nobel and Others v Commission* [2007] ECR II-5049.

- (3) Health and safety policy was determined on a group basis. Likewise, to some extent, was marketing.
26. Overall, therefore, there was “abundant evidence before us that Durkan Holdings had a direct influence on Durkan Pudelek in respect of many, if not all, of the potential areas of influence mentioned by Advocate General Kokott in paragraph 92 of her Opinion in *Akzo Nobel*, namely “corporate policy, strategy, operational policy, business plans, investment, capacity, provision of finance, human resources and legal matters”.” (para 58)
27. As to the second indicator of decisive influence, the CAT referred to various examples of the subsidiary being treated as part of the same corporate group and presenting itself as such to potential clients, among others. It also referred to the number of overlapping directorships within the group of companies, illustrating that those with day to day responsibility for the subsidiary were considered to be part of the “family of directors” (para 71).
28. Finally, the CAT had regard to the degree of involvement of the parent in the running of the subsidiary, particularly its involvement at board meetings. The role of the parent went well beyond that of a “silent partner”; “its interest in the success of [the subsidiary] was bound up with the importance to the group of its brand and reputation in the market as well as simply a financial interest” (para 89).
29. The CAT therefore dismissed this ground of Durkan’s appeal. It did so on the basis of a thorough analysis of the evidence, including the testimony of Durkan witnesses. The principal legal interest lies in the CAT’s approach to the principles arising from *Akzo Nobel*, in particular its use of the criteria set out at para 92 of the Advocate General’s opinion in that case: by contrast, the Court had been less specific in its enumeration of relevant factors.²²

Penalty

²² See para 74 (“account must be taken...of all the relevant factors relating to economic, organisational and legal links which tie the subsidiary to the parent company, which may vary from case to case and cannot therefore be set out in an exhaustive list”).

30. By way of preamble to its consideration of the penalty arguments, the Tribunal set out in all of its *Construction* judgments the context in which cover pricing took place. It noted the reasons why cover pricing was prevalent in the industry. In particular, firms engaged in cover pricing where they were unable or unwilling to provide a bid. They sought cover prices so as to remain on the tender lists of those involved in arranging construction contracts and so as to avoid the considerable expense of calculating genuine figures themselves. The companies were concerned that if they did not respond to an invitation to tender, they would be regarded as being either unable to carry out the work or uninterested in doing so. It was believed that this might well lead to their being placed at the bottom of tender lists and ultimately removed from such lists altogether (*Kier*, para 17). This perception was accepted by the OFT to be genuine and widespread.
31. The CAT considered that “simple” cover pricing was materially distinct from “bid rigging” as ordinarily understood: bid rigging involved or assisted in the determination of the price which will actually be charged to the customer; cover pricing, whilst capable of distorting competition, was less serious in nature. Whilst cover pricing was not an innocuous activity:

“100. ...it also needs to be recognised that “simple” cover pricing is a bilateral arrangement in the context of a multi-partite tendering exercise. Its purpose is not (as in a conventional price-fixing cartel) to prevent competition by agreeing the price which it is intended the client should pay. Indeed, its purpose is quite the reverse, namely to identify a price which the client will *not* be willing to pay. Nor is its purpose to reach an agreement that the recipient of the cover price will cease to be a contender – it is strongly argued by the Present Appellants, and not disputed by the OFT, that in a case of “simple” cover pricing the recipient has already made its own unilateral decision not to compete for the work before the request for a cover price is made.

101. To the extent that cover pricing is capable of compromising the immediate tendering exercise, the most serious aspects are: the possible exclusion of a substitute tenderer in place of the one who has received a cover; and the risk that the whole tendering exercise may be subverted if a large number of covers are given. We consider it unlikely, although it is not inconceivable, that where some but not all competitors have been provided with covers, the cover provider may be encouraged to price his own tender a little higher on that account. The likelihood is that, even with the knowledge that only one genuine opponent remains, a tenderer who wishes to win will

still put forward its keenest bid. It is therefore unsurprising that in none of the “simple” cover pricing infringements in the Present Appeals, indeed in none of infringements of that kind in the Decision, is there a case where the price paid by the customer was found, or even alleged, to have been directly affected by the infringement. It is also perhaps worth noting that it would be the receipt of a *request* for a cover which might embolden a tenderer, for that is the source of his knowledge that the requester does not wish to win the work and is not a serious contender. He has this knowledge whether or not he agrees to supply a cover price.” (*Kier v OFT*)

32. The CAT also pointed to slim margins – typically 2% - which did not support the existence of substantial overcharges (*Kier*, para 102) and to the existence of industry publications which gave the impression that cover pricing was a normal and acceptable practice (para 104).
33. In the CAT’s view, all of these considerations had a bearing on the seriousness of the infringements and provided significantly more mitigation generally than had been recognised by the OFT (para 107).
34. The CAT considered that the final penalties imposed for “simple” cover pricing were excessive in the light of such considerations (para 108).

The CAT’s role in penalty appeals

35. Before turning to the specific arguments raised by the appellants, it is worth noting the CAT’s comments on its role in penalty appeals.
36. Under para 3 of Sch 8 to the 1998 Act, the CAT’s jurisdiction is to decide appeals “on the merits” by reference to the grounds of appeal set out in the notice of appeal. The Tribunal may impose, revoke or vary the amount of the penalty. In other words, it has full jurisdiction.
37. The OFT is under a duty to have regard to its penalty guidance when setting the amount of a penalty: s 38(8) of the 1998 Act. The Act, however, imposes no such duty on the CAT. To what extent should the CAT have regard to the penalty guidance?
38. The CAT rehearsed its previous case law, approved by the Court of Appeal, as follows:

“74. ...the Tribunal will disregard neither the Guidance nor the OFT’s approach and reasoning in the specific case. On the other hand, the Tribunal is not bound by the Guidance and should itself assess whether the penalty actually imposed is just and proportionate having regard to all relevant circumstances as put before the Tribunal in the course of the appeal.”

39. Whilst the OFT has a margin of appreciation with regard to the application of its guidance, that does not impede or diminish the Tribunal’s undoubted jurisdiction to reach its own independent view as to what is a just penalty in the light of all the relevant factors. The CAT continued:

“76. ...Provided the penalty ultimately arrived at is, in the Tribunal’s view, appropriate it will rarely serve much purpose to examine minutely the way in which the OFT interpreted and applied the Guidance at each specific step. As the Tribunal said in *Argos* (above), the Guidance allows scope for adjusting at later stages a penalty which viewed in isolation at an earlier, provisional, stage might appear too high or too low.

77. On the other hand if, as in all the Present Appeals, the ultimate penalty appears to be excessive it will be important for the Tribunal to investigate and identify at which stage of the OFT’s process error has crept in. Assuming the Guidance itself is unimpugned (and in the Present Appeals there has been no attack on it), the imposition of an excessive or unjust penalty is likely to reflect some misapplication or misinterpretation of the Guidance.”

40. In other words, it seems that the CAT will start at the end, asking itself whether, in all the circumstances, the penalty imposed is excessive; if so, it will look at the OFT’s application of the methodology contained in the penalty guidance to see where the error(s) crept in. Of course, this begs the question as to what amount is an excessive amount. It might be said that the CAT’s judgments do not cast a great deal of light on this critical question.

The CAT’s views on the OFT’s application of the penalty guidance

41. A summary of the CAT’s views is set out below.

Step 1

42. First, the CAT considered that 5% of relevant turnover was too high for “simple” cover pricing when the maximum under the guidance was 10%: “the appropriate level is lower than the mid point of [the 0-10%] range, since the difference between 5% and 10% does not in our opinion adequately reflect the distinction in culpability between cover pricing as practised in the construction

industry in the relevant period and, say, a multi-partite horizontal price fixing or market sharing cartel. Greater head-room is required to accommodate the latter type of offence within the range currently provided by Step 1 of the Guidance” (*Kier*, para 114).²³ The CAT considered that a starting point of 3.5% was appropriate in such cases. On the other hand, the OFT was justified in adopting a starting point of 7% for infringements involving compensation payments: *Kier*, para 286. Further, the OFT was entitled to choose the same starting point for all infringements: differences among them could be accommodated at a later stage in the fining methodology (para 121).

43. The CAT noted that, for the purposes of assessing “relevant turnover”, the markets had been very narrowly defined; this was likely to have created a “mismatch” between the step 1 amount and the harm done by cover pricing (para 110) and led to relevant turnover that was capable of differing dramatically – “it could make a huge difference that a firm had built a school rather than a warehouse, for these buildings fall into different product markets” (para 111). In other words, the need to consider adjustments at step 3 became almost inevitable; had a broader approach been taken to market definition, adjustments may not have been necessary or only to a more limited extent.
44. Some of the appellants criticised the year selected for assessing “relevant turnover”. The penalty guidance is not particularly specific: it simply states (at para 2.7) that:

“The relevant turnover is the turnover of the undertaking in the relevant product market and relevant geographic market affected by the infringement in the undertaking's last business year.”

45. Until the entry into force of the most recent version of the guidance in December 2004, the OFT had used turnover in the last year of the undertaking's participation in the infringement. The OFT then started to take the turnover in

²³ Note also the CAT's views on the guidance itself at para 109. It points out that the OFT had “confined itself quite narrowly” in the guidance by using a starting range of just 0-10% of relevant turnover; compare this with the European Commission's guidance ([2006] OJ C 210/2), under which the Commission calculates the basic amount of the fine by reference to up to 30% of annual sales in the relevant market. The CAT noted that “A more generous range would obviously provide more headroom at the outset, and greater scope for reflecting the circumstances of individual cases, with the result that there may well be less call for substantial Step 3 adjustments of the kind which have assumed such significance in the Present Appeals. As and when the Guidance comes to be reviewed some modification of the Step 1 range may be worthy of consideration.”

the relevant market in the last year prior to the adoption of the decision as the relevant turnover. This was said by the OFT not to be a change in policy: the 2004 version of the guidance had been altered to reflect changes to the statutory maximum penalty, and the OFT's policy had always been to align the last business year under step 1 with the corresponding definition in the subordinate legislation imposing the ultimate cap.

46. The CAT disagreed. It held that the guidance, so far as it relates to step 1, should be interpreted as being unaltered, namely as referring to the business year preceding the date when the infringement came to an end. The OFT had therefore misapplied the guidance. There was nothing to suggest in the consultation leading to the 2004 version of the guidance, or in the guidance itself, that the amendment to the subordinate legislation imposing the ultimate cap meant that the year on which "relevant turnover" was based should also change. It was relevant that Steps 1 and 5 serve different purposes: the former is concerned with reflecting the seriousness of the infringement (which is closely related to its harmful effects on the specific market to which it relates), whereas the latter is concerned with ensuring that fines do not exceed a certain measure relating to the firm's economic size.²⁴
47. The CAT held that, to the extent that the OFT wished to change the year of assessment, the OFT should first have consulted upon and sought approval for the change, including a corresponding revision of the current text of the guidance. That said,

"138. ...as a matter of principle the OFT's former practice is preferable where one is seeking to arrive at a provisional penalty based on turnover in the market affected by the infringement. In this respect we cannot put the point more neatly than the ECJ when it emphasised the importance of taking into account "turnover which reflects the undertaking's real economic situation during the period in which the infringement was committed."²⁵

²⁴ The CAT rejected arguments based on Article 7 ECHR that the penalty imposed was heavier than that applicable at the time of the commission of the infringement: *Tomlinson*, para 110.

²⁵ See Case C-76/06P *Britannia Alloys v Commission* [2007] ECR I-4405, para 25. In *Durkan*, at para 157, the CAT held that the guidance was "sufficiently flexible to enable the OFT to apply, after consultation, an appropriate price or cost index to make an adjustment at step 3 in such a case in order to restate the penalty at present day values". Note however *Tomlinson*, at para 102, in which the CAT stated that s 60 does not require the OFT to align its guidance iwth that of the Commission: there were

48. The CAT's decision in this respect is clearly of some practical importance: as it noted, there is often a considerable time lag between the termination of the infringement and the adoption of the decision. In the meantime, the undertaking may have grown significantly (or even shrunk), possibly as a result of acquisitions. The selection of the relevant year will therefore often make a significant difference to the penalty figure at step 1. That said, the point should not be over-emphasised: even if a smaller figure emerges at step 1 (and therefore also at step 2), it will be open to the OFT to increase it at step 3, to the extent that it does not achieve the aim of specific and general deterrence.
49. Finally, there may still be a question of what constitutes "relevant turnover" even once the market has been correctly defined and the year correctly selected. In *CRF*, the appellants contended that the OFT had wrongly included charges made by agencies to clients in respect of wages paid to temporary workers as part of the relevant turnover, which were simply "passed through" to the clients. The CAT agreed:

"relevant turnover is used to reflect the effective scale of activity of the undertaking and thus, where several undertakings are involved, to reflect the appropriate relationship between the penalties imposed on each of them" (para 44).

50. In other words, the OFT cannot in every case simply go off turnover figures found in the undertaking's audited accounts; it may need to consider, additionally, whether there are more appropriate indicators of actual economic performance and activity of the business carried out by the undertaking in question.²⁶

Step 3

51. The OFT's approach to deterrence has been summarised above. The MDT was first deployed in its decision which led to the CAT's judgment in *Makers*²⁷.

in 2004 (the date of the most recent version of the guidance), and still are, significant differences between the two sets of guidance

²⁶ Cf *Tomlinson*, para 133: "[t]he fact that a significant proportion of a construction undertaking's turnover comprises monies paid over to the subcontractor is a factor which affects the extent to which turnover can be regarded as a useful indicator of economic presence in this market." Rather than take this into account in terms of "relevant turnover", the CAT considered it as part of its analysis of whether the fines arrived at after steps 1 and 2 of the guidance were a sufficient deterrent: para 135.

²⁷ *Makers UK Ltd v OFT* [2007] CAT 11

One can understand why the OFT, confronted with a huge number of infringements and parties, wanted to find a formula which it could easily apply to all parties. One can equally understand the apprehension that by assessing each case individually, the OFT ran the risk of not treating each party equally and that this was a risk it wished to mitigate. The use of the MDT, however, was an inappropriate way of doing so: it went against both the principle that penalties had to be assessed on a case-by-case basis, taking into account the individual circumstances of the parties, and the principle that penalties had to be proportionate. It also resulted in some dramatic increases in the penalty from step 2 to step 3.²⁸

52. The formulaic approach adopted by the OFT was subjected to criticism from the CAT.²⁹ In summary:

- (1) It was unclear where the figure of 15% of total worldwide turnover came from, apart from that it had been used in previous cases, but in any event it was not at all obvious why the figure of 0.75% of worldwide turnover (5% of 15%) would produce a penalty with the minimum deterrent effect.
- (2) The MDT was far too blunt an instrument to achieve deterrence in individual cases. It was also liable to result in disproportionate figures, particularly in the case of firms with very substantial activities outside the sector to which the infringement related.³⁰

²⁸ See e.g. *Crest Nicholson*, in which the penalty was increased from just over £2,000 to almost £5.5 million.

²⁹ Note, however, the CAT's dictum that "it is probably going too far to say that the application of the MDT amounted to an "alter[ation] of the Guidance...[T]here is nothing in Step 3 which precludes, or is inconsistent with, use of a mechanism to assist the OFT in making an appropriate adjustment, provided always that the resulting figures are subject to an individual appraisal ensuring a proportionate penalty": *Kier*, para 181.

³⁰ See the example given at *Kier*, para 169 of a multinational oil company with a UK subsidiary operating in the construction industry: a single instance of cover pricing would, using the MDT, result in a penalty measured in the hundreds of millions of pounds, which would "undeniably" infringe the principle of proportionality. Note also para 254: when considering the need for specific rather than general deterrence, it was relevant (in the case of one undertaking) that the infringing subsidiary had ceased to trade several years before the adoption of the decision and that the undertaking had minimal business in the UK; the risk of reoffending by this undertaking was therefore "rather small". See also *Eden Brown* at para 95: in the case of *Randstad*, the immunity recipient, the relevant turnover was £200 million but the worldwide turnover attributable to the Dutch parent company was £5.7 billion; that led to a penalty of almost £117 million prior to immunity, which in itself demonstrated the disproportionate nature of the OFT's approach.

- (3) MDT focussed inappropriately only on turnover.³¹ That was not the key issue for most companies: profit and cash flow were more important factors. Account should also be taken of margins on turnover in the industry in question (*Kier*, paras 170-172). However, “it is [not] appropriate to be prescriptive...since the circumstances will vary from case to case and even for individual undertakings in the same case”.³²
- (4) Ultimately, penalties must be proportionate. Both deterrence and seriousness/culpability are relevant in this respect. The CAT recognised that these concepts may pull in different directions; if so, a “fair balance” between them has to be sought (*Kier*, para 175). The problem with MDT was that it completely lost sight of the seriousness of the offence and culpability of the offender.
- (5) “In short, determination of the penalty requires a refined consideration and assessment of all the relevant circumstances, and the element of deterrence, while undoubtedly one of those circumstances, should not lead to the level of penalty being calculated according to a mathematical formula.”³³
53. Finally, the CAT distinguished *Makers*, which had found the MDT to be “an appropriate way in which to ensure that the overall figure of the penalty meets the objective of deterrence referred to in the Guidance”, on the basis that the turnover to which the MDT was applied in that case was the turnover of the immediate infringing company rather than that of the group of which it was part (*Kier*, para 178).
54. The exercise of striking a fair balance between deterrence and seriousness is obviously a very difficult one. With respect, the CAT’s judgments do not throw much light on how the OFT should do so. In particular, the CAT’s own recalculations of the appellants’ penalties contain virtually no reasoning at all, and

³¹ In *Barrett* at para 44 the CAT observed that whilst there was “nothing objectionable to the use of a percentage of total turnover to provide a provisional benchmark when calculating the Step 3 adjustment, such a mechanism must not be used as a substitute for an individual assessment of the case, and provided always that it does not result in the imposition of a gross penalty which is excessive and disproportionate.”

³² *Eden Brown*, para 98.

³³ *Ibid*, para 99.

do not refer to each undertaking's profit figures (on whichever basis they should be calculated) or cash flow.³⁴ One is therefore left to guess what was in the CAT's mind when deciding upon the figures.³⁵ In any event, the judgments are likely to have a bearing on some of the appeals against the OFT's *Tobacco* decision, in which the OFT also applied an uplift for deterrence based on the proportion of total turnover accounted for by relevant turnover, albeit not using the same methodology.

55. Finally, it should be noted that the CAT recommended that the OFT make explicit in the guidance that in making any adjustment at step 3 the OFT will "step back" and ensure that a penalty at the proposed level is necessary and proportionate (para 186).

Further points of interest

56. It is worth noting that the CAT dealt with numerous other arguments on penalty in its judgments, including in relation to step 4 of the guidance. Some of these are summarised below.

- (1) A number of appellants contended that the fines imposed were very large compared to penalties imposed by way of sentence for corporate crime such as health and safety and corporate manslaughter. Reference was made to the Hatfield rail disaster in which 4 people were killed and 102 injured, where a fine of £7.5 million was imposed on a company whose group turnover was some £5 billion. The CAT dismissed such comparisons, finding that the circumstances with which such cases were dealing were too remote from the competition regime to provide the CAT

³⁴ See e.g. *Kier*, paras 232 and 259-260. Note the case of *Bowmer*, which had been involved in one infringement involving a compensation payment and two instances of "simple" cover pricing: the CAT made no adjustment to the step 2 amount in respect of the latter infringements but doubled the amount of the penalty in respect of the first: see *Kier*, para 291.

³⁵ The CAT appears to shed some limited light on its approach in *Tomlinson* at para 164: "we have not applied any particular percentage to that turnover in order to arrive at a minimum level. Instead, in those cases where we consider that an uplift at Step 3 is necessary for deterrence we have applied a multiplier to the provisional aggregate fine to arrive at a figure we consider appropriate." The CAT does not, however, say what the multiplier is or how it should be arrived at. The CAT is not the only judicial body which might be subjected to criticism here: in *National Grid v GEMA* [2010] EWCA Civ 114 the Court of Appeal similarly gave no detailed reasons for its "broad brush" substitution of a figure of £15 million for the £30 million levied by the CAT to reflect the role of GEMA in the genesis of the offending conduct: see para 115.

with much assistance. Further, neither the 1998 Act nor the guidance published by the OFT required the OFT to have regard to fines in other statutory contexts. The CAT accepted the OFT's position that other regimes were subject to different policy objectives (see especially *Tomlinson*, paras 136-139).

- (2) Some appellants argued that the OFT should not have imposed a fine for each of several infringements in circumstances where one of the penalties had been adjusted at step 3 for MDT purposes, on the basis that the 'global' penalty exceeded the amount necessary to ensure deterrence. The CAT rejected such submissions: the OFT was entitled to impose a fine for each infringement that the undertaking was found to have committed, even if the overall total was more than necessary to achieve deterrence.³⁶
- (3) The CAT cautioned against comparing the fines imposed in the *Construction* decision with those imposed in previous "object" cases. Useful comparisons were almost impossible (*Tomlinson*, para 145).
- (4) Likewise, the CAT did not consider it a useful exercise to compare the penalties imposed on particular undertakings in the construction decision with those imposed on others: the final figure for the fine imposed on each addressee was the result of "many different choices" made by the OFT as to the factors to be taken into account (*Tomlinson*, para 150).³⁷ In a limited number of cases, the CAT did however find that the OFT had breached the principle of equal treatment.³⁸

³⁶ Although it does not elaborate its reasons, one can readily see why the CAT reached this conclusion. Whilst deterrence is one of the key objectives under the guidance, so is seriousness/culpability: *ceteris paribus*, the involvement of a firm in multiple infringements is a more serious matter than involvement in just one.

³⁷ See e.g. *North Midland*, para 102: "comparisons between individual penalties will rarely be justified as a basis for an appeal. Whilst for understandable logistical reasons all the cover pricing infringements were dealt with by the OFT in one composite decision, each of the appeals against the Decision involves largely unrelated individual infringements, and the financial and commercial circumstances of each of the addressees of the Decision are distinct."

³⁸ See e.g. *Crest Nicholson*, paras 74-81 (OFT failed properly to consider whether Crest Nicholson's unique position among recipients of the FTO, in terms of its ability fairly to admit liability in response to it, merited a different level of reduction from those undertakings which simply made a post-SO admission of liability).

- (5) The relevance of the introduction of compliance programmes post-infringement on the appropriate step 3 adjustment was discussed in both *Kier* and *Eden Brown*, albeit with different outcomes. In *Kier*, the CAT held that such a programme may have a bearing on specific deterrence and so should be taken into account by the OFT in assessing deterrence more generally (para 217), whereas in *CRF* the Tribunal held that the OFT had correctly confined the relevance of such programmes to step 4 (para 101).
- (6) The CAT confirmed that, by contrast to the position under Regulation 1/2003, there was no limitation period in the statutory regime for imposing penalties on infringements (*Tomlinson*, para 171).³⁹ It also rejected arguments based on the Limitation Act 1980, the word “action” in ss 2 and 9 not extending to the commencement of, or other steps in, administrative proceedings (*Quarmby*, para 54-56).
- (7) Certain appellants pleaded financial hardship and contended that the OFT had wrongly refused to accept such claims and/or had not reduced the penalty sufficiently to reflect such hardship. The CAT agreed with the OFT that a reduction of the penalty on such grounds should be an exceptional step and that a high threshold was appropriate (*Tomlinson*, para 262). The CAT also agreed with the OFT’s general approach, which was to use the undertaking’s adjusted net assets and average profit thresholds to trigger case-by-case assessment of the issue (*Barrett*, para 114). Further, when considering financial hardship it is appropriate to look at the group of companies as a whole, rather than at the infringing entity (*Tomlinson*, para 232). In *Barrett*, however, the CAT concluded that “the use by the OFT of 50% of adjusted net assets and 150% of annual profits for this purpose was not likely to identify all instances of financial hardship”, finding that:

³⁹ See also *Quarmby*, paras 45-46 (holding that s 60 of the 1998 Act did not require a “read across” from Regulation 1/2003 and distinguishing the CAT’s earlier judgment in *Pernod-Ricard v OFT* [2004] CAT 10 on the basis that there was an express power, not constrained by any limitation period, to impose penalties in s 36 of the 1998 Act, whereas in *Pernod* the CAT was dealing with legislation which, although it recognised the ability of third part complainants to bring an appeal by virtue of s 47, was otherwise silent as to their broader role).

“these figures are too high given the particular characteristics of the construction industry, the impact of the recession on the industry and these Appellants, the very low profit margins...the difficulty of liquidating much of a company’s net assets (e.g. book debt) and the importance of retaining sufficient net assets in order to secure future work.” (para 115)⁴⁰

- (8) Finally, one interesting procedural point emerges from the judgments: the CAT decided to give all appellants the benefit of submissions as to the relevant year for step 1 purposes despite the fact that they had only been advanced by some appellants.⁴¹ On the other hand, some panels did not hear argument as to the appropriate starting percentage for simple cover pricing, and so proceeded on the basis that the 5% figure used in the construction decision was correct.

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⁴⁰ The EU Commission’s penalty guidance, at para 35, also provides for an undertaking’s “inability to pay in a specific social and economic context” to be taken into account where the imposition of a fine as provided for in the guidance “would irretrievably jeopardise the economic viability of the undertaking concerned and cause its assets to lose all their value”. For a recent example of the Commission’s practice in this respect, see its press release in *Animal feeds phosphates* ((IP/10/985): “Two of the undertakings have invoked their ‘inability to pay’ under point 35 of the 2006 Guidelines on fines. These applications have been thoroughly assessed on the basis of financial statements for recent years, projections for the current and coming years, ratios measuring the financial strength, profitability, solvency, liquidity, and relations with outside financial partners and with shareholders. The Commission also examined the social and economic context of each applicant and assessed whether its assets would be likely to lose significant value if it were to be liquidated as a result of the fine. As a result of this assessment, the Commission accepted one of the applications and granted a reduction of 70% of the fine.”

⁴¹ See *Kier*, para 228 in relation to the appropriate year of relevant turnover (although ultimately it made little difference, since the CAT considered it necessary to adjust the penalty at step 3 for deterrence purposes); contrast *Eden Brown*, para 70, where the CAT did not do likewise – partly because it would have resulted in an uplift at step 1 for one of the two parties not to have raised it and partly because the calculation of relevant turnover in this case was complex and it would not be appropriate to expect the OFT to conduct that exercise again.