

Cover Pricing in the Construction Sector



Jonathan Sinclair

Partner - Commercial and Competition Litigation

stewartslaw

Telegraph.co.uk

Construction industry hits out at OFT 'price rigging' penalties

Why is the OFT so unfair?: Coverpricing vs bid-rigging

Builders hammered by OFT price-fixing probe

Date: 17-Apr-08



Tuesday, 29 June 2010

Can we price-fix it? Yes, we can

Construction giants accused of price fixing by OFT

Apr 17 2008

Building companies fined £129.5m

Against The Law But 'Common Practice'

From The Times

September 23, 2009

Cover price fines are a bargain for builders

'price distortions'

Cover Pricing in the Construction Sector

- Context/current position
- Extent of the problem
- Implications for public sector clients

OFT Decision - 21 Oct 2009

- Total fines of £129.5 million (low)
- 103 construction companies
- 199 separate sites
- 86 of the companies benefited from leniency

Context

- Bid rigging – other sectors/abroad
- Roofing
- Investigation
- Geographic scope
- Size of project

How it's meant to work

- Selected builders are contacted
- Asked to bid for a project – against detailed specifications and terms
- 2-3 bidders (usually on price) asked to give detailed breakdown
- Preferred bidder chosen

Case study 1 - Wycombe

- District council puts a large refurbishment project out to tender
- Five building companies are contacted
- One builder has 'insufficient resources' to take on the job and so contacts one of the other bidders to obtain a cover price
- The inflated cover price is submitted as a genuine bid

Case study 2 - Nottinghamshire

- County council puts an office extension project out to tender
- Four building companies are contacted
- One bidder promises payments to two of the other bidders for them to 'back off' and submit inflated cover prices
- Two unsuccessful bidders invoice the winning bidder using false invoices for machinery
- "Compensation" payments are made
- (Alternative taking turns)

Fines and leniency

- 37 companies applied for leniency by giving incriminating evidence
 - 33 successful
 - Fines reduced by up to 35-65% (or 100% if the OFT did not previously know about the offence)
- A further 12 companies received small reductions for later admissions
- Fast track offers were made to the remaining companies
 - 45 applied (41 accepted): fines reduced by 25% if bid-rigging was admitted

Appeals

- 25 of the companies appealed
- 19 contesting the level of the fines
 - (ie not contesting the illegal activity)
- 3 were claiming that the parent company should not be fined for the illegal activity of its subsidiary
- 2 claimed that the evidence was not strong enough
- Only 1 appeal expressly denied any cover pricing

Limitations of investigation

- Why did the OFT only go after 103 companies?
 - Limited resources – overwhelmed
 - 5 year investigation anyway – systematic filter applied
 - Decided only to prosecute a maximum of 3 tenders per company
 - Only prosecuted companies involved in at least 5 suspect tenders

Prevalence of Cover Pricing

- The OFT acknowledged that their investigation only uncovered the tip of the iceberg
 - Evidence in over 4000 tenders
 - Worth around £3 billion
 - Involving over 1000 companies

Legal perspective

- Illegal - even if this collaboration does not affect price (object or effect of restricting competition)
- Exchange of bid information between competitors
- Even if one of the competitors does not intend to submit a genuine bid
- Inherently misleading client in that process understood to involve competitive bids

Construction industry perspective

- Common practice - Even described in text books
- Unaware illegal - Though companies often went to great lengths to hide the practice
- Necessary to protect business - OFT found little evidence for this but later survey gives limited support (13% of procurers said that they not would invite companies that had previously failed to provide bids - 35% could not say – 52% would invite)
- Has no effect on cost of winning bid ?!

Effect of cover pricing

- How does cover pricing result in increased prices?
 - It reduces the number of genuine bids
 - Knowing that some or all competitors will be submitting higher bids may influence a genuine bidder to pitch at a higher level
 - Involves deception and temptation for outright fraud

Public sector impact

- Decision cases were a mix of private and public sector, but
- 75% of the cases involved:
 - public sector
 - charities
 - housing associations
 - educational establishments

Financial loss

- OFT no need to prove (... **object or effect**)
- Claimant must prove loss
- All tenderers involved?
- Compensation payments?
- Review of winning bid against expected cost
- Government discourage
- Many law firms effectively “conflicted”

Evidence of change?

- Investigation finding - endemic
- OFT surveys pre (March 2008) and post (June 2010)
- Less prevalent (44% in 2010)
- But nonexistent or seldom occurring (pre and post) ??!
- Disadvantaged by competitor bid rigging (30%) ??!
- Industry self reform eg NFB code of conduct
- Massive cultural challenge

A procurement perspective

- What steps can you take?
- When preparing a project for tender
 - Carry out an independent assessment of the likely costs
 - Assurances that non-bidders will not be penalised
 - ‘No collusion’ clauses
 - Ensure that there are good number of bidders
- When considering tenders ask for full breakdowns
- Future policy of delisting tenderers proven to be involved in cover pricing

Cover Pricing in the Construction Sector



Jonathan Sinclair

Partner - Commercial and Competition Litigation

jsinclair@stewartslaw.com

0113 222 0022

stewartslaw