



This update provides an overview of the key legal and policy developments in UK & EU Competition law in March 2011. For further information, please contact a member of our competition team or your usual Burges Salmon contact.

Competition Appeal Tribunal reduces fines imposed on construction companies by 90%

Key points

- The Competition Appeal Tribunal (“CAT”) has reduced the fines imposed on six construction companies for “cover pricing” by around 90%.
- The CAT’s judgment highlights critical flaws in the OFT’s current approach to calculating fines.
- Both the headline reduction in fines, and the CAT’s departure from the way in which the OFT has applied its fining policy, raise serious questions for the OFT’s enforcement policy, both historic and for the future.
- In particular, this judgment is likely to lead to significant reductions in fines for many pending and future appeals.

Background

In September 2009, the OFT announced that it had imposed fines totalling £129.2 million on 103 construction companies for engaging in the practice of “cover pricing”.

Cover pricing occurs where a company does not wish to undertake a particular piece of work but wishes nevertheless to respond to the invitation to ensure it will be included in future tenders. Through ascertaining the price at which another bidder is offering its services (the “cover price”) the company is able to bid at a level which ensures that it does not win the work but at a price that is not grossly inflated.

In its decision, the OFT treated the practice of cover pricing as effectively equivalent to bid-rigging and so imposed high fines to reflect this degree of seriousness. This analogy was surprising, particularly as cover pricing, unlike bid-rigging, does not involve the determination of the price which will actually be charged to the purchaser.

In calculating the contested fines, the OFT applied its fining guidance published in 2004¹ which sets out a five step process for calculating penalties following an infringement decision.

Twenty-five companies appealed the OFT’s decision to the CAT.

Judgment

The CAT handed down its first judgment covering six penalty appeals.² The main grounds of appeal raised in each of these cases were: (i) the starting point of the fine; (ii) the correct year of account for calculating relevant turnover; and, (iii) the application of the minimum deterrence threshold.

Starting point of the fine – seriousness of the infringement

Under its fining guidance, the OFT can choose a starting figure for a competition fine of between 0 and 10% of the company’s ‘relevant turnover’ (see below). The percentage will depend on the relative seriousness of the infringement.

The CAT found that *“there is no doubt that “simple” cover pricing constitutes an infringement of the Chapter I prohibition, but in our view the practice is materially distinct from “bid rigging” as ordinarily understood... Cover pricing is less serious than conduct of that kind.”*³

¹ The OFT’s guidance as to the appropriate amount of a penalty (OFT423).

² Kier Group; Ballast Nedam; B&K; Corringway; Thomas Vale; and, John Sisk & Son.

³ Paragraph 94 of first judgment [2011] CAT 3.

Accordingly, the CAT ruled that the starting figure of 5% set by the OFT was too severe given the nature of the offence. Instead, the CAT settled on 3.5% as being the appropriate starting point in these cases.

The year of account for calculating turnover

Since 2004, the OFT has calculated fines according to the relevant turnover in the last financial year prior to the OFT's *final decision*.

The CAT has ruled that this approach is unlawful. Rather the OFT should calculate fines according to the relevant turnover in the last financial year *preceding the infringement*. This is consistent with the approach of the European Commission and better reflects the links between the harm caused by the infringement and the size of any fine.

This clarification by the CAT may well lead to fine reductions in many pending and future cases. For example, in the OFT's Tobacco decision, which is currently being appealed by six parties,⁴ the OFT largely based its turnover calculations on the financial year prior to its decision (2008/09), whereas on the basis of this judgment, the OFT should have based its turnover on the year preceding the date when the infringement came to an end (2002/03).

Minimum deterrence threshold

Where the relevant turnover for calculating the fine represented a relatively low proportion of the company's total turnover, the OFT uplifted the fines imposed on the basis of a minimum deterrence threshold ("MDT") which is used to increase fines in order to deter the recipient of the fine and companies of a similar size from breaching competition rules in future.

The CAT held that the MDT had been applied overly mechanistically and gave rise to penalties that were *'excessive and disproportionate'*.

The CAT went so far as to say that it was tempted to rule that the MDT was in principle such a radical departure from what could be regarded as an 'adjustment' (as permitted by the OFT's fining guidance) that it could not be supported without formal consultation and ministerial approval. However, it instead decided on the narrower ground that the OFT's application of MDT in this case was flawed, rather than ruling that the use of the MDT was unlawful per se.

Conclusions

The judgment is a blow to the OFT which has sought to emphasise the size of financial penalties that companies may be exposed to for breaching competition law. It raises serious questions for the OFT's enforcement policy, both historic and for the future. The message from the judgment is that the OFT cannot exercise its discretion to impose fines which are disproportionate to the harm caused.

However, it is important to note that in cases of blatant anti-competitive behaviour (such as price fixing, market sharing, bid-rigging and other "hard-core" cartel behaviour) the OFT may well be justified in imposing a fine of up to 10% of relevant turnover. This decision does not give companies carte blanche and so competition law awareness and thorough compliance procedures should remain high priorities, particularly for companies with market power and large market shares.

Taking a longer term view, at some point in the next few years the OFT and Competition Commission will merge into a new Competition Markets Authority (see below). The Government is currently consulting on options for the structure and operation of this new Authority and one such option is the introduction of a two-phase investigation process, whereby a panel of independent office holders would review the initial investigation conclusions. This additional internal process could help to ensure that appropriate fines are set at first instance and, as a result, companies would not need to go through the long and expensive appeal process in order to obtain justice.

OFT publishes guidance on Competition Act investigation procedures and announces new post of Procedural Adjudicator

On 2 March, the OFT published the final version of new guidance on Competition Act investigation procedures. The new guidance covers the OFT's entire investigation process, including submission of complaints, prioritisation assessments, information gathering and inspections, procedures following issuance of a statement of objections and the final decision.

In terms of making a complaint to the OFT, the guidance explains that non-cartel complaints should be submitted to the OFT's Enquiries and Reporting Centre. The OFT commits to providing an initial response within 10 working days in most cases, and a substantive response in complex cases within 30 working days. The OFT aims to inform complainants within four months of whether it has decided to open a formal investigation.

In relation to complaints about how a particular investigation is being handled, concerns or complaints should be made in writing to the designated Senior Responsible Officer (SRO) in the first instance.

Certain procedural complaints may also be referred to the Procedural Adjudicator, a new role established on a trial basis, beginning on 21 March for an initial one year period.⁵

The role of the Procedural Adjudicator will be to resolve disputes in relation to OFT case team decisions on certain procedural issues in cases in which a formal Competition Act investigation has been opened.

⁴ Including Co-operative Group Limited, for whom Burges Salmon is acting.

⁵ At the end of this trial period, the OFT will decide whether to establish the role permanently. If cases are taking longer than before as a result of the Procedural Adjudicator role, it is highly likely that the OFT will discontinue the trial.

In particular, the Procedural Adjudicator will be able to review case team decisions in relation to:

- deadlines for responding to information requests;
- requests for confidential redactions at the access to file and statements of objections stages, or in the final decision; and
- requests for disclosure/non-disclosure of certain documents at the access to file stage.

The standard of review exercised by the Procedural Adjudicator will be similar to judicial review grounds: whether the case team's decision was unreasonable or irrational; whether the case team has respected the necessary procedural requirements; and/or whether the party's rights of defence have been respected.

OFT makes first "fast track" merger reference in relation to Thomas Cook/Co-operative Group joint venture

On 2 March, the OFT announced that it has decided to refer the anticipated travel business joint venture between Thomas Cook, the Co-operative Group Limited and the Midlands Co-operative Society Limited to the Competition Commission. In so doing, the OFT has, for the first time, used the fast track reference procedure.

The OFT's merger guidance⁶ introduced a new "fast track" reference procedure whereby, exceptionally, it may be possible to significantly accelerate the treatment of cases for referral to the Competition Commission. A fast track reference may be appropriate where the case raises clear *prima facie* competition issues or there are complex issues that the parties do not consider can be resolved in the OFT's first phase investigation. In this case, the OFT was convinced that a reference was appropriate given that the joint venture will bring together two of the three largest travel agents on the UK high street.

The merger guidance states that the overall time taken from formal notification to a fast track reference decision could be as little as 10 working days. In this case, the parties requested a fast track reference on 14 February. Therefore, the reference decision came on the 12th working day after that request.

European Commission confirms dawn raids in the e-book publishing sector

On 2 March, the European Commission announced that its officials conducted unannounced inspections at the premises of companies active in the e-book publishing sector in several EU Member States.

Press speculation indicates that the investigation centres around so-called "agency pricing" which allows publishers to set retail

prices for downloaded books and has been accused of stifling competition, leading to higher prices for consumers.

Depending on the complexity of the case, and the co-operation of the companies involved, the investigation could take a number of years to complete.

Secretary of State consults on undertakings in News Corp / BSkyB merger

On 3 March, the Secretary of State for Culture, Olympics, Media and Sport, Jeremy Hunt, issued a consultation on the proposed undertakings submitted by News Corp in lieu of referring their acquisition of BSkyB to the European Commission. The proposed undertakings are based on advice from the OFT and Ofcom and are unusual in that they are drafted to safeguard media plurality in the UK as opposed to addressing potential adverse effects on competition.⁷

The proposed undertakings will see Sky News (including key editorial staff) spun off into an independent, publicly owned NewCo following the merger. NewCo's financial viability will be protected by a ten year carriage agreement to provide BSkyB with the Sky News channel and other services in return for the payment of a fee. BSkyB will also enter into arms-length agreements to provide facilities and operational support to NewCo.

Under the proposed undertakings, editorial independence would be protected by a number of corporate governance measures including restricting Sky's shareholding to 39.14% (equal to its existing shareholding in Sky News) and requiring a majority of NewCo's board and its chairman to be independent of BSkyB / News Corp.

Commission opens Phase II investigation into proposed merger between UPM-Kymmene and Myllykoski

On 3 March, the European Commission announced it had initiated a Phase II merger investigation into the proposed acquisition of sole control by UPM-Kymmene Corporation of Myllykoski Corporation.

Both companies are active in the production of paper and pulp, amongst other products. The Commission is particularly concerned that the proposed merger would lead to high market shares in the magazine paper market and has opened a Phase II investigation to consider the compatibility of the merger with the internal market.

This is the third Phase II investigation to be launched by the European Commission this year.⁸

⁶ OFT 527 (June 2009), paragraphs 4.71 – 4.75.

⁷ The background to the merger is outlined in our November 2010 and Dec/Jan 2011 issues (issues 5 and 6).

⁸ See also: COMP/M.5907-Votorantim/Fischer/JV and COMP/M.5969-SCJ/Sara Lee.

OFT launches private healthcare market study

On 10 March, the OFT formally launched its market study into private healthcare.⁹ Responding to concerns that the private healthcare sector is not working well for consumers, the OFT has confirmed that the market study will look at the nature of competition in the provision of private healthcare, market concentration, barriers to entry, the role of consultants and constraints on consumers.

In relation to the role of the NHS, the market study will examine the provision of private healthcare by the NHS through Private Patient Units (PPUs). In particular, the OFT will examine concerns expressed by a number of stakeholders that PPUs enjoy unfair competitive advantages (due to access to state funded pensions, tax exemptions, the absence of regulatory fees and access to NHS facilities) and that the NHS is cross-subsidising PPUs.

Government consults on structure of reforms to the UK Competition Regime

On 16 March, the Department for Business, Innovation and Skills ("BIS") published a consultation on the options for reforming the UK Competition Regime. The most eye-catching reform is the proposed merger of the OFT and the Competition Commission into a single Competition Markets Authority.¹⁰

The proposed reforms outline what will unquestionably amount to the most substantial reform of the UK competition regime in over a decade.

The consultation seeks views on a wide range of possible new procedures and structures, including:

- *merger control*: changing the merger control regime to make notification for competition approval mandatory for mergers where the turnover of the target business is over £5m;

- *anti-trust enforcement*: requiring the new Competition Markets Authority to present its cases for scrutiny before an independent internal tribunal before publishing a decision, thereby creating a two phase structure in Competition Act investigations akin to that for mergers and market references; and
- *cartel offence*: removing the dishonesty element from the offence and defining it so that it does not include agreements made openly.

The breadth of the consultation is such that it is difficult at this stage to predict which direction the Government will ultimately take. At this stage, it appears that almost every aspect of the UK competition law regime, from merger control to the criminal cartel offence, could be subject to considerable change.

BIS invites comments on this consultation by 13 June 2011. Given that the majority of the proposals would require legislative changes, it is expected to take at least two years before any of these will come into effect.

OFT refers proposed mortgage software merger to Competition Commission

On 17 March, the OFT referred the anticipated acquisition by MBL Holdings Limited of TrigoldCrystal Limited to the Competition Commission.

MBL and TrigoldCrystal are the two largest UK suppliers of mortgage sourcing software and are considered to be each others closest competitor. The merger would lead to a very high market share in the mortgage sourcing software market, which already suffers from high barriers to entry.

It should also be noted that this was the fourth merger that the OFT has referred to the Competition Commission so far in 2011, already exceeding the total number of references made in 2010.¹¹

⁹ We reported on the initial announcement of this market study in our Dec 2010/Jan 2011 issue (issue 6).

¹⁰ The merger of the two authorities was considered in our October 2010 issue (issue 4).

¹¹ The lead article of our February 2011 issue (issue 7) reported on the first two merger references made so far in 2011. The third reference was the Thomas Cook/CGL merger discussed above

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