

CHAPTER 8: CONCLUSIONS AND RECOMMENDATIONS ON THE PUBLIC INTEREST

Introductory

210. While we have found it necessary in the foregoing chapters to survey most of the activities of the L.B.C. and certain other practices used by builders generally, our terms of reference require us to consider the effect on the public interest of only the two following practices which, as we have explained in Chapter 4, we are satisfied are "things done" as a result of and for the purpose of preserving the conditions to which the Act applies:

- (a) communicating to a person other than the person calling for tenders for the construction of a building the amount of any proposed tender for such construction in accordance with any agreement or arrangement so to communicate;
- (b) adjusting the amount of any proposed tender for the construction of a building in accordance with any agreement or arrangement between the proposed tenderer and any person other than the person calling for tenders for such construction."

Both practices (a) and (b) are essential features of the L.B.C.'s Fair Price Scheme; and practice (b) is also used in the L.B.C.'s Tendering Scheme and from time to time by builders, both within and outside the L.B.C., who tender cover prices by mutual arrangement, for example, in the case of second competitions.

211. Our terms of reference are also limited in other ways. We are not required to consider the supply of buildings in the United Kingdom as a whole, but only in an area comprising London and Middlesex and parts of Essex, Hertfordshire, Kent and Surrey. Within that area we are concerned only with new buildings which cost more than £1,000 each to construct. Out of an estimated total of some 126,000 building concerns in Great Britain, in January, 1953, only 1,074 were engaged in the erection of, or had contracts for, buildings of the type covered by the reference, and the 438 members of, and co-operators with, the L.B.C. were responsible for at least 65 per cent. by value of this building work.

212. The L.B.C. has told us that the drastic reduction in capital expenditure during the economic crisis of the early nineteen-thirties produced conditions in which there was severe competition between builders for the work available; and that at the time of the Conference's formation in 1935, although the expansion in house-building was going a long way to restore full employment in the industry, competition between contractors remained sharp. The Simon Committee in 1944 found that the worst feature of the building industry between the wars was its irregularity: "The total volume of orders placed with the building industry at different periods was irregular; the orders received by any individual contractor were irregular; and, worst of all was the irregularity of employment for the operative." It is clear that since the end of the war conditions have been different. Demand has been very large in relation to the capacity of the industry and, although building for private owners has been restricted and until quite recently there has been no speculative building, most builders have been able to obtain as much work as they could carry out. In the past year or two, conditions have been modified as Government regulations have been relaxed, and a considerable degree of freedom is now permitted in private building of all kinds.

213. In the years immediately before the war the L.B.C. was operating a Fair Price Scheme which was intended both to recover the costs of tendering and to determine and maintain a fair price for all contracts which came

within the scope of its activities. These arrangements were suspended during and for some time after the war. In 1947 they were revived in a modified form ; at first they were concerned only with tendering expenses ; in January, 1949, the Fair Price part of the arrangements also was reintroduced, but on the understanding that it would be applied only when the preliminary prices showed "an unreasonably wide spread". In practice since the war the Tendering Scheme has not always been applied, and the Fair Price Scheme has been applied very rarely and has been in suspense since November, 1952.

Communication and Adjustment of Tenders

214. From the standpoint of the building owner the primary purpose of the system of tendering is to enable him to compare competitive offers to carry out his requirements, and to choose that which suits him best—usually, but not necessarily, the lowest. If this system is to work satisfactorily, whether he calls for tenders by open advertisement or invites them from a limited number of contractors, he should be entitled to expect that each tender will be a genuinely competitive offer entirely independent of any other.

215. Any communication of prices between competitors or, still more, any adjustment of the amounts of tenders by arrangement between builders appears to us to frustrate the purpose of this system of tendering, since the tenders cease to be the independent offers they are held out to be. Inasmuch as they have this effect, therefore, there is reason to suppose that both of these practices are prima facie against the public interest. We have still to consider whether they are beneficial or harmful in the particular circumstances in which they are operated. We have accordingly thought it necessary to form a judgment about the wider arrangements of which these two practices are integral parts.

Conad (i.e. Fair Price plus Tenad)

216. Since the Fair Price Scheme is never used in isolation, we consider first the full L.B.C. arrangements, i.e. the Fair Price Scheme in conjunction with Tenad. The avowed purposes of these arrangements are (1) to induce building owners to invite fewer builders to tender for individual contracts, (2) to charge tendering expenses as far as possible to the building owner for whom they are incurred, (3) to encourage owners to invite only builders of approximately equal standing to tender for individual contracts, (4) to discourage the cutting of prices which leads, it is said, to depreciation of quality, and (5) to endeavour to secure a price which shall be fair to both builder and building owner.

217. The L.B.C. submits that completely open competitive tendering in the building industry, where entry is easy and bad workmanship hard to check, is bound to lead to the cutting of prices and the depreciation of quality. Its representatives have told us that, even if unlimited competition were appropriate to the conditions of every other industry in the country, it would require "some measure of modification" in the building industry because of circumstances peculiar to that industry. Thus, they say, unrestricted competition, with its accompanying price-cutting and low quality, is bad for the building owner as well as being unfair to the builder who tries to give a good quality job. If he is to compete against builders who depreciate quality and cut prices, in their view he must either lower his standards or incur losses which will ultimately force him to go out of business. Consequently, it is desirable, they say, not only to limit the number of builders invited to tender in any competition, but to ensure that they are all of approximately the same standard and capabilities and can be relied

on to produce the same grade of work ; only so will the prices tendered be genuinely comparable. Since, the L.B.C. says, architects and building owners are usually mainly interested in getting the lowest possible price, they may well try to obtain the best at a price which entitles them only to the second best, and they cannot be relied on to take a wider view of the interests of the industry and ultimately of themselves ; thus it has fallen to the L.B.C. to try to take steps to maintain fair and reasonable standards of competition and prices. The Conference adds that if a fair level of prices can be maintained the lower quality builder will be induced to raise his standards of building by the example of his competitors and because he will find it profitable to do so.

218. In support of these arguments, the L.B.C. has invoked the findings and recommendations of the Simon Committee. The Committee said in their report that "It is . . . a fundamental condition of good building that every contract shall be placed at a fair price with a responsible builder" ; and one of their recommendations was that "The selection of the general contractor should be made as a result of tenders from a limited and carefully selected list of builders who are judged capable of carrying out the particular contract to the required standards." The L.B.C. submits that in pursuing the purposes set out in paragraph 216 it is acting consistently with these views. It points out that the Committee failed to define what they meant by a "limited" list or "a fair price", or to recommend any method of securing the general adoption of the principles they advocated, and that building owners and architects, who were clearly able if they wished to implement the recommendations, made no attempt to do so in the years immediately after the war. The L.B.C. says it has sought practical means of bringing about the general adoption of the Committee's recommendations and has persevered with its arrangements single-handed only after doing its best to secure the co-operation of architects and surveyors.

219. Whatever force there may be in some of the L.B.C.'s arguments, and whatever views may be held about the implementation of the Simon Committee's recommendations, it does not follow that it is right for builders on their own to try to deal with the situation by means of a scheme such as that operated by the L.B.C., designed to limit the choice of building owners. It is one thing to say, as the Simon Committee and the Howard Robertson Committee have said, that tenderers should be limited in number and carefully selected ; it is in our view quite another matter if those building owners who continue to prefer large competitions or competitions between builders of widely differing standards are to be induced to alter their practice by arrangements between builders for communicating and adjusting the amounts of their tenders and sharing part of the proceeds of contracts between the tenderers. In any event, we see no reason why, before a building owner selects his contractor, his choice should be limited to builders of a given level of performance unless he himself so wishes. It may well be that in inviting tenders he wishes to discover how much more he will have to pay for the best than for the second-best before making up his mind which particular combination of quality and price is most suitable to his requirements and his pocket. It is the function of his architect and his surveyor to advise him in making his decision and to ensure that, if he prefers a lower priced tender, he is not ignorant of the risk of lower quality which he thereby incurs. Further, once a tender has been accepted, it is for them to protect their client's interests by seeing that the specifications are strictly adhered to.

220. The reallocation of tendering expenses is stated by the L.B.C. to be a secondary purpose of its arrangements, though desirable in itself. There is, no doubt, something to be said for charging an expense incurred on

behalf of a particular building owner to that owner if a simple and generally agreed method of doing so can be found. We note, however, that the Howard Robertson Committee say they "do not advocate any payment in the form of a fee by way of even a part reimbursement of the cost of preparing tenders". Our evidence shows that builders do not attempt to isolate the amount of tendering expenses incurred on behalf of individual building owners and could not easily do so. In any event, for the reasons given in paragraph 225 below, we consider that the L.B.C.'s arrangements in this respect do not effect any improvement over the normal method of allocation of tendering expenses as an overhead expense.

221. The L.B.C. does not suggest that the avowed purposes of its arrangements are fully achieved but rather that the Conference is doing what it can to achieve them by independent action after failing to win the co-operation of the building owners and their professional advisers. It points to an increasing tendency since the L.B.C. was set up to adopt selective tendering and to reduce the numbers of builders invited to tender for individual contracts, and it claims that this is, in part at least, an effect of its operations. It admits that the immediate material effects of the Fair Price Scheme in its post-war form have been negligible since it has been so rarely applied, but asserts that the very knowledge that some arrangement exists, without disclosure of the Conference's actual membership, scale of operation or sources of information, has had a "psychological" effect quite out of proportion to the scale of its actual operations. The L.B.C. has told us, indeed, that it has relied throughout its history on creating the impression that it is much more powerful than it really is. Even in the case of Tenad, which has been applied more widely but has had a negligible effect on prices, it is claimed that the "psychological" effects are more important than the direct ones.

222. These "psychological" effects, it is claimed, extend not only to building owners and their advisers, but also to the builders who are parties to the arrangements. The L.B.C.'s arrangements create in the mind of the builder, it is said, "a measure of confidence in the reasonableness of the behaviour of his fellow competitors". Moreover, it is suggested that if the market became severely competitive the scheme, regularly applied, would by bringing in a significant revenue to each participant deter him from resorting to poor quality building as the only means of avoiding losses.

223. Whatever success the L.B.C. may have had in directing attention to these matters, we have found no support for the Conference's claim that its arrangements themselves have in fact produced a marked tendency towards small competitions or the inclusion only of builders of equal standing, nor any definite evidence that the arrangements have had a material effect in this respect. There are a number of reasons why there should be an increasing use of selective tendering. The example set by the Ministry of Works and the recommendations of the Simon Committee are themselves, no doubt, among the principal causes; and the growing variety of methods of building and the corresponding trend towards specialisation by particular builders may well have been a contributory cause.

224. We are not convinced that the arrangements have the effects which the L.B.C. claims. As to the direct effect on any particular contract of the Fair Price Scheme, we are not satisfied that it results in prices which are as fair to all parties as the prices that would result from independent tendering. The Fair Price was calculated as the average of the lowest two-thirds of the preliminary prices submitted. As the R.I.C.S. has pointed

out,* there are many different factors which influence an individual builder's price for a particular job; the lowest price might, therefore, be quite a reasonable one for the builder concerned and yet be increased by the application of the scheme. In such circumstances the building owner might be prevented from receiving the original lowest offer although the builder who was prepared to make the offer himself regarded the price as a "fair" one. Moreover, only a small proportion of the Conad was eventually retained by the successful tenderer, and the L.B.C. has admitted to us that its arrangements up to the present have not provided an effective answer to the criticism of the Simon Committee that, this being so, raising the price would have no effect on the quality of the builder's work, a criticism which would remain valid however intensively the scheme was applied.

225. The Tendering Scheme does indeed achieve some redistribution of the incidence of tendering expenses between building owners. In theory the Tenad varies directly with the number of tenderers (though there is provision for abatement when outside competition is expected—see paragraph 109); and at first sight the scheme might, therefore, be expected, as claimed by the L.B.C., to favour small competitions against large ones to some extent. In practice, however, having regard to (1) the absence of any clear and consistent relationship between the Tenad and the actual tendering expenses of the participants, (2) the frequent inclusion of cover prices for the purposes both of calculation and distribution of Tenad, (3) the inclusion of outsiders in the calculation but not in the distribution, (4) the absence of any regular practice in passing on the charge to the building owner, and (5) the failure to apply the arrangement regularly, we see no reason to suppose that this method of recovering tendering costs is any more equitable than the normal allocation as an overhead expense.

226. There remain for consideration the "psychological" effects which the L.B.C. attributes to its arrangements. A number of building owners and architects told us that the main effect of partial knowledge of what the L.B.C. was doing was to induce them to invite more rather than fewer tenderers in an effort to ensure that there was some independent competition. Others knew very little about the L.B.C. and were not impressed one way or the other, and none said that he had been influenced in the manner suggested by the L.B.C. Nor can we ourselves see any serious grounds for believing that the knowledge that the L.B.C. has some arrangement for adjusting the amounts of tenders is likely to have the effect which is claimed on the minds of building owners or architects. As to the alleged psychological effects on members of the L.B.C., we have no evidence that the scheme gave them increased confidence in their competitors or led them on any occasion to refrain from tendering a cut price. We do not see why the scheme should be expected to have any such effect; indeed a builder who was very anxious to get a particular contract might, if he expected Conad to be applied, cut his price a fraction more with the expectation that his share of the Conad would enable him to make some profit.

227. We conclude, therefore, that there is nothing either in the evidence or in reason to show that the L.B.C.'s arrangements achieve their avowed purposes. They may have some slight effects in this direction, but we are not satisfied that these are of substantial significance.

228. We have also considered whether these arrangements produce any other effects, good or bad. The L.B.C. admits that, if and in so far as they are effective in limiting competitions to small numbers of builders of

* See paragraph 158.

equal standing, they tend to make entry to, and advancement in, the industry more difficult; it adds that this effect is desirable since, for reasons already mentioned, the industry is too easily entered and, therefore, liable to be overcrowded. In view of what we have said above, we think the arrangements have no significant effect in this respect. We express no opinion as to whether entry into the industry should be easier or more difficult.

229. The L.B.C. also claims that by reducing the number of invitations to tender its arrangements reduce the incidence of cover prices. Although selective tendering may have this effect in some instances, it is possible that in others a builder who does not want the contract will feel an even stronger obligation to submit a tender simply because he knows he is one of a select number to receive invitations. We believe that the L.B.C.'s arrangements have little bearing one way or the other on this matter.

230. The L.B.C. has said that, in so far as its arrangements reduce the average size of competitions, they reduce the total expense of tendering which falls on the building industry and ultimately on building owners. We think that the saving, if any, may be too dearly bought at the price of restricting competition in the industry. In all industries it is impossible to avoid treating some selling costs as overheads, and it is always a matter of judgment what selling costs it is worth while for a business to incur. In this case we consider that the public interest is likely to be best served by allowing the play of genuinely competitive prices to guide the individual builder's judgment of the proper balance between the tendering expenses he incurs and the amount of business they help to bring in.

231. We believe that the L.B.C.'s arrangements have produced some positively harmful effects. We are impressed by the weight of evidence from all sides of lack of confidence in the relations between builders on the one hand and building owners and architects on the other, and of the need to improve those relations if contracts are to be carried out efficiently. The L.B.C. lays the blame for this at the door of the architects, and argues that, though they have held a dominating position in the industry, they have failed to show leadership and declined all offers of co-operation. The architects tell us, on the other hand, that they desire above all to dispel this atmosphere of suspicion and to return to an easy, confident relationship with the builders. Wherever the blame may lie originally for this state of affairs, we are convinced that the L.B.C.'s arrangements, in view particularly of the secrecy which largely obscures the effect of their operation on particular contracts, have intensified this ill-feeling, to the detriment of that co-operation which, as the L.B.C. points out, is so necessary to the efficient working of the industry.

232. The cost of running the L.B.C.'s arrangements seldom forms more than a very small element in the price of any contract to which they are applied. This charge on the building owner is not, however, justified by any advantage which he or the public generally obtains from the Conference.

233. We have mentioned at the end of paragraph 222 the L.B.C.'s view that if the market for building became severely competitive its arrangements regularly applied could provide builders with the financial strength they would need to resist the cutting of prices and quality. We believe that this argument, applied to the scheme in its post-war form and scope, both exaggerates the significance of the individual member's receipts and underestimates the pressure on the builder when orders are scarce to secure enough work at any price to keep his organisation in being. This is not to say, however, that we consider that in such conditions the L.B.C. would be of

no importance. On the contrary, the maintenance of its organisation against the onset of less favourable conditions seems to have weighed with its members, and we think that it could, and no doubt would, extend its arrangements. We consider that this would not be desirable.

234. We conclude that the effects of the L.B.C.'s arrangements as a whole on the public interest are harmful and, therefore, afford no justification for the two practices specified in our reference which form an integral part of those arrangements.

The L.B.C.'s Proposed Modifications of its Fair Price Scheme

235. As we have explained in paragraph 195, the L.B.C. during our last hearing with its representatives on 9th April, 1954, informed us that it was considering an amendment of the Fair Price Scheme designed to meet the criticisms advanced by the Simon Committee in their report published in 1944. We were given to understand that the proposed modification had not been worked out in detail, but that its principal effect would be to alter the distribution of Conad, which would be pooled and shared annually among those members only who had won contracts to which it had been applied (subject to the usual deductions to meet the Conference's expenses and to separate distribution of that part of the Conad which was intended to cover tendering expenses). In this way, it was claimed, the winning tenderer in any such competition would obtain, not indeed the precise amount of the difference between his preliminary price and the price at which the contract was let, but a considerable sum—the greater part of the average Conad for all such contracts. He would thus be given a substantial inducement to provide quality equivalent to the Fair Price which the building owner would pay. It was further argued that since no member would know in advance whether the scheme was to be applied to any particular contract, and since receipt of the price increment would be delayed, there could not be any tendency to discount the Conad in the preliminary prices.

236. It appears to us that builders who were willing to cut their prices, whether or not they made an equivalent reduction in the quality of building provided, would have an additional inducement to do so under the modified scheme, since they could rely on getting part of their reduction back in the form of Conad for, at any rate, a proportion of the contracts for which they tendered. Moreover, Conad cannot be applied unless preliminary prices are first called for; unless, therefore, contrary to the present practice, preliminary prices had to be submitted for a majority of contracts, the members would in fact have a fairly clear idea of the occasions when the scheme was likely to be applied. We see no reason for supposing that the modified scheme would more nearly achieve the L.B.C.'s stated purposes than the present one, or that it would mitigate its harmful effects.

Tenad

237. We have considered the Tendering Scheme in the foregoing paragraphs as an integral part of the L.B.C. system, when that system is in full operation. Tenad can, however, be applied on its own, and has, in fact, been so applied in the great majority of cases in which the L.B.C. arrangements have been applied at all since 1947. The L.B.C. itself defends the whole of its system, whether currently operative or not, and—subject to the proposed modification mentioned above—has not suggested that it should abandon any part of it. We have, nevertheless, felt it necessary to consider whether our conclusion as to the desirability of the system would be the same if Tenad were alone to be continued.

238. Tenad involves the adjustment, but not the communication, of the amounts of tenders. We have discussed in paragraphs 220, 225 and 230 its distinctive features, and we consider that what we have said there applies equally when Tenad is used without the Fair Price Scheme. Most building owners know little of the Conference's arrangements, and cannot know in any particular case whether Tenad or Conad or neither is being applied. The effect of an arrangement for adjusting prices to an undisclosed extent in an undisclosed number of cases may be equally damaging to relations between buyers and sellers, whether the adjustment is in fact large or small, or made regularly or infrequently. Tenad, moreover, has been operated in a very flexible manner, regard being paid in particular to the extent of outside competition; indeed, it appears to us to have been operated as virtually a minor form of Conad, to be applied in cases where a more substantial addition to the price would involve the risk of loss of the contract to an outsider. We conclude that the Tendering Scheme considered in isolation affords no justification for the practice of adjusting the amounts of proposed tenders.

The Submission of Cover Prices by Arrangement

239. As we have explained in Chapter 4, we regard the practice of submitting cover prices as coming within our terms of reference in relation to the public interest only when there is a mutual understanding between two or more builders affecting the amount that at least one of them is to quote. The L.B.C. itself provides for such arrangements (a) when a member withdraws an "uneconomic" price at the request of the Chairman, and (b) in the case of a second competition. In the former case the L.B.C. justifies the practice as part of the Fair Price Scheme, our conclusion on which is recorded in paragraph 234 above. In the latter case the Conference claims that a second competition, being an attempt by the building owner or his architect to beat down the prices which have already been quoted, is wrong in principle. The L.B.C. has deliberately followed the policy of trying to defeat second competitions and this attitude is not confined to the L.B.C.; the L.M.B.A., for instance, has told us that in the case of second competitions the builder concerned might take steps by the use of cover prices "to protect the position".* Whatever the merits of second competitions, it appears to us that the proper course for a builder who disapproves of a second competition is to decline to tender or re-tender, and we regard the formation of a "ring" for the purpose of inducing the building owner to accept a particular builder's tender as undesirable. We conclude, therefore, that such circumstances afford no justification for the practice of adjusting the amounts of proposed tenders by mutual arrangement.

Final Conclusion

240. For the reasons which appear in the preceding paragraphs of this chapter we conclude that the arrangements of which the practices described at (a) and (b) of our terms of reference form an integral part, have no such beneficial effect as would justify either practice and that both the practices in question are against the public interest.

Remedies

241. We are required to consider remedies for any mischiefs which result, or may be expected to result, from either of these practices. In our reference the practices are described in general terms, and consequently we have to formulate our recommendations for remedies in general terms also and cannot,

* See paragraph 205.

as we have usually done in our earlier reports, limit them to specific actions to be taken by particular persons. We wish, nevertheless, to make it clear that the recommendations which follow are intended to relate to agreements and arrangements of the kinds which have come to our notice in the course of this inquiry and with which we have dealt in the body of this report. We recommend that agreements or arrangements of the following kinds should be brought to an end :

- (a) any agreement or arrangement to communicate the amount of any proposed tender for the construction of a building of the kind covered by our reference to a person other than the person calling for tenders ;
- (b) any agreement or arrangement between a proposed tenderer and any person, other than the person calling for tenders for the construction of a building of the kind covered by our reference, to adjust the amount of any proposed tender for such construction.

We think it best to make no recommendation as to the method by which these agreements or arrangements should be brought to an end, because in our view it can be determined only after discussion with the various parties concerned—the representative bodies of builders, architects, surveyors and Local Authorities as well as the L.B.C.—and it is for the appropriate Government Departments to undertake these discussions.

D. A. S. CAIRNS (*Chairman*)

G. C. ALLEN

J. ARCHDALE

T. J. BARNES

J. A. BIRCH

W. G. CULLEN

C. N. GALLIE

C. H. P. GIFFORD

A. L. GOODHART

W. L. HEYWOOD

I. C. HILL

ARNOLD PLANT

GORDON STOTT

C. E. WRANGHAM

R. E. YEABSLEY

WILLIAM HUGHES (*Secretary*)

18th June, 1954.