IN THE COMPETITION APPEAL TRIBUNAL

Case No. 1114/1/1/09

Victoria House,
Bloomsbury Place,
London WC1A 2EB

28 June 2010

Before:

THE HONOURABLE MR. JUSTICE BARLING
(President)

PROFESSOR ANDREW BAIN OBE
PETER CLAYTON

Sitting as a Tribunal in England and Wales

BETWEEN:

(1) KIER GROUP PLC
(2) KEIR REGIONAL LIMITED — Appellants

- v -

THE OFFICE OF FAIR TRADING — Respondent

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HEARING

APPEARANCES

Mr. Mark Brealey QC (instructed by Simmons & Simmons) appeared for the Appellants.

Mr. David Unterhalter SC and Mr. Alan Bates (instructed by the General Counsel, Office of Fair Trading) appeared on behalf of the Respondent.

THE PRESIDENT: Mr. Brealey?

MR. BREALEY: Sir, we have prepared a written text.

THE PRESIDENT: Oh, for us?

MR. BREALEY: Yes, just so that there is, hopefully, certain logic to it, and it is the best way of trying to make the oral submissions.

THE PRESIDENT: Yes.

MR. BREALEY: As the Tribunal will have seen, the fine imposed on Kier (in round numbers £2.7 million) to reflect the seriousness of the infringement, and then at step 3, you will have seen this was increased by 600 per cent, and the 600 per cent meant the fine increased by £16.2 million, and then the fine was reduced by £940,000 in respect of the compliance programme which we refer to, a 5 per cent reduction. Then, importantly, for our second ground of appeal, no further reduction was given for Kier for not challenging the allegations of infringement.

So £2.7 million to reflect the seriousness, and then there was the 600 per cent increase for deterrence. The Tribunal picked up from the documents that we have two main grounds of appeal. First, we say that the 600 per cent increase of £16.2 million was inflated, above the level necessary for deterrence, that is the relevant test, as we will see, and secondly that we should have received a further 15 per cent reduction for co-operation. So we should have received a discount like other parties have got for not challenging the facts relating to the infringement, and essentially admitting that cover pricing was unlawful, and we did not get that further 15 per cent reduction, unlike other parties. So those are our two main grounds of appeal. We say in para. 3 the first ground of appeal raises slightly more important policy issues, but nevertheless ground 2 is worth in excess of £2 million, which is still a very significant sum.

What I would like to do for the majority of my 50 minutes is deal with the first ground, deterrence, but then spend 15/20 minutes dealing with the second ground. Paragraph 4 sets out what we say is one of the tests relevant to deterrence, i.e. the penalties should not be inflated above the level necessary for deterrence, and that is what this Tribunal said in *Argos* and was endorsed by the Court of Appeal in *Argos*. We always have to ask the question: has this fine been inflated above the level necessary for deterrence?

What I have tried to do at para.6 is to try and draw some basic principles together, because obviously there is a margin of appreciate ion, there is a discretion, but that discretion has to be based on certain rational principles. At para. 6 I have set out what, in my submission, are three basic principles.

First, the OFT should ensure that the deterrent fine is not out of proportion to the fine imposed for the defence. In other words, there must be a reasonable connection between the deterrence and the culpability and I will expand on that; there must be a link between the fine for the offence, and then the fine for deterrence.

Secondly, the OFT must properly assess the overall impact of the fine, so when it comes to deterrence, they are looking at impact, and here we say the OFT should cross check the level of fine by reference to other financial measures other than turnover – that is our "profit v turnover" point that you will have picked up from our submissions.

Thirdly, the OFT must properly assess the extent to which the company in question needs to be deterred. We are talking about deterrence here, it does not exist in a vacuum, and the OFT should ask itself the question: "To what extent does this company need to be deterred, because it has general deterrents, and specific deterrents". We say – and I will try and articulate it a little later on – that compliance programmes are relevant to the question of deterrence. They are not just a mitigating factor.

At para. 8 we say that the OFT has not had regard to these three basic principles, that there is a disconnect between the amount of the fine for the infringement, and the amount of the fine for deterrence. There is a disconnect between the amount of the fine for deterrence and its impact on Kier, and there is a disconnect between the increase for deterrence, and the reduction for compliance.

So with that basic introduction in mind, can I then turn to para. 9 of this speaking note where I try and articulate what I call the first basic principle. The Tribunal has been taken to the penalty guidance, but the OFT does emphasise that it has twin objectives – "twin" usually means they are closely related, and these twin objectives are to impose penalties on infringing undertakings which reflect the seriousness of the infringement, and secondly to ensure the threat of penalties would deter undertakings from engaging in anti-competitive practices. So those are described by the OFT as the "twins". They are clearly rational and legitimate, we see it elsewhere in other areas of crime and punishment, s.142 of the Criminal Justice Act, for example. The important point to note is that the first objective essentially concerns retribution; it is concerned with the offence that has been committed, and making sure that the punishment inflicted is proportionate to the offence.

The second objective concerns deterrence. General deterrence is concerned with deterring third parties and so to an extent it does conflict with the principle of retribution, since it involves punishing an offender more than is deserved for the specific offence. So they are twinned, they are related.

It is at this stage we say that the first basic principle comes into play, that is to say that the fine levied for deterrence we know must be proportionate but the proportionality must be judged in part by reference to the crime committed and to the seriousness of the offence. It is an important point, if the link between the punishment for the offence, and the punishment to deter others is lost, if that link is lost we have, in my submission, a very unfair system of penalties. We no longer have closely related twin objectives, offenders are being heavily punished simply to deter others. So when assessing the level of the fine for deterrence, in my submission it would be a rational exercise of the discretion to look at the seriousness of the offence and the amount of fine imposed for the seriousness.

How does that principle apply here? To say the assessment of the fine at step 1 is to determine the seriousness of the offence and potential harm to the market affected, that is the purpose of step 1; that is the retribution. The starting point will depend in particular upon the nature of the infringement, the more serious and widespread the infringement the higher the starting point. At para.90 of the decision the OFT notes that step 1 is to ensure there is a correlation between the penalty and the harm.

Again, I emphasise the point that at step 1 we are talking about the punishment for the offence. It is important, in my submission, to recognise that the starting point was 5 per cent, this was not a 9 per cent BA/Virgin secret cartel fixing the price of fuel to the consumers. The starting point of 5 per cent the OFT underplays this in its defence documents and its response documents, the starting point of 5 per cent reflected several mitigating factors, and I have set them out here. Does the Tribunal have our Notice of Appeal bundle?

THE PRESIDENT: Yes.

MR. BREALEY: For example, if one goes to the notice of appeal bundle – I am going to the decision so I do not know if the Tribunal has its own marked up copy of the decision ----

THE PRESIDENT: Which paragraph.

MR. BREALEY: It is at tab A, paras. 19 to 29, this is IV 19 to 29, the beginning of tab A, p.27 of the bundle. What I am trying to tease out here is that the OFT in its decision refers to several mitigating factors as to why it took 5 per cent for the seriousness. The first one was the perception in the industry that cover pricing was permitted. So if we look at para.IV.19:

> "The extent to which the practice was regarded as both legitimate and widespread in the construction industry is further demonstrated by a text book on the bidding process (*Construction Planning, Programming and Control* by Brian Cooke and

Peter Williams, Blackwell Publishing 2004) that contained the following advice to bidders:"

'*Degree of competition'* – first, second and third bullet point. The fourth bullet point:

"Do we want the work or should we take a cover price (i.e. an arrangement whereby one contractor is given a price by another contractor which his then submitted as a tender offer. The price will be sufficiently realistic to look like a bona fide tender but high enough so as not to win the contract)."

We know now that these companies that engaged in cover pricing, certainly from Kier, it knows that this was an infringement of the competition law – I am going to take the Tribunal to the response – but it is important to note that that is what the OFT perceived, and if we go to IV.29 it is going to take this fact into consideration when it fines the companies. So "Notwithstanding this" i.e. although the textbooks and I have never known a text book which says you can carry out this practice which turns out to be unlawful, but that is what the text book said. At 29, it says that the undertakings were at least negligent, but

"Notwithstanding this, the OFT has taken into account the Parties' representations when determining the level of penalty…"

What I am trying to do here is re-emphasise the fact that this was a 5 per cent for seriousness.

At para.15 I have set out other factors, that the OFT says were relevant as mitigating factors when setting the level of the fine. There was no intent to inflate prices rather than a desire to remain on the customer's tendering list. I will not go through it because of the time, but I have set out the relevant passages here. The acceptance that cover pricing may not have increased prices, the fact that the infringements did not apply to the whole of the relevant market, but to an individual tender and the lack of any centrally controlled and orchestrated scheme.

These are all the mitigating factors in the decision as to why the OFT took a 5 per cent seriousness. It was not 7, 6, 8, 9 or 10, it was 5 per cent. So what I am trying to show the Tribunal on this first basic principle that the OFT should be looking at when fining for deterrence is say that with a 600 per cent increase in the fine by £16.2 million has that link been lost? We say there is no reasonable link between a £2.7 million fine for the potential harm done, the seriousness of the offence, and then a whacking £16.2 million fine for deterrence. There is no link between a 5 per cent seriousness infringement and a 600 per cent increase for deterrence. "Deterrence" is a very easy word to use. You can speed and you get fined for speeding, but you do not get your hands chopped off. If you got your

hands chopped off that would act as a deterrent, but it is a disproportionate response to the crime. So the deterrence is easy to say but it has to be based, we say, on some basic principles, which should underpin the exercise the OFT's discretion when it comes to fining companies. The OFT should not lose sight of the link between the offence that has been committed and the increase of the fine for deterrence. So that is the first basic principle which I would urge the Tribunal to adopt.

The second basic principle concerns the amount of deterrence, and its impact. Again, what is this principle? Paragraph. 18 of the OFT's response states:

> "Where the undertaking's relevant market turnover represented less than 15 per cent of total turnover, the MDT operated to increase the penalty at the end of step 2 to what it would have been had around 15 per cent of the undertaking's commercial activity taken place in the relevant market."

So it takes 15 per cent of Kier's worldwide turnover and pretends that turnover is relevant turnover so that is essentially the market that has been harmed.

Paragraph 18 of its response, this is the OFT's response t o our reply skeleton, continues with a statement that multi-national companies should not have a penalty that will be very small compared with the undertaking's overall size and scale.

Paragraph 19 refers to the need to make a significant impact on multi-national companies. So paragraph 18 says that 15 per cent of worldwide turnover, whether it is in – we are talking about construction here, but it could equally be in window cleaning in the USA, it could be in water manufacturing in Australia – whatever it is you would take 15 per cent of its worldwide turnover. Why? Because these multinational companies, says the OFT, must have a fine which has a significant impact on it. I emphasise the word "impact" - we emphasised particularly in our reply skeleton, and our notice of appeal, and I emphasise it today. How do you assess impact? We say you do not assess impact simply by taking a company's turnover. You have to do a bit better than that. We are no longer talking about the seriousness of the offence, you have taken the turnover, the volume of sales, and you have been fined for the offence committed, we are now trying to work out how the OFT should assess the impact on the company. We say that you should look at the financial situation of the company, that will include turnover, but it will also include other financial pleasures.

The irony of that submission is that that is indeed what the OFT's own guidelines say. We are not trying to depart from the guidelines. If one reads the OFT's guidelines, it specifically refers to turnover in step 1. It specifically refers to turnover in step 5 on the

cap, but when it comes to the guidelines the relevant para. 2.11 of the deterrence aspect of the guidelines, it does not refer to turnover at all, it refers to the size and financial position of the undertaking in question. The reference to the financial position of the undertaking in question we say is completely consistent with looking at the financial position of the company not simply to turnover. If you are acquiring a company, you have your accountants on board and you say: "I want to buy this company, what is the financial position of this company?" you do not just give the person the turnover, you give it other financial measures – net assets if necessary. But here, because of the slim margins in this industry in general we have concentrated on profit. We say that is a matter of simple commonsense. If you are looking to assess the impact of a fine on a person or on a company, you should not simply be looking at turnover. You should also be looking other official measures including profit.

Dealing with certain arguments of the OFT in its response skeleton – para. 24 of the speaking note – the OFT said that profit may go up, profit may go down, to which we say "So does turnover", and I do emphasise this point because even if the Tribunal dismisses all our arguments on my three basic principles, and concludes that the OFT is entitled to take 0.7 per cent of worldwide turnover.

The turnover for 2009 was such that the fine would be reduced by just over £2 million, and we would say that we could not get our 2009 to the OFT because as Deena Matar explains in her witness statement, we were some couple of weeks off, so the OFT took 2008. This Tribunal can take the 2009 accounts, because it can take the impact of the fine, having regard to all relevant matters – this is the Tribunal in *Napp* – this Tribunal can have a look at all relevant matters, and even taking the OFT's 0.75 per cent, if one takes the 2009 turnover, and most of the companies on these appeals had their 2009 turnover taken, the fine would be reduced by some £2 million.

THE PRESIDENT: It was £221 million, was it, the worldwide turnover was reduced? It must be, must it not?

MR. BREALEY: Yes. The OFT says – para.21 of the response – that companies make a loss. If profit is relevant what do you do about companies that make a loss? Superficially attractive, but we say that if a company is loss making that should be a factor to the size of any deterrence fine. Loss making companies are still punished for the offence, you still take the relevant turnover at step 1. You still take the seriousness into account, and you pay the fine for the offence. But if a company is consistently loss making it will not be able to afford as much as a hugely profitable pharmaceutical company, and it would be rational to

say that a smaller fine for deterrence would have a similar impact on a loss-making company. You do not need the same deterrence fine as you would on a pharmaceutical company if the company had been losing money for the last 10 years a smaller deterrence fine may have a similar impact. But to say that profit, or the financial position generally of the company is irrelevant – and this is the important point – we would say it is irrational. It is simply irrational to say "I am going to impose a fine so as to make an impact on this company", and then not look at the financial position of the company, and that is all we are asking. We are not seeking anything wholly unreasonable here. All we are asking is that the OFT should have slightly more wider recourse to looking at more factors having regard to further considerations than it does, because as the Tribunal knows all it did in this case – I am going to look at the application of the principle in a minute – but all it did was say £2.7 million, which was the fine for the offence, is small compared to £2.5 billion turnover, which is true, and therefore I am going to take the 15 per cent worldwide turnover and pretend that it is in the relevant market. Then there is no sense check as to the link between the offence and the deterrence, there is no sense check as to the actual impact of that 600 per cent increase, that £16.2 million fine, on Kier. The application of the principle on Kier I refer to at para. 28. When one sees what the pre-MDT fine, and then the post-MDT fine by reference to its profit it is massive. The pre-MDT fine was £2.667, almost £2.7 million. As I say, all the OFT did was say that that is small compared to £2.5 billion. But when you actually look at the financial position of the company – I put that in square brackets, but speaking to the directors at Kier just outside, as I understand it as long as the Tribunal does not mind they would like it to stay in square brackets – it is that times the operating profit that Kier estimates earned on all the contracts, so four times the operating profit that Kier estimated earning on all the contracts in the relevant markets in 2008.

The pre-MDT fine represents almost 60 per cent of the entire estimated profit derived from the three relevant markets over the last nine years. All these figures are in the witness statement of Deena Matar in the notice of appeal.

Of the total worldwide profit, the pre-MDT fine represents for 2008 – 5.6 per cent, for 2009 – 16 per cent and averaged over 8.3 per cent. The OFT never asked itself the question: "If I fine Kier £2.7 million, what is the impact of that £2.7 million on Kier?" It never asked that relevant question. All it did was to say: "That is small compared to £2.5 billion." I must admit that if you are looking, for example, at the 2009 accounts, and you are looking at pre-MDT fine at the moment, and you conclude that that represents 16 per cent of your worldwide profit; that is not small. I have referred to the unchallenged statement, we asked

the OFT whether it wanted to cross-examine Deena Matar, the finance director, they do not. We set out there at para.30 why she says that the pre-MDT fine is significant. It would have been an exceptional item in the accounts, and to say it is small purely because it is small compared to £2.5 billion does not really take you very far – remembering again this is for three individual instances of cover pricing.

In the post-MDT it wipes out all the operating profits earned in the three relevant markets over the last nine years by a factor of four. So to put that into perspective, the fine of £17.8 million it would take Kier about 36 years to pay off the penalty using operating profits from the three relevant markets, and that is what she has said in her witness statement and it is unchallenged. It represents in excess of 100 per cent of total profit for 2009, nearly £1 million more than Kier's worldwide profit after tax for the year ended 30th June 2009, and 37 per cent of total worldwide profit for 2008.

All I am asking is the Tribunal to accept that these are relevant considerations because the flip side is that they are irrelevant. The OFT says "we do not look at profit, we look at turnover, and if its guidelines talk about having regard to the financial position of the company, these sorts of figures are relevant. Is it proportionate, for example, to impose a 600 per cent increase, £16.2 million on Kier for deterrence purposes, for the three individual Infringements relating to cover pricing, which is a 5 per cent seriousness, and say that wiping out this company's worldwide profit for 2009 is proportionate. In my submission, it is not. That is the second basic principle – the extent to which the OFT and, indeed, this Tribunal should have regard to financial measures other than turnover. The third basic principle is the link between deterrence and compliance. We know that the OFT has regard to compliance at step 4 after the fine for deterrence, but is that logical, is that rational. We say it is not.

The OFT acknowledges that compliance programmes achieve the same aim, it gave a 5 per cent reduction at step 4, OFT considers that these parties are the ones that are most likely to have successfully minimised the likelihood of future infringement, that is why it got a reduction at step 4. The OFT at para.21 acknowledges penalties also incentivise the infringing undertakings and other undertakings to put robust compliance programmes in place to ensure they avoid participating in infringing conduct.

Notwithstanding those, the OFT says that compliance is irrelevant. We submit that logically a robust compliance programme is a relevant factor when deciding how to fine a company by way of deterrence, any fine must be proportionate – it is trite law – proportionality is dictated by a reasonable aim, and reasonable measures necessary to

achieve that aim. The fact that a company, that has taken its own measures to prevent it infringing again, we say is relevant to the extent to which that company is to be specifically deterred. I am not talking about general deterrence here, I am talking about what the OFT describes as specific deterrence – the amount of the fine which is necessary specifically to deter that company. I do urge the Tribunal to consider the compliance programme that we have referred to in our notice of appeal. It is set out in the witness statement of Mr. John Dodds, the previous chief executive of Kier.

It is important to note that he personally oversaw a policy to ensure that from top to bottom there was a culture of compliance within Kier. I do emphasise the points that we make at para. 14. The compliance programme that was rolled out was set in motion days after receipt of the fast track letter which was the first time Kier knew of the investigation. It was implemented at the highest level by Mr. Dodds, within days a memo had been sent to all 91 directors of the various Kier boards stating that anti-competitive practice including cover pricing was unacceptable, and a letter was sent out to all employees attached to their payslips setting out the company's compliance programme. If you are being investigated you have a compliance programme, you are not going to be immune from fine, but again is it a relevant question? When you are asking the question: "Should this company specifically be deterred?" is it relevant to see what the company has done as soon as it knows of the investigation? We say it is relevant and the 5 per cent reduction, the £940,000 reduction, was insufficient for the extent to which this compliance programme was set in motion. It was a very, very comprehensive compliance programme, as the Tribunal will have seen.

So the conclusion on ground 1, which is concerned with the OFT's policy of deterrence, the OFT has not had any regard to the gap between the fine for the offence, and the fine to deter others. There has been no cross check or sense check whereby the OFT, taking 0.75 of worldwide turnover, said to itself: "Is a 600 per cent increase for deterrence really necessary given the 5 per cent seriousness of the offence?" The OFT has refused to consider any other financial measure, save turnover to calculate the penalty.

I would ask the Tribunal to note the passages in the OFT's consolidated defence to which we refer in our reply skeleton where the OFT seems to accept that simply taking turnover is not sufficient. That is what it expressly says in the defence, and yet that is essentially what it has done.

Lastly, the OFT has refused to consider the extent to which Kier needed to be deterred, so it is specific deterrence. Paragraph 45 is important because *Makers*, for all the reasons I am

sure lots of companies are going to be submitting to the Tribunal and we submit in our notice of appeal, does not endorse taking 0.75 per cent of a multi-national company's worldwide turnover. This MDT is new. The introduction of a percentage of worldwide turnover for multi-national companies is new, and it has the potential to fine a large company far more than smaller companies, even though the larger company may actually have played a minor role in the actual infringement. That could be the impact of that. As I say, just because a particular division of a company is part of a much larger company that has window cleaning in America, or water production in Australia, the fine is potentially a lot larger, even though the company itself may have played a very small role.

Just taking this percentage of worldwide turnover, it needs to have some sort of sense check. We submit that the three basic principles that I have tried to identify should be endorsed buy the Tribunal, and if the Tribunal does accept one, two or three of the basic principles then the fine, in my submission, should be substantially reduced, and a 600 per cent increase amounting to £16.2 million is inflated beyond the level necessary for deterring Kier and third parties.

That is the first ground of appeal. Can I quickly go on to the second ground, which is co-operation? One has the decision there, the approach to further reductions for co-operation is set out by the OFT at p.1700 (p.121 of the bundle). As I say, this makes about £2 million difference to Kier. It concerns co-operation, it refers at 323 to the Fast Track Offers that the Tribunal will know a lot about at some point. Then at 326 it sets out its approach:

> "… as noted above … the new admissions do add some value and the OFT is therefore granting the following discounts at step 4 of the penalty calculation to these parties.
>
> * where a party has made a clear admission of the facts …"

and I would ask the Tribunal to underline "<u>or alternatively a clear positive statement that it does not dispute or contest the facts: 10 per cent discount</u>." It is that part that the OFT has certainly overlooked – "a clear positive statement that it does not dispute or contest the facts: 10 per cent discount."

> "* where, *in addition* to the above, a Party has clearly admitted that its conduct constituted an infringement of the Act: 15 per cent discount."

So that is 10 plus 5, so 15 per cent. One has to look to see how the various companies then replied to the SO. I have set out a couple of examples, the example of Connaught at para.50 – given the time, because I want to go through Kier's response – para IV 999 the OFT refers

to "Connaught does not dispute the facts challenged against it." For that it got 10 per cent.

I do apologise, but if the Tribunal looks at my para. 46 you will see that I have corrected ----

THE PRESIDENT: 46 of your reply skeleton?

MR. BREALEY: No, 46 of this. In the reply skeleton – it was my fault – I put Connaught had 15 per cent, but it did not, it got 10.

THE PRESIDENT: So this is correct?

MR. BREALEY: This is correct, yes. Also at para.58 of the reply, the part in quotes does not refer to para. 3.7, it refers to para. 60. Connaught had 10 per cent for the statement: it does not dispute the facts alleged against it. An example of BNA: "BNA has no means of challenging the evidence now presented, admits liability for the cover price infringements alleged by the OFT, and it got 15 per cent."

There are several passages relating to Kier, and again I want to go to the response, but basically what the OFT does, it refers to two paragraphs, paras. 1.2 and 2.1 of Kier's response to the SO. They are paragraphs where Kier says it is not commenting on the alleged infringements. One assumes, although it is never expressly set out, that that was not enough to comply with the two bullet points at 3.26 of the decision. What I would like to do is quickly take the Tribunal through t he response because in my submission Kier not only did not dispute the facts but quite clearly admitted that it was engaged in unlawful cover pricing. How the OFT, with the greatest respect, continues to say that Kier did not frankly is a mystery.

THE PRESIDENT: So this is Kier's response to the statement of objections.

MR. BREALEY: Yes, and what I have done in the speaking note is set out the relevant passages which, in my submission, clearly show that Kier did not, I adopt the phraseology, "dispute or contest the facts" and in addition admitted that its conduct constituted an infringement of the Act.

Simply referring to those two paragraphs, 1.2 and 2.1, it is an extremely uncharitable view of this response.

1.2, which is the first paragraph I emphasise.

THE PRESIDENT: We are looking at the response now?

MR. BREALEY: We are looking at the response, p.145 in the bundle.

> "Having reviewed the SO, neither Kier nor Group wish to offer any comment on the allegations in the SO that Kier breached the prohibition."

I am going to come on to other bits in a moment which puts it beyond doubt that even offering no comment, if you take a dictionary definition of "comment" it usually connotes

some critical comment, and so what Kier is doing at 1.2 they are not offering any critical comment on the allegations. The OFT say that is not enough, but when we come ----

THE PRESIDENT: They are looking for something that gives them a cast iron – they can say "We do not have to worry about proving that now, they accept it".

MR. BREALEY: This is it ----

THE PRESIDENT: Well not offering a comment does not preclude you from ultimately pleading not guilty, does it? I do not know – you are just not going to say anything at this stage.

MR. BREALEY: Well no, what they are saying ----

THE PRESIDENT: I mean I am sure you go on to say a lot more.

MR. BREALEY: I do go on to say a lot more, but I would say that offering no comment, and saying "All I am going to do is deal with the penalty, is making the OFT's life easier because the facts are there and it is not essentially challenging the facts. All I am doing ----

THE PRESIDENT: A clear admission of the facts is what para.326 is saying it requires.

MR. BREALEY: Well no, with great respect, "… or alternatively a clear positive statement does not dispute or contest the facts", so it is not a clear admission.

THE PRESIDENT: Well that is the alternative. Does "not a comment" mean that you are not ultimately going to dispute or contest the facts?

MR. BREALEY: I will go above myself. If you go to 2.4.

THE PRESIDENT: Give us your best one.

MR. BREALEY: I was hoping I would succeed on the first one. I want to go to a few more paragraphs, but 2.4 at the third bullet point:

> "Kier and Group have co-operated with the OFT in seeking an early end to this process. This has informed the decision to offer no comment on the allegations in the SO. To the extent that this absence of any challenge facilitates the OFT's work …"

There is Kier saying there is an absence of any challenge.

THE PRESIDENT: I think that is better, but it leaves me wondering what it means.

MR. BREALEY: Well it is not challenging the facts underlying the infringement.

THE PRESIDENT: It says you are seeking an early end to "this process".

MR. BREALEY: When one reads this document as a whole ----

THE PRESIDENT: You are taking us to paragraphs, so I am just commenting on this paragraph. Yes, I agree it looks a bit ----

MR. BREALEY: A statement that it does not dispute or contest the facts, that is in the bullet point at 3.26. A statement that does not dispute the facts, and here it is to the extent that

there is absence of any challenge. I am not challenging the allegations in the SO. There is an absence of any challenge. That neatly dovetails – Kier was not aware of this OFT ----

THE PRESIDENT: It has to be equating the absence of a challenge to the offering of no comment, this is an informal decision to offer no comment on the allegations. To the extent that this absence of any challenge facilitates it seems to treat it as the same thing.

MR. BREALEY: Or a more charitable way you say: "What does Kier mean by offering no comment? It is not challenging the facts."

THE PRESIDENT: I think it is open to your interpretation but whether it is clear enough to give them a warm feeling that they are home and dry.

MR. BREALEY: Can we go back to 2.2 then. "The following points should be taken into account when considering the nature of the infringement." The third bullet point, last sentence, Kier says: "[Kier] now clearly understand that cover pricing is a breach of the law." So they are telling the OFT that they are accepting that cover pricing is a breach of the law. That is starting to get you to the second bullet point at 3.26, clearly admitting that the conduct constitutes an infringement.

2.3, the third bullet point:

> "Kier and Group enforce a strong culture of compliance throughout their businesses. They now have a clear understanding of the fact that cover pricing infringes competition law and have put in place strict competition law compliance policies."

THE PRESIDENT: Does that amount to admitting the infringement that is charged against them. They might say: "Yes, I think cover pricing is ----"

MR. BREALEY: 2.4 first bullet point, over the page: "It was genuinely the case that none of those concerned in the Alleged Infringements …" - an "alleged infringement" is the term used by the OFT in the SO – "… thought they were acting unlawfully." So there is Kier saying that none of those concerned in the infringements thought they were acting unlawfully. That has to be read then with the extent that there is absence of any challenge. Over the page at 3.5, first sentence: "First, the Alleged Infringements are examples of cover pricing." Again, the two bullets were not in existence when Kier wrote this so you have a sense of Kier saying at 2.4 "It was genuinely the case that none of those concerned in the alleged infringements thought they were acting unlawfully" "The Alleged Infringements are examples of cover pricing", and you have a statement saying that cover pricing is an infringement of competition law.

You could go on over the page to 3.19:

"To conclude on this point, whilst Kier takes no pride from the fact that it, along with others, misunderstood the law and therefore failed to ensure compliance, it would urge the OFT to assess the Alleged Infringements as mistakes based on ignorance of the law, rather than a conscious effort to subvert it."

When one reads this document I have set out other passages in the speaking note, 3.62, again: "Cover pricing is an infringement of competition law. It now fully understands its obligations under competition law."

The whole tenor of this response is that "yes", Kier was involved in the cover pricing. It was not challenging the allegations relating to cover pricing and that Kier accepts that cover pricing is an infringement of the law. When you then look at the attachments, which refer to the compliance programmes, you have the memos dealing with cover pricing. Page 170, this is attached to the response. This is to: "All Staff" from: "John Dodds". From the very top of Kier. There you have Kier quite clearly telling its staff on 25th May, just after it was informed of the investigation this practice is unlawful. So the second and third paragraphs.

PROFESSOR BAIN: Mr. Brealey, as a layman this looks to me like a document drafted by a lawyer. Can you remind me whether, in the Statement of Objections, these are infringements or alleged infringements?

MR. BREALEY: They are as alleged infringements.

PROFESSOR BAIN: They are described in the Statement of Objections as "Alleged Infringements".

MR. BREALEY: I checked that a few days ago, because ----

PROFESSOR BAIN: So you are using exactly the same language.

MR. BREALEY: Yes.

PROFESSOR BAIN: Thank you.

THE PRESIDENT: "Alleged Infringement" that is why it has a capital letter, is it?

MR. BREALEY: That is why it has capital letters.

THE PRESIDENT: Yes, it is a term of art.

MR. BREALEY: It is a term of art saying these Alleged Infringements number 77" so that the person who is using this is adopting the same terminology.

PROFESSOR BAIN: Thank you, that answers my question.

MR. BREALEY: And it is not saying "these are alleged but denied". I will finish now, I have had my 50 minutes. When one looks at the compliance programme which is attached to this response, because this compliance programme, the letter from John Dodds is attached to the response. You have statements, the alleged infringements are examples of cover pricing,

that it was genuinely the case that none of those concerned in the alleged infringements thought they were acting unlawfully. They thought it was industry practice.

THE PRESIDENT: Yes, so they are effectively admissions, you are saying.

MR. BREALEY: Admissions, and it is a very uncharitable interpretation, and all the OFT do, I remind the Tribunal is refer to 1.2 and 2.1, which is "We are not offering any comment." What Kier are doing there, they are not offering any comment, they are not challenging the infringements, they want to go on and try and persuade the OFT that given the compliance they thought with the misunderstandings of the law the fine should not be severe.

THE PRESIDENT: Is the thing you very helpfully set out under para. 53 and 54, are those the things we ought to look at?

MR. BREALEY: Yes. I have tried to pick out what I consider the best points. When one looks to see what sort of statements that Connaught gave we are clearly up with Connaught, and to deny us the 15 per cent reduction we say is inappropriate.

PROFSESOR BAIN: I have one or two issues I would like to explore with you, Mr. Brealey.

MR. BREALEY: Of course.

PROFESSOR BAIN: The first has to do with the relevance of turnover and profits in determining the MDT. You do not challenge the step 1 calculations. You seem to accept that both turnover and profits are relevant to step 3. Now, turnover seems to me acts as a scale factor, but if we put aside for the moment the question of exactly what turnover should be taken into account, we will come to that later, if two companies in the same industry have the same business models, but one has ten times the turnover of the other, whilst the larger turnover might reasonably be given a penalty that was ten times that of the smaller – would you agree with that? Just treating it as a scale factor, other things equal – if you are ten times bigger, you get ten times the penalty?

MR. BREALEY: Just on scale factor the mathematics are correct, but on fining policy ----

PROFESSOR BAIN: You would not accept that?

MR. BREALEY: No.

PROFESSOR BAIN: Assuming profits were ten times would you accept it? Profits as well as turnover?

MR. BREALEY: I do not want to avoid the question. To answer that one has to decide what you are fining the company for and, as I say, there are twin objectives. The first objective is to fine the company for the offence.

PROFESSOR BAIN: You come back to the relationship with culpability and if that did not change by a factor of 10 then you would not accept it?

MR. BREALEY: If the company had 10 times the amount of relevant turnover then would expect 10 times the fine, because that is a bigger company in the market that has been infringed, it has 10 times more relevant turnover than the smaller company, it will know that it will get, unless there are other considerations, but yes, that is the scale, because turnover at step 1 is dealing with almost volume of sales, and that is why we say that we can understand why turnover in step 1, dealing with the offence, when one is looking at volume of sales, the impact on the market, is rational.

PROFESSOR BAIN: Let me move on to the relationship with profits. In your notice of appeal and today you have referred to the profits made by Kier. What I want to explore with you is if there is a relationship with profits, should it be the profits of the particular company, or should it be the general profitability of the industry to which that company belongs. In other words, should a more efficient company that is more profitable get a larger fine than a less efficient company doing the same kind of business which is less profitable?

MR. BREALEY: It is a good question, sir. Again, we are now looking, in my submission, on deterrence, because normally profit will not be relevant to step 1, so we are looking to see whether we should be fining this company more in order to act as a specific and a general deterrence. The fact that a company is inefficient should not necessarily mean that it attracts a lesser fine for deterrence – inefficient companies would not necessarily be excused from being find. Here, we are not talking about inefficiency as such, we are talking about just taking a percentage of turnover and not looking at the impact on Kier in the construction industry.

PROFESSOR BAIN: What I am trying to see is whether we should be looking at the impact on Kier or looking at the impact on the typical firm in the construction industry.

MR. BREALEY: The answer to that would be both. I cannot see why you should take one and not the other. If Kier is typical of the companies in the industry - so, it is typical that in this industry you make 1.4 percent margins and you are going to take 0.75 percent of total turnover - there is going to be a massive impact on Kier, Kier being typical of the company in the industry. But, if you are asking me, sir, "Should inefficient companies somehow pay less than efficient companies?" -- It is a stark question but the start answer is probably, "No".

PROFESSOR BAIN: Let us move on to the issue which I said I would come to of turnover. Clearly the OFT has not confined their notion of deterrence to the market's identified in the Decision. They explain why they consider that the broader activities of the companies that they are imposing penalties on are relevant in determining the size. Kier obviously has an

interest in narrowing the range of the activities they are taking into account. Can you explain why the OFT should narrow the range?

MR. BREALEY: If you take my first basic principle, Principle 1, if you are going to take a percentage of the turnover in window cleaning in America and water bottling in Australia, the higher up you go, if you are a multi-national company, you are just going to end up with a higher fine, and it is going to be disconnected from the offence which took place in north-east England. So, there were three separate offences which were, you know, discreet offences. But, the OFT has taken a percentage of worldwide turnover. By taking the other businesses you are starting to disconnect yourself from the offence.

PROFESSOR BAIN: What of its infrastructure in the UK which was outside the relevant markets rather than aspects of construction that are in the relevant markets? Should you be restricting it to all the relevant markets, or should you go beyond that?

MR. BREALEY: Again, it comes down to: What are you trying to do for deterrence? This Tribunal, in *Argos*, if the Tribunal remembers, they fined Argos because it was price fixing of toys. We have referred to this in our notice of appeal. However, the OFT took girls' toys - even though it was only one girl toy that was subject to the price fixing. The Tribunal said, "That is inappropriate because you are actually taking the turnover of a company which has got absolutely nothing whatsoever to do with the fine".

So, your question to me is not related to the seriousness of the offence - not Step 1. The question is, "Why should you be taking for deterrence worldwide turnover?"

PROFESSOR BAIN: If you take the *Argos* example - if I can just pursue that - what it seems to me you are saying is that you should be fining for deterrence in the range of activities that are liable to be affected by the infringements. In other words, in this case, the relevant markets. Boys' toys were relevant markets. Girls' toys, it was decided, were outside. The fine was related to what was going on in boys' toys. If you take that analogy, the analogy here would be that you should be looking at the activities in the relevant markets - not taking account of activities outside - whether in the UK or anywhere else.

MR. BREALEY: Although arguing against myself, that is not what I am saying.

PROFESSOR BAIN: That is not what you are saying. Tell me what you are saying.

MR. BREALEY: What I am saying is that at Step 1 you take relevant turnover. That is turnover which is essentially affected by the infringement. That is your offence. That is what you are being fined for. The question now is: Are you going to fine the company more to deter third parties, for example? So, we are no longer in retribution any more, as my basic

principle. We are now into deterrence for third parties. What is the basis upon which you are going to fine ----

PROFESSOR BAIN: It is before deterrence for this company.

MR. BREALEY: We have accepted that if you fine Kier £50,000 it may not be as much a deterrent as a small builder in Islington whose turnover is £50,000. That is a given. Therefore, you may look at worldwide activities of a multi-national company to see its financial position. You have always got to bear in mind, in my submission, the basic principle no. 1. There has to be a reasonable connection between the fine for the offence and the fine for the deterrence. You just cannot take a percentage of worldwide turnover and say, "That's it. That's where I end up". The complaint here is that the OFT never had a sense check to work out what the result of its calculation was. So, yes, it can take a percentage of turnover for deterrence. But, that is not the end of the matter. It has got to work out what the implications of that are to the company, particularly when it says, "I want to make an impact on this company". That is the vice, sir. Step 1 is about the infringement on the market. My basic principle 1 says that there has to be a reasonable connection between deterrence and that. Yes, you can take a percentage of turnover, but - and this is the big but - you have got to work out what it's impact is on the company.

PROFESSOR BAIN: Thank you very much.

THE PRESIDENT: Mr. Unterhalter?

MR. UNTERHALTER: I am going to use my learned friend's structure because it is helpful in seeking to clarify why it is that in the OFT's submission recourse to worldwide turnover is a proper measure for the purposes of determining appropriate penalties for deterrence and the suggestion that that should be added by way of a consideration of profit, in our submission, would not assist the inquiry and certainly not in a way that we submit was required of the OFT.

May I begin firstly with the proposition that says that whilst you may do the work of deterrence you may not do it in such a way as to travel too far from the nature of the infringements which are being penalised by way of infringement. That is the first principle my learned friend relies upon. It is this notion that this is where what should be a twinned principle leads to a fissure that is not warranted and is disproportionate.

It is, in our submission, quite clear from the structure of the guidance, as also from what one is trying to do by way of a consideration of seriousness and deterrence, that these are different things in kind. The seriousness attempts to consider what has been done and to work out what is the appropriate measure of penalty for what has occurred - it is a

backward-looking consideration and it is intended to be, as it were, a just measure of pain for the infringement that has occurred -- Deterrence looks, as has been said now on a number of occasions - at a forward-looking and consequentialist analysis that is to say, it is using the occasion of the infringement to achieve forward-looking policy goals and it is using the infringer for that purpose, both in providing incentives for the undertaking itself not to engage in recidivism, but equally, by way of general deterrence, to ensure that those who look upon this kind of conduct and may be tempted by it, will understand, again, what the consequences of this might be.

So, when one is trying to say, "Well, these two must be linked, and the one must somehow encompass or be connected to the other", one is, in a sense, seeking to conjoin two values that go to penalty that actually seek to achieve entirely different things.

THE PRESIDENT: There is no logical link.

MR. UNTERHALTER: There is no logical link. Indeed, they are simply different purposes of punishment. Now, there is this vast literature - philosophical and otherwise - on this as to whether it is proper to engage in deterrence as a feature of the penalties. But, no-one has suggested that deterrence is not a proper purpose, and certainly not this appellant; nor that the guidance improperly suggests and requires that something must be done by way of deterrence. So, one is seeking to provide a just penalty in respect of what has been done and a future-looking penalty that serves other purposes. So, the conjoining, which is my learned friend's first principle, we submit, is neither coherent, with respect, nor logical in terms of what one is seeking to achieve in this punitive regime. So, he is seeking a connection, some sort of overlap, some sort of restraint which the one is intended to impose or require in respect of the other where one will never square the circle. You cannot make two different things be at one or overlap, or constrain one another. It is just logically not a structure that works. We do submit that is the relevant way to examine this proposition.

Hence the first principle is not availing in the way that my learned friend suggest.

It is also, in our submission, not correct that adopting the 5 percent range is itself somehow something that has a gravitational pull on what one can permissibly do by way of deterrence. My learned friend said it is a mid-range penalty and that there were certain mitigating features and this somehow, as it were, brings down what you can permissibly do by way of deterrence .

I do want to submit as far as that is concerned that that decision, though a nuanced one, by no means says that because these practices were pervasive and appeared in textbooks and the like, therefore for that reason this was not extremely serious. Indeed, the tenor of what

is reflected in the decision is quite to the contrary. It says these are very serious matters. It indicates why it is that cover pricing has a considerably harmful consequence for competition, whether by object or by investigating effect. I will take you briefly to some of the passages as far as that is concerned. However, the key principle is that the OFT applied a principle of restraint to itself. It examined the question as to whether notwithstanding what had happened in roofing, and the apparent failure of the industry to take heed of those infringements and the way in which they had been penalised -- whether there should be an additional percentage that was applied over and above that which was of application in the roofing cases, and it chose a principle of restraint.

It is hard, again, in our understanding of this, to say, "You will do less work by way of deterrence because you have applied a measured view as to where this species of infringement lies for the purposes of a different object which is the retributive one or the serious or culpability question which arises in respect of Steps 1 and 2.

So, we, again, do not submit that one can utilise the reasoning which was prudent reasoning, and, in a sense, beneficial to the undertakings that had infringed, somehow now to rein in the deterrence. Indeed, the way it is cast in the decision is to suggest that this is of medium to high side of seriousness within some range and then there are factors which are taken into account simply by way of saying, "We will, as it were, allow one further round where we will not increase this further, although indeed we might well do so". We do submit that on that score there is no warrant again to draw back on the deterrence that is properly due.

This is simply illustrative of some of the discussion that took place around these matters, but in the Decision you will see that there is an extensive discussion about the anti-competitive objective of cover bidding, which is in (iii) at para. 97 onwards. There is a recitation of the matters found in Apex as to why cover pricing was problematic. That is in para. 99. If one reads on, it is clear that there is a very full consideration as to why these kinds of activities are extremely harmful. Some of the arguments that were raised to suggest that they were not always understood to be so -- that they appeared in textbooks and the like -- well, ultimately, insufficiently availing for the purposes of a substantial discount in the conception of seriousness as to what had happened here. That is not the basis upon which the OFT proceeds.

If I might then turn to the second principle which is to say that there must be a proper computation of impact. One will necessarily fail to make that computation if you do not take into account profit as a measure. Now, the OFT has explained - and I shall come to its reasons in a moment - why it is that it adopts turnover over as the standard. It has a number

of reasons for doing so. But, the question is whether the OFT must, in a case of this kind, take profit into account. Here one does engage again in this question as to whether this falls within the margin of appreciation available to the OFT. In other words, while there may be a whole variety of financial measures that one could at least theoretically use, why must the OFT add in the question of profit - because profit, and profitability as a standard, has a number of inherent disadvantages to it that turnover does not? Again, the issue for you will be whether it was necessary to the fairness/proportionality of this matter that the standard of profit must have been taken into account. Exactly how it is to figure alongside a different financial measure of turnover we have not yet fully understood from our learned friend's submissions - that is to say, one could use a whole variety of financial matrix. But, how do they help you ultimately and how are they integrated, one with the other, for the purposes of coming to a view finally on what deterrence is meant to do?

Here we would submit that deterrence needs to be considered within the scheme of this Act and what it is aimed at achieving. We are not here concerned with traffic offences. Here we are concerned with the question as to whether undertakings can be incentivised to adopt a particular form of behaviour. We are asking the question as to how that will best be done in circumstances where there are intrinsic temptations to engage in collaboration. This is not irrational behaviour. This can be perfectly rational behaviour for profit maximising firms to engage in. So, within the context of these kinds of markets we are asking not a general abstract question about incentives; we are asking about how incentives will work to prevent a particular kind of commercial conduct engaged in by undertakings in markets. That is where, again, the question of the undertaking and the variety of markets that it might operate in becomes relevant, and this emerges from some questions that were posed of my learned friend by the Tribunal, because we are seeking not simply to effect deterrence in respect of the particular relevant markets where the conduct took place and not just in respect of this undertaking, but in respect of all undertakings that will observe the outcome of this case and determine whether they should or should not engage in this kind of behaviour across markets.

THE PRESIDENT: Does that really help much, because your minimum deterrent would apply the same way if it was one worldwide market or a hundred worldwide markets that was encompassing – the attack is really not just on the disconnect between the MDT and the seriousness, but also on the other aspect of it which leaves out of account the other aspects of financial position. What is the question you should be asking yourself in relation to deterrence? Is it what fine is necessary to deter this and other similar companies of this

size? Is that not the justification for the MDT? What is necessary to deter a small company may be much smaller than what is necessary to deter a very large company. If that is not the justification what is?

MR. UNTERHALTER: It is unquestionably the case that it is intended to be a reflection of the economic power of the undertaking and have the deterrent effect felt given its size, so that it hurts proportionately to its size.

THE PRESIDENT: Have you to ask another question, and this is something I touched on this morning – I am not sure still quite understand it – at what point, if at all, do you ask is this – whatever you come up with having applied the MDT and the other steps – is this necessary to deter this company, or a company of similar size? In other words, where is the check on that in your approach?

MR. UNTERHALTER: The approach seeks to say that you have to determine some ratio between the penalty that you are going to apply for deterrence, and the size of the undertaking, that is the basic ratio that is being determined and under the MDT that is 0.75 ----

THE PRESIDENT: Yes, you have your guide, rule of thumb, call it what you like.

MR. UNTERHALTER: And the rationale as to why it is turnover rather than profit, which is of course where all this is heading, is that what one is seeking to do is provide incentives which are relative to the economic side of the entity and its economic power, but more particularly that will have a direct impact at a transaction level when parties are thinking about engaging in the conduct. In other words, the very conduct that we are here concerned with is about engaging in transactions on markets, and what parties need to know is that it is not whether they had a good or a bad year that is going to determine the measure of their deterrence, but that there will be an attack upon the economic value of the entity, and that is usually represented by turnover.

THE PRESIDENT: Well it could be profit or turnover. Turnover fluctuates just as much as profit fluctuates.

MR. UNTERHALTER: My learned friend made that submission but in fact turnover is very, very steady relative to the kinds of fluctuations – I am talking as a rather general principle – but if one takes m any companies, we refer to British Airways as one example, you have companies that durably maintain very sizeable turnovers but they can have highly fluctuating profits, and that is just one example and there are others ----

THE PRESIDENT: I think the argument that is made against you is not that it should be determinative necessarily, and equally not that it is not appropriate to take account of

turnover, it is simply that one should not leave certain basic measures out of account to see whether the thing is proportionate. It is the old thing, "proportionality" is a sledge hammer to crack a nut. Is this a sledge hammer, or can we afford a smaller tool in the circumstances of this company or this industry.

MR. UNTERHALTER: The question though is whether profitability is the right metric to determine whether you have the correct instrument to be doing the work of deterrence. What we have not heard other than that profitability is something that undertakings will obviously look at to measure their performance, why it is that that is an indicative indicator for the purpose of doing the work of deterrence, because the submission that we are seeking to make here is that what you are concerned to do is to provide the right set of incentives, and the right set of incentives are those incentives which will say to a company - not just this company but others that observe what happens – that "you will suffer punishment, penalties, that go directly to the exchange value of this company in the market". In other words, the very kinds of transactions that you would possibly be tempted to engage upon that generates turnover, it is exactly that measure that we utilise for the purposes of deterrence, because we are trying to prevent you from engaging in sales by way of anti-competitive conduct, it is actually intrinsically linked to the turnover that you will generate from that kind of conduct, so there is a natural link between what you are trying to incentivise, turnover is the relevant measure, and why it is that almost universally authorities such as the OFT use a turnover standard rather than a profits standard.

MR. CLAYTON: The most important ratio to a company, or the most important economic interest is profit, is it not? That is what hurts a company is the percentage of its profit which is taken away or added to the turnover as such, and it depends very much on the ratio of profits to sales, profit to turnover, so profit surely is a crucial thing that any company is facing.

MR. UNTERHALTER: We would not for a moment suggest that it is not important to a company, what profits it is making, but we do submit that profit as a concept, and I was going to come to it but let me deal with it now, profit raises a whole variety of questions which are problematic from a regulator's point of view. The first is: what measure of profit is going to be utilised? Is it gross profit, net profit, operating profit, profit before tax, profit after tax? Which of these are more sensitive metrics for the purposes of showing a link between incentives and deterrent. No answer is provided – understandably the appellant because it is enormously hard to k now which of those various metrics to use and why more particularly.

We have emphasised in our skeleton that profit and profitability is a highly variable matter. You can have a situation where a very sizable undertaking which, to use the language of the General Court, has significant economic power in markets because of its turnover and presence in those markets which is thought to be the relevant consideration, might have a very small profit, or in a particular year have no profit at all. That gives rise to another question which was posed by the Tribunal, and that is you have the problem of perverse incentives. You have the oddity that in cartel enforcement regimes, where you would be most sensitive to what kind of measure of deterrence you utilise, you would have a situation where as you become less profitable and might become more tempted into cartel behaviour you will suffer less deterrence because of the adoption of a profitability standard.

In our submission that would again be a strong counter indicator to the utilisation of profit or profitability as the right standard for the purposes of determining deterrence.

MR. CLAYTON: But the valuation of companies is almost always taken on the basis of profit, is it not – the price earnings ratio of a company? So when the market is valuing a company it does not look at the turnover of that company necessarily; primarily it will be looking at the earnings stream of that company over a period of time?

MR. UNTERHALTER: I am no expert about these matters at all, but as I understand it at least one way of measuring the net asset value of a company is to look at its income stream over time, but I cannot say that I am knowledgeable about what particular financial models are applicable.

PROFESSOR BAIN: "Income" in that context meaning its profit stream?

MR. UNTERHALTER: Yes.

PROFESSOR BAIN: Not turnover, its income, its profit.

THE PRESIDENT: What is of concern, I think the point which is being made against you, and I am not sure whether this is this case because we have now had two cases, it is trite that there are industries where there are very low margins, and the construction industry may be one of those where there is an amount of subcontracting on which there is very little profit, and the profit is made on whatever the balance is by the main contractor and so on and for whatever reasons there are very low margins traditionally, typically; and there are industries where there are very high margins, and the pharmaceutical industry is an example of one of those. If one adopts, as it were, without some adjustment, or without some sense check, a deterrence approach which simply looks at turnover and applies that, then one is actually over deterring in some industries, and possibly under deterring in others. Is it important, or

is it not necessary actually to have a look at what the underlying financial position is of companies in this particular industry?

MR. UNTERHALTER: We would have two submissions as far as that is concerned. The first is that there has been much talk about certain low margin industries of which it is said that construction is one.

THE PRESIDENT: I think you accept that do you not? I am sure I read it in the decision somewhere.

MR. UNTERHALTER: I do not believe it is contested, the margin, but these are all very relative concepts, so for example Standardly supermarkets, for example, are said to operate on extremely low margins, yet they can have pervasive effects across large parts of the retail sector. So is one going to say that because you happen to be in supermarkets with relatively low margins – and the key word there is "relatively" – we are going to have a different approach to deterrence, to the situation we might have in a highly specialised scientific area of technology.

THE PRESIDENT: Well why not? That would not be a different approach, it would be the same approach but you would be calibrating it, you would have exactly the same approach, you would aim to deter the company by fining it sufficiently to deter that company given the industry in which it is operating; that would be the same for everybody, but it might not necessarily mean that you take the same percentage of your worldwide turnover in every case.

MR. UNTERHALTER: Our submission is that these are very impressionistic concepts as to whether one engages in activity in the supermarket sector, the grocery sector or this sector and says of it that it is relatively low profit and so we will use that as some suppressant. These judgments, certainly – and this is obviously the critical question – from the point of what does it do to the incentives of those who are engaged upon it ----

THE PRESIDENT: Precisely.

MR. UNTERHALTER: -- is one necessarily going to be having ----

THE PRESIDENT: Where is that question answered? Where do you ask yourself? The question I keep asking is: where do we find the OFT asking itself that question in relation to these fines?

MR. UNTERHALTER: It has a number of reasons why it does not adopt profitability and I will take you to the passages where that is said, but the reason why competition regulators generally steer clear of profitability, or profits, as a standard is precisely because it is very hard to know how to answer these kinds of questions, and it is very hard to know whether

you should be looking at construction versus supermarkets, or versus pharmaceuticals, or whether you should be comparing types of construction companies within a sector and as to their variable kinds of profitability within the sector or not, and it is because of these sorts of difficulties which do not seem clearly and obviously to impact upon incentives in a way that has been explained as a relevant ground for intervention on this score, that a much more neutral standard has been adopted by way of turnover.

The reasons that the OFT adopted the turnover standard are set out both in the defence in paras. 77 to 81, and in the decision at VI, from para. 70 onwards. Perhaps I should just give a very brief recitation of what those considerations are.

The first of them deals with the fact that the structure within which these penalties are determined all works with turnover in mind. The cap at steps 1 and 2 is 10 per cent of relevant turnover. The ultimate cap at step 5 is equally about total turnover. So it utilises a scheme, as it were, of turnovers. The natural order of things as one is progressing from steps 1 and 2 through to 5 is to adopt a turnover standard at step 3. There is, as it were, a coherence aspect to it and that its why it has been adopted. That is the first kind of reason that has been relied upon.

There is also the fact that by reference to the manner in which the Commission looks at these matters, and I have taken you to an authority earlier this morning which referred to how fines are computed for the purposes of the Commission, there too the standard that is utilised is turnover based; it is not profit based. Perhaps I could just very briefly in that context remind the Tribunal again of just one or two points as far as that is concerned.

The first of them is the *Archer Daniels* case that I referred to this morning at vol 7, and I shall not repeat it again, but it is under tab 96 at para.131.

THE PRESIDENT: Yes.

MR. UNTERHALTER: There is also the *Degussa* case, which is in vol.8 and that is at tab 99. At paras. 283 and 284 there is reference to the *Tokai Carbon* case and one sees there too that the consideration is:

> "The Court has thus already held that one of the undertakings concerned, 'owing to its enormous worldwide turnover by comparison with the turnovers of the other member of the carte, … could more readily raise the necessary funds to pay its fine, which, if the fine was to have a sufficiently deterrent effect, justified the application of a multiplier'."

So the second order of reasoning here is to say: "This is the way which it is done elsewhere" and of particular relevance to us, by the Commission.

The third consideration is that turnover is a fairly easy measure, it is unproblematic, it does not have these questions as to what kind of profit measure is to be utilised, and therefore it is also utilised here as a relatively simple measure that is hard to manipulate and standardly available. So those are the kind of considerations. But the fundamental issue still remains that it is utilised as a standard because of the ultimate consideration which his that it is in the indicator economic size and power, and that is the best way of seeking to incentivise conduct because if your economic power in markets is diminished then it is a very direct way of signalling how deterrence will be done, and that is the fundamental concept about size and deterrence rather than the variability of profitability and how that might figure in the kinds of calculations that are made.

So it is our submission that turnover remains the right standard, that profitability is a problematic standard and that how to utilise the profit standard with a turnover standard and come up with a rational and comprehensible account of what the right measure of deterrence is by using these different metrics again is unexplained and, in our submission, would be very of application. Indeed, if the Tribunal were itself to consider how it would measure up these different financial metrics and think about the right number that is meant to emerge for the purposes of deterrence we would submit that that is not at all easy to determine.

Therefore, although there are by reference to different estimates of profitability, and my learned friend has taken you through them, as to how this impacts upon Kier's profits, the fact is that if turnover is the right consideration then there is no sense of disproportionality, because the invocation of profitability is precisely intended to create this notion that for various reasons its operating profits would be covered many times over by the penalty that is being offered. We submit that the real measure – the primary and real measure – to be considered here is a turnover standard because that tells you how big and sizeable and powerful a company is in the market and I have made my submissions as to how that works and why a 0.75 percentage of turnover is not of the order that is likely to have the sorts of drastic consequences that are spoken of and invoked by my learned friend.

It is for that reason fundamentally that we contend that there was no fault on the part of the OFT in not taking profitability into account.

MR. UNTERHALTER: If I might now, in what is probably limited time ----

THE PRESIDENT: Well we have taken time up questioning so do not worry.

MR. UNTERHALTER: If I might come to the last proposition that was raised in respect of deterrence? That went to the question of compliance. What was said by my learned friend

was that his client had undertaken laudable efforts to engage in a compliance programme and that should, of itself, count for the purpose of deterrence -- It should not be something that is utilised after Step 3 for the purposes of some kind of mitigation.

We submit that, here again, there is a misconception as to what deterrence is seeking to do. Our learned friend's conception of this, I think, rests on a sort of predictive judgment that is being asked of the OFT, which is to say that if a laudable compliance programme is put in place, does that mean that there is less likelihood of some recurrence, and consequently something less is due by way of specific deterrence in respect of Kier? That must be the general logic of what is entailed by the notion that rigorous compliance should entail less deterrence. We made submissions this morning, but for the benefit of my learned friend perhaps I should perhaps, just very briefly, repeat that what is done by way of deterrence is not subject to a divisible metric of the kind that is at least implied in the proposition that is offered, which is to suggest that whilst the general object of deterrence are both general and specific, there is not a specific division that is to be made to say, "Ah, well, 10 percent would ordinarily be the right amount in substitution of a compliance programme, but because you have got a compliance programme you get a 10 percent penalty reduction". Deterrence does not work in that way. It is intended to be a single figure that is intended to have a pervasive effect, both specifically and generally, and this divisibility proposition is not readily capable of either implementation or is necessarily a logical matter. The figure does not bear upon the particular object that you can so precisely isolate and then determine in relation to that specific object.

The second proposition around compliance is, again, that you are trying to ensure ongoing incentives for management, and particularly senior management. Of course, a compliance programme again, whilst it draws attention to the relevant matters that are required by way of proper and lawful conduct -- Fundamental to the cartel offence is that it is a rational temptation for those who engage in business. It is not as if it is a kind of irrational calling - a sort of psychopathic tendency that you have got to root out by therapy. It is a rational economic possibility in markets.

So, the point of the deterrence is that it is intended to hurt companies where it matters most to them - which is in respect of their turnover, their financial well-being. That being the case, however good a compliance programme may be what undertakings need to know is that if they engage then there us a sharp whip at their back. That is also necessary in light of the fact that we know that many infringements are hard to detect. Therefore, when they are detected a very strong message needs to go out. Therefore, the fact that after the event

you say, “Sorry, we did not realise this was happening. We are now going to try and do it better internally” is just not enough. It is not a sufficiently significant factor. Therefore it is correctly situated, in our submission, as a mitigating circumstance, but not something that does significant work in relation to deterrence.

Again, we cited the *Nintendo* case, which is in the authorities at Volume 8, Tab 100. That, again, indicates that this is not a factor which requires very significant consideration.

If I might then lastly come to the amount that is said to have not been given to Kier when it should have? If I may do my own exercise by reference to the response at Tab B. It was shrewdly observed by the Tribunal that this is a statement produced by lawyers. There is a degree of circumlocution here which is, regrettably, a trait of our profession. The fact is that if you wish to admit something and if you wish to make it clear by way of a positive statement that you do not dispute something it is not very difficult to say either of those things. You can say, “I admit that this firm, this undertaking on such-and-such a date engaged in the following conduct”, or you can say, “That is too painful”. You can say, “I do not dispute that on such-and-such a date at such-and-such a time the following, as alleged against me, was done”. These are not difficult things to do and are done all the time, and it does not take much by way of explanation. The truth is they are painful and difficult things to say. They have consequences for the saying of them. Therefore, what there is in this statement is a very carefully crafted effort to appear to be co-operative without saying the magic words. It is for that reason that because the OFT, if it does not receive the magic words is required to satisfy itself that these infringements have taken place, it looked to what was said and was not satisfied under the standards that it had enunciated for itself that these standards were met.

If I could just very briefly take you through these? If one might begin at 1.2?

> Having reviewed the SO, neither Kier nor Group wishes to offer any comment on the allegations.”

If somebody says, “No comment”, as people do from time to time, they do not mean to admit -- they do not mean to deny -- they simply are not responsive to -- That is what ‘No comment’ means. So, 1.2 simply says - and this is the introductory portion, and so one must read all of this together - that the first and primary response is , “No comment”, and not, “I admit -- I do not deny --“ or anything of the sort. One then reads that together with what is said in 2.1. “Although Kier and Group do not wish to comment on the alleged infringements themselves --“ That is a general category - it is not specific to specific conduct, that is just the term of art that is used in the SO. In other words, although not

wishing to comment - which is simply reproducing the same language in 1.2 -- "-- there are a number of comments and observations that Kier and Group wish to make, and the case being brought by the OFT, which should be taken into account by the OFT when calculating any penalty". So, on the question of liability - which is what this admission is intended to go to - what you should understand by this introductory remark is, "Well, what we have things to say about is the penalty, why it should not be harsh, and that there are various factors which should be taken into account. Group also wishes to comment on the conduct of the case going forward --" So, it is concerned about penalties. It wants to co-operate and engage with the OFT as to the matters that are coming. However, on the key point nothing that is said in 2.1 properly engages with what is required.

In 2.2, if one reads the introductory wording,

> "The following points should be taken into account when considering the nature of the infringement and setting a starting point for any financial penalty".

Again, perfectly clear. They are engaging with penalty issues - not with liability issues. There is an acceptance, which was endemic, of the textbook. Then,

> "Kier and Group have a strong culture of compliance and would never have condoned unlawful behaviour. They now clearly understand that cover pricing is a breach of the law".

That simply goes to their general knowledge of lawfulness and unlawfulness. It does not make any statement of specific admissions about specific facts. Similarly, under 'Deterrence' at 2.3, bullet point 3,

> "Kier and Group enforce a strong culture of compliance throughout their business. They now have a clear understanding of the fact that cover pricing infringes competition law ----"

Again, it is a similar point. They are just saying, "We may not have understood it before, but we understand it now. Take that into account for the purposes of the appropriate penalty". Then, in 2.4 one sees under the third bullet point, which is predicated upon the observation, "-- but also the relevance to Kier and Group of many of the factors as mitigating". Then, at the third bullet point,

> "Kier and Group have co-operated with the OFT in seeking an early end to this process. This has informed the decision to offer no comment on the allegations in the SO".

That is simply a repetition of all the failings to actually meet up to what is required for the purposes of making an admission.

"To the extent that this absence of any challenge facilitates the OFT's work, Kier must be given full credit by way of reduction to a financial penalty."

The absence of a challenge and the making of an admission are simply not the same thing. It is simply passivity. "No comment. I am not going to take this on." It is not the same thing as the positive act, as it is required -- a positive statement of an admission or that it does not dispute.

Finally, in 3.4 and 3.5 one sees that the alleged infringements are referred to again, which is a general category and then, in 3.5, "The alleged infringements are examples of cover pricing rather than more serious price fixing or bid rigging activity."

THE PRESIDENT: There is an implicit admission, is there not? They have said earlier that cover pricing is unlawful ----

MR. UNTERHALTER: Yes.

THE PRESIDENT: Now they are saying that these are examples of cover pricing. So, sort of implicitly you look at 3.19. I think Mr. Brealey's point is that if you read 3.19 with all those other paragraphs then you can find an implicit admission.

MR. UNTERHALTER: In our submission one should not be having to engage in this close textual analysis of how one can combine threads in one paragraph with bits of another and maybe find, if you are lucky, an implied admission. What is required is that there must be a clear admission. A clear admission is not a difficult thing to do, but a clear admission is something that says, "This is what we have done. Here I am telling you that it is so". Alternatively, a clear, positive statement that it does not dispute or contest the facts, which are the facts about Kier - not some general concept about cover pricing in general being unlawful or lawful, or whatever. You have to say, "This is what I did. This is what is alleged that I did. I do not dispute that it was done".

THE PRESIDENT: You get *nul point* for that.

MR. UNTERHALTER: So, in our submission there is nothing that was due to them. The 10 or 15 percent are alternatives. They are not accumulated. In our submission nothing is due and that second ground is not warranted.

Unless there are further questions?

THE PRESIDENT: Thank you. Mr. Brealey?

MR. BREALEY: In my submission it is an uncharitable interpretation. Again, one reads para. 3.5, "The alleged infringements are examples of over pricing ..." At para. 2.4, "It was genuinely the case that none of those concerned in the alleged infringement thought that they were acting unlawfully." Absence of any challenge, which is exactly what the OFT

say in its Decision, they should get 10 percent for. They do not have to make an express admission. It is an alternative.

THE PRESIDENT: Mr. Brealey, I am sure you did tell us this, but this was the response to the SO. Now, I do not think we have the SO in this bundle. I know we have it somewhere. What is the sort of equivalent bit to 3.23?

MR. BREALEY: There is not. It is an important point because when Kier drafted the response they were not on notice that they would get 10 percent or 15 percent reduction for not challenging the infringements or admitting that they were an infringement, that cover pricing was an infringement. There is no equivalent in the SO. So, this is not drafted with 10 or 15 percent in mind. What the OFT did in its decision was say, "Well, after the SO certain companies did not challenge the infringements. Certain companies admitted that cover pricing was unlawful, and because that fast-tracked essentially its investigation it would get a reduction for co-operation". It is important to understand that those two bullet points are not there when the people are drafting this. That is why, when you have the phrase 'the absence of any challenge' and genuinely the case that none of those concerned in the infringement thought they were acting unlawfully, take no pride, etc. -- It is not implicit. In my submission it is clear on the face of this document, when it is read properly as a whole, that Kier is admitting that its employees were involved in cover pricing, and Kier is admitting that cover pricing is unlawful. It is as simple as that. Again, it is important that the OFT only refer in the Decision to para. 1.2 and 2.1, which is the 'no comment'. They do not refer to all the other paragraphs that I have referred to.

Very quickly by way of reply, just on basic principle 1, on the link between fine for offence and fine for deterrence, in my submission there should be a link. The OFT cannot go around fining people simply to deter others. One always must have regard to the offence that has been committed. So, there should be a link. Indeed, when one reads the OFT's documents - for example, para. 18 of its response skeleton - there is clearly a link because the OFT, at para. 18, says, "In many cases the penalty set at the end of Steps 1 and 2 was already sufficient to serve the objective of deterrence". The OFT say, "Well, if the fine at the end of Step 1 and 2 is not sufficient for deterrence we are going to go further". So, there is a link between Steps 1 and 3. They are not divorced from each other.

On basic principle 2, the authority that was referred to - and we do not have to go to it - was the *Degussa* case. You were only referred, I think, to para. 284. But, paras. 283 and 285 also show that even the Commission will try and assess whether the fine is negligible or excessive in the light of the financial capacity of the company. It refers to the undertaking's

owner or resources. So, that does not completely take the OFT home in saying that the turnover is the only criterion.

At the end of the day, if one is looking at the question whether the fine is 'excessive' (para. 283 of the General ** case). The OFT say that 0.75 percent of the overall worldwide turnover is not excessive. That is essentially what it is saying. If one looks at £2.5 billion, 0.75 percent of that -- Well, that is not excessive. It is said that that did not have drastic consequences for Kier. Yet, the whole of its worldwide profit has been wiped out by this fine. We have the financial director and the CEO and various other directors in the room. They are quite clearly of the view that wiping out their worldwide turnover for 2009 has "drastic consequences". That is a measure by which to judge the proportionality of the fine. So, that is basic principle 2.

Basic principle 3 - *Nintendo* is referred to. We have dealt with this in our reply skeleton. We say that that can be interpreted by reference to general deterrence and not specific deterrence. However, we have referred to that in our reply skeleton.

THE PRESIDENT: Thank you very much.