

736. The BEAMA has terminated the agreement between its Condenser Section and the Condenser Plate Association (see paragraph 73).

CHAPTER 33. CONCLUSIONS ON THE PUBLIC INTEREST AND RECOMMENDATIONS

(1) Introduction

737. Our reference requires us to reach conclusions under six heads, namely as regards the home supply and exports of machinery in each of the three classes, (a), (b) and (c). In the preceding chapters we have set out the relevant facts separately for each class of machinery, and within the section dealing with each class we have described the arrangements which are operated when the machinery in question is sold in the home market and by export respectively. Both the market conditions and the manufacturers' arrangements under the six heads of our reference have a number of common features, but there are also some marked differences.

738. The value of the total production in the United Kingdom of machinery covered by our reference was £88 million in 1952 and is probably about £100 million per annum at present. Of this total nearly one-half falls within class (b), the rest being divided more or less equally between classes (a) and (c). About one-third of the total production is exported; the exports are divided fairly evenly in value between the three classes of machinery.*

739. Our reference is not concerned with a self-contained industry. It covers certain types of capital equipment made by the electrical industry, including some of the heaviest and most important. The total production of the electrical industry was about £727 million in 1951.† Some of the manufacturers with whom we are concerned make a complete or almost complete range of electrical products and others specialise in certain lines; few confine themselves to the machines covered by our reference. Moreover, the larger machines within our reference are in many cases made in workshops which are also turning out other products with which we are not concerned. Some of the goods within our reference—the steam and water turbines and condensers and feed water heaters—are heavy engineering rather than electrical machines, but are so closely associated with electrical machinery in use that they are generally, though not always, made by manufacturers whose principal interest is in the electrical industry.

740. The electrical industry has expanded greatly at a fairly steady rate throughout the present century. As far as we are able to judge, a limit to this expansion is not in sight. The demand for machinery of the kinds with which we are concerned has increased, and must we think continue to increase, proportionately with this expansion. We understand that atomic power, at least in the early stages, is expected to be applied to industrial use principally by providing an alternative source of heat for steam driven generating plant; so that as far as can be foreseen the steam turbo generator will not itself be superseded but will continue to be required, together with motors and transformers, on an increasing scale. There also appears to be no prospect that water driven generating plant will be superseded for many years to come.

* Only about one-quarter of total production of machinery in class (b) is exported, as against one-half for class (a) and two-fifths for class (c) (see paragraph 7). In practice a good deal of the machinery in class (b) which is supplied in the home market is subsequently incorporated in other products, some of which are exported.

† See paragraph 6.

741. All turbo alternator plant in class (a), the larger transformers in class (c), and the larger generators and motors in class (b), are made to order. Part of the demand for the smaller motors in class (b) and the smaller transformers in class (c) can be satisfied by standard machines made in quantity; there is, nevertheless, a substantial proportion of users whose requirements even for these machines are so diverse that they can be met only by manufacture to individual design.

742. In the home market the Central Electricity Authority (CEA) buys approximately 80 per cent., by value, of the machines in class (a) which are supplied and, with the Area Boards, approximately 70 per cent. of those in class (c). Some of the larger machines in class (b) are designed for special uses in a limited market, which in some cases consists of a single buyer, such as the National Coal Board. There is a much wider market, however, for most machines in class (b) and for the small transformers in class (c). There is a little trade in small motors through electrical contractors and distributors, but practically all the products covered by our reference are supplied direct by manufacturer to user or to another manufacturer for incorporation in his own products.

743. In export markets the demand for machinery in classes (a) and (c) is naturally more widely spread. Although there are fewer buyers of turbo alternator plant and large transformers than of small motors, there is no single buyer who dominates the export market for any of these products.

744. The principal trade association for manufacturers of electrical products is The British Electrical and Allied Manufacturers' Association (Incorporated) (BEAMA), and most of the important manufacturers of the products with which we are concerned belong to it. Nearly all the manufacturers who are parties to the principal practices on which we have to form a judgment are members of the BEAMA, but the practices are not operated by the BEAMA and not every member of the Association who makes these products is a party to the practices. The practices are operated under the agreements of the Groups, or in some cases under agreements sponsored by The International Electrical Association Ltd. (IEA), and only those manufacturers who are signatories of the agreements are normally* parties to the practices. As far as class (a) is concerned, independent production—that is production by a manufacturer who is not a signatory of any of the agreements for that class—is negligible; but one of the largest manufacturers, C. A. Parsons & Co. Ltd. (Parsons), now negotiates prices with the CEA on a partly independent basis as described in paragraphs 227 to 239. There is also very little independent competition with the Group manufacturers of large transformers in class (c) and of the larger machines in class (b). There is substantial independent production of motors in class (b) and of small transformers in class (c).

745. In export markets, the manufacturers who are parties to Group or IEA agreements have to face vigorous competition from foreign manufacturers of every type of product. Their principal competitors are now, as before the war, the manufacturers in the U.S.A. and Germany. About 70 per cent. of the export trade of the United Kingdom manufacturers is with Commonwealth countries, in some of which they enjoy an advantage over their competitors by way of preferential tariffs and goodwill. There is every reason for supposing on the one hand that demand for these products from all parts of the world will continue to increase, and on the other that competition from the present producing countries will not diminish and that fresh competitors will appear.

* In isolated cases certain manufacturers who are not signatories "co-operate" with the signatories.

746. The earliest Group agreements were made before the 1914-18 war. The provisions varied from time to time and as between one product and another, and some agreements lapsed altogether for certain periods, but agreements providing for common prices have existed continuously from the 1930's to the present time in respect of the supply in the home market of nearly all types of product covered by our reference. Agreements governing export markets are generally of later development, and it is only since 1939 that agreements providing for common prices in export markets have been made for most of these products.

747. Some 40 United Kingdom manufacturers are signatories of one or more of the Group and IEA agreements with which we are concerned. Five of them have more widespread interests than the rest and between them are responsible for more than half of the total sales of products covered by our reference. These five manufacturers, through the Groups Joint Administration Board (GJAB), exercise a co-ordinating influence over the Groups, but the Board is only advisory. There is no evidence that the five companies can determine the policy of Groups whose membership is relatively large, that is, generally, those concerned with the smaller machines. For large machinery the number of manufacturers is much smaller, and there is no doubt that these companies have a preponderant influence. Two of the companies, Metropolitan-Vickers Electrical Co. Ltd. (Metro-Vick) and The British Thomson-Houston Co. Ltd. (BTH), are subsidiaries of Associated Electrical Industries Ltd. (AEI), and are together responsible for more than one-third of home supplies of machinery in class (a).

748. From what has been said in paragraphs 737 to 747 it will be seen that conditions in the home market differ for small and large machinery. The principal differences are that:

- (i) there are powerful buyers who dominate the market for large machinery but not for small;
- (ii) there is competition on a considerable scale from independent manufacturers of small machinery, but it is negligible for large machinery;
- (iii) some small machinery is produced in quantity but all large machinery is made to order; and
- (iv) there are fewer manufacturers of large than of small machinery.

The most important of these differences are the first and second; these do not apply in the export market, where there are many customers and substantial foreign competition for all types of machinery.

749. The principal restrictive practice we have to consider in relation to the public interest under all the heads of our reference is the observance of minimum prices; with few exceptions, its effect is that the manufacturers concerned charge common prices. We deal with the practice in paragraphs 751 to 794. In addition there are a number of subsidiary arrangements which are operated in varying degrees according to the type of product and market. These are:—

- (i) compensation for tendering expenses, applying to the home and export supply of machinery in class (a) and large machinery in class (b) (paragraphs 796 to 799);
- (ii) notification of enquiries and orders, applying to practically all products within the reference except some of the smaller machines in classes (b) and (c) (paragraphs 800 and 801);

- (iii) agreed discounts or other differentiations in price for specified buyers, applying to machinery of all three classes supplied in the home market, and supplemented in the case of smaller machines in class (b) by certain arrangements involving aggregated quantity rebates and allowances dependent on a degree of exclusive dealing (paragraphs 802 to 810);
- (iv) arrangements involving differentiation between one manufacturer and another, applying to the home and export supply of certain types of machines in classes (a) and (c) (paragraphs 811 to 813);
- (v) the observance of common conditions of contract, applying to the home and export supply of practically all machines within the reference (paragraphs 814 to 816);
- (vi) a number of other practices of minor importance, most of which are designed to support the common price system (paragraphs 817 and 818);
- (vii) certain arrangements made by individual manufacturers which affect their exports of particular types of machinery in classes (a) and (c) (paragraphs 829 to 831).

750. In addition we have to consider in relation to the public interest the position of the CEA as a buyer (paragraphs 819 to 822) and of the subsidiaries of AEI as suppliers (paragraphs 823 to 828) of more than one-third of the total home supplies of machinery in class (a).

(2) Group and International Electrical Association Ltd. Arrangements

(A) Common Prices

751. As there are arrangements for charging common prices for nearly all the types of goods covered by our reference, whether supplied in the home market or by export, we deal first with the considerations which are of general application, and then with considerations which are peculiar to the home market for large machinery, to the home market for small machinery, and to the export market respectively.

(i) General

752. The case put forward by the manufacturers in justification of their arrangements is set out fully in Chapter 32. They argue that (i) the industry has an exceptional need for stability, (ii) stability is exceptionally difficult to achieve without price agreement, (iii) price competition would have disastrous effects on the industry, on the buyers and on the national economy, (iv) the system of common prices is justified by results (v) the level of common prices adopted is justified by the moderate level of average profits for the industry, (vi) the apparently wide spread of costs does not reflect a corresponding spread of manufacturing efficiency, and (vii) the least efficient manufacturer whose capacity is needed should, in any event, have the livelihood which the level of prices under the common price system affords him.

753. The manufacturers say that they need stability in the sense that they must have substantial and steady earnings to meet the high overhead charges which the industry has to bear because of its costly capital equipment and expenditure on research and development. We are aware that some of the equipment for making and testing the larger machines in particular is extremely expensive, and that to keep pace with developments in the electrical field a considerable outlay on research is required. At the same time, because

much of this machinery is made to order, many of the processes in the workshop cannot be mechanised, and the elements of cost attributable to labour and to the drawing office are also considerable. Our costing inquiry showed that probably about one-third of total cost is represented by indirect wages and other overheads. These overheads are not all fixed costs, but we think that the ratio of fixed overhead costs to total costs is rather higher than in many industries, though not outstandingly so.

754. Though we recognise that the ratio of fixed overhead costs may be relatively high, we do not think it reasonable or realistic to expect to maintain in this industry so high a degree of stability as the manufacturers appear to want, and it seems to us that the effort to maintain it by the means actually used may only retard progress. The fact that there is expensive capital equipment which needs to be kept fully employed makes it all the more important in our view that the pricing policy of individual manufacturers should be as flexible as possible. The manufacturers appear to believe that the expansion and technical development of their industry, to which they properly attach great importance, can best be achieved by orderly co-operation in a system under which the least progressive and the most progressive charge the same prices. We think that this is a mistaken view. If the United Kingdom industry is to make the most of the opportunities presented by the expanding world demand for its products, it must always outstrip or at least keep pace with its foreign competitors in inventiveness, efficiency and enterprise. We believe that the attitude required is more likely to exist if the individual manufacturer is able to operate freely in accordance with his own judgment and to change his price when he thinks fit. We are strengthened in this belief by the consideration that there are substantial differences in design and manufacturing methods between one manufacturer and another.

755. The manufacturers go on to say that there are three reasons why the stability they desire cannot be achieved without a system of common prices. Their first reason is that because of the high ratio of fixed overhead costs to total costs there is a standing temptation for the individual manufacturer to accept a low price in a weak market. As we have explained above, we do not agree that the ratio of fixed overheads is outstandingly high; but in any event we see no reason why a manufacturer should be discouraged from accepting a low price whenever he thinks this will be more advantageous than foregoing an order. On the contrary, he may be serving the public interest if by so doing he is able to keep in production plant and labour which would not otherwise be employed to full capacity. The manufacturers' second reason is that the individual company cannot easily gauge the market and may weaken it still further by accepting a lower price than is necessary to get the order. We think that any competent manufacturer ought to be able to act independently in the light of his assessment of the strength of the market in which he is operating. Furthermore the common price system itself alters the balance of the market. A system under which the principal suppliers act in concert affords little opportunity either to the buyers or to those suppliers themselves to check their estimates of the market against genuine competitive offers; the concept of a market price determined by the interaction of supply and demand thus tends to disappear, and in its absence the suppliers may quote prices above the highest the buyer is prepared to pay or, conceivably, below the lowest he expects to be asked to pay. The third reason advanced by the manufacturers is that with a small number of sellers and buyers in the field one individual can break the market. This argument is closely associated with the manufacturers' contention that the buyer is able and willing to beat down the price unjustifiably, and the seller peculiarly vulnerable to such tactics (see paragraphs 756 and 760).

756. The manufacturers contrast the benefits of their system of common prices with the ill effects which they say price competition has had, and would have, on themselves, on their customers and on the public interest. They say that there were prolonged periods before the war when prices were barely sufficient to cover the costs of the lowest cost producers, and that such conditions might very well return if they were to compete with one another in price. Such conditions, they say, must weaken the industry's financial structure, retard technical progress by reducing the funds available for development, and lead to competitive debasement of quality to the disadvantage of the purchaser; and if the weaker manufacturer is put out of business in the process, his capacity will be missed when the market strengthens, and the surviving manufacturers will then be in a position where they can charge exorbitant prices for their products. These arguments are bound up with the view that the buyer of the manufacturers' products has a strong bias towards the lowest possible first price, regardless of quality and of the true capitalised cost of his purchase when its efficiency and durability and the amount of servicing required are taken into account. The manufacturers say that it is in the public interest that every buyer should give full weight to these technical considerations, and that he will do so only if he is not distracted by differences in price.

757. We appreciate that although the market which the manufacturers serve may be expected to expand in the long term, its strength may fluctuate in the short term. But the manufacturers appear to us to over-estimate the likelihood of a protracted weak market, to take a mistaken view of some of its effects if it should occur, to be unduly optimistic about the effectiveness of their own arrangements for maintaining the level of prices in such conditions, and to under-estimate the buyer's interest in the quality of his purchase.

758. The conditions which the manufacturers envisage as a result of price competition are, in fact, those of general trade recession. We think that in this respect the manufacturers are over impressed by earlier experience in quite different conditions, and that fear of a recurrence of these conditions has led them to adopt a cautious and rigid attitude in the face of change. This attitude also leads them to over-estimate the probable effects of a recession in trade on the industry, the buyers, and the public interest. It is possible, we agree, that a prolonged weak market might put out of business those of the weaker manufacturers who were unable to adjust themselves to the adverse conditions, and that there might be a temporary shortage of capacity when the market recovered. As the manufacturers themselves have pointed out, it does not necessarily follow that their manufacturing capacity would be lost to the national economy permanently. Nor should it be assumed that the surviving manufacturers will necessarily be financially weaker than before or will inevitably fall behind in matters of technique, research and development; on the contrary some of them may be stronger than before. The assumption, on the other hand, that the surviving manufacturers will be able to charge what prices they like when demand recovers also appears to us to be unrealistic. This could happen only if there were a sudden and overwhelming increase of demand, and in that event would be likely to be corrected by the introduction of new productive capacity in the industry as a result of the high level of prices.

759. Even if we agreed with the manufacturers' views about the need to provide against a general recession and the conditions which would follow, we should still be doubtful whether their system of common prices would survive in such circumstances. We think that the ratio of fixed overhead costs to total costs, if not outstandingly high in this industry, is high enough

to make any manufacturer with spare capacity reluctant to refuse an order at a price which would cover his costs. For this reason, we should expect that in a time of serious recession some manufacturers would be forced to break away from the common price system, as happened on occasions between the wars, or the system itself would become so flexible as to be ineffective for the manufacturers' purpose.

760. Much of the manufacturers' anxiety arises from the assumption that they have to deal with purchasers whose principal aim is to beat down the first price. We deal in paragraphs 772 and 773 with the special case where there is a dominant buyer in the market; but whether there be one or many buyers, we can see no reason for believing that in the conditions of the electrical industry they will buy products of inferior quality for the sake of an apparent saving on first cost. The manufacturers' products are capital goods. Many of the buyers are as well-informed as the manufacturers in technical matters, and almost all of them are sufficiently experienced in their own businesses to realise that first cost cannot be the sole consideration. The buyer, no doubt, wants to make the best bargain he can, and we think he is generally competent to decide whether one product of a certain quality at a certain price suits him better than another of different quality at a different price. If he is not competent to make this choice, then he can hardly be competent to choose between a number of products of different quality and design at the same price. No doubt there will always be a few buyers and a few manufacturers who will be tempted to reduce price at the expense of quality, but we find it impossible to believe that the manufacturers as a whole are subjected or are likely to be subjected in this respect to pressure they cannot resist. Most manufacturers of these products wish to maintain their reputation for quality whether the market is strong or weak, and most buyers of them are capable of discriminating and prepared to pay for the quality they want. In these circumstances we can see no serious danger of progressive deterioration of price and quality if the buyer is given a choice of prices.

761. The manufacturers contend that, whatever arguments may be advanced against a common price system, their own arrangements are justified by the results actually achieved. They point to the expansion and technical progress of the industry and claim that some of the credit is due to their price arrangements; they also assert that the inflow of new manufacturers shows that enterprise has not been stifled. We agree that the common price system has not prevented substantial expansion and technical progress, but it does not follow that the system is responsible for these advances. The continuing growth in the demand for electricity provides much of the explanation, and there is no means of judging how the common price system has affected the degree of progress achieved. The progress of the industry has probably been assisted by technical collaboration between the manufacturers, but we do not believe that the elimination of price competition is a necessary pre-requisite to other and more desirable forms of co-operation. As far as the flow of new manufacturers into the industry is concerned, this has varied with the nature of the product. Manufacture of the larger machinery requires heavy capital outlay, and there has in fact been little or no movement of new manufacturers into this part of the industry in recent years. We think that even if the existing manufacturers had wished it they could not have prevented newcomers from undertaking the manufacture of the smaller products. There is, on the other hand, no evidence that the common price system has acted as a deterrent; indeed if a group of manufacturers agrees to sell at common prices it may offer

a standing inducement to newcomers to enter the market and undersell them.

762. The manufacturers recognise that it is not sufficient for them to justify the common price system in principle, but that they must show that their particular system produces prices which are reasonable for all concerned. They say that the reasonableness of their system should be judged by the level of the average profit for all the manufacturers concerned and for all products covered by our reference, and that their average profit does in fact bear comparison with the rates achieved in other industries. In support of this statement they point to the profits earned by three groups of industries in 1952 (see paragraph 643). The figures relate to the profits of five companies in the motor vehicle industry, twelve in electrical manufacturing and thirteen in a miscellaneous group, for which the average rates of profit were 22 per cent., 20 per cent. and 21 per cent. respectively on capital employed. The comparable average figures for 1952 for machinery covered by the reference were 19 per cent., 28 per cent. and 22 per cent. on capital employed for classes (a), (b) and (c) respectively, or 22 per cent. for the three classes taken together (see paragraph 642). The evidence submitted by the manufacturers is very limited in scope, and we think that the summary we have prepared from statistics of industrial profits and assets published by "The Economist" (see Appendix 12), which covers some 2,000 companies and a wide range of industries, affords a more reasonable basis for comparison with the profit rates in other industries. It appears from these figures that the profit rate of 22 per cent. earned in 1952 on products covered by our reference was higher than that for any of the seventeen manufacturing industries represented in Appendix 12, and substantially higher than the average rate of 15.4 per cent. for those industries. In 1951 the figures for four of the seventeen manufacturing industries were higher than the rate of 22 per cent. earned on products covered by the reference, but the average rate for the seventeen industries was again lower at 19.4 per cent. In 1951 and 1952 the level of the average profit for products covered by the reference may well have been affected as much by the strong sellers' market as by the common price system. Whatever the explanation, the figures do not appear to us to lend much support to the manufacturers' argument. In any event the argument ignores the points that a low level of profit may reflect a high level of cost, and that the common price system itself may remove a stimulus to reduce costs and help to keep in business manufacturers whose costs are high.

763. The manufacturers say that they have never sought to protect high cost producers, and that the price levels they have set have not in fact done so. They recognise that at a particular moment some manufacturers have higher costs than others for similar products, but they argue that no manufacturer is a low cost producer for all his products, and that a comparatively high profit on one product is usually offset by lower profits on other products.

764. We accept that the manufacturers, when fixing prices, do not follow a deliberate policy of protecting the high cost producers. The records of the Groups show that there is often a tug-of-war between the higher cost and the lower cost producers, and that the prices eventually agreed represent a compromise between these opposing views. But while it is true in such cases that the high cost producer accepts a lower price than he would like, it is equally true that the low cost producer goes some way to meet him by agreeing to a higher price than he could afford to sell at, and possibly would sell at if there were no common price system. We have noted, moreover, that in 1951 and 1952 there were only a few cases

where an individual member of a Group incurred a trading loss on the sale of any particular category of goods for which there were common price arrangements; that is to say the higher cost producers in most Groups were able to earn profits from the prices fixed by those Groups. It appears to us that, except when the market is very weak, such a result is almost inevitable, since the higher cost producers could not for long remain in business if the common price system afforded them no profit.

765. The manufacturers' contention that a high rate of profit on one product is generally offset by a low rate on another cannot be accepted without qualification. In the first place there are some specialist manufacturers who earn high rates of profit on the only goods covered by the reference which they make.* And while the contention is true of five of the six manufacturers with the widest interests whose results we examined in some detail (see paragraphs 639 and 640), the sixth, whose interests are rather less wide than the others', has earned outstandingly high rates of profit on machinery in classes (a) and (c) taken together. In any event we think that the common price system must be judged by its effect on the efficiency of individual manufacturers and on the prices of individual products. To consider only the average profit earned over the whole industry would involve disregarding not only the question whether average costs are higher than they need be but also differences in cost between manufacturers and differences in profit between products. The CEA has told us in this connection that "the manufacturers who produce a wide range of products invariably claim that the departments responsible for each product are expected to operate effectively as separate economic units" (see paragraph 669). It seems to us natural that a business with multiple interests should be run on this basis, and we think it proper to compare the costs and profits of individual manufacturers for particular products when considering the effects of the common price system.

766. The manufacturers have suggested that we ought not to attach very much significance to the apparently wide spread of costs and profits disclosed by our costing investigation and by the figures they themselves submit to certain Groups. They say that the spread of costs is due first to variations in costing methods, and secondly to differences in manufacturing methods and design of the product. They go on to say that, in so far as there are also differences in manufacturing efficiency, these are reflected arbitrarily in costs taken out at a particular moment; they suggest that there is, in fact, no permanent spread of costs but that the common price system stimulates competition in technical matters and that, in the race to improve efficiency, it is inevitable that different manufacturers achieve success at different times.

767. As we have explained (see paragraph 651), we are satisfied that the spread of costs is attributable to differences in manufacturing efficiency as well as to the other factors mentioned by the manufacturers. The figures we have examined suggest that some of these differences in efficiency are of long standing; certain manufacturers appear consistently to earn the highest and others the lowest rates of profit on certain products. Even if this were not so, we should find it hard to understand how the explanations advanced by the manufacturers could be thought to justify the common price system they are defending. To the extent that the apparent spread of costs is due to differences in manufacturing methods and in actual products, it is in our opinion a strong argument against agreeing common prices for those

* Many of these manufacturers, in fact, make other goods but we have no information about their profits on goods which are outside our reference.

products; to the extent that it is due to different methods of costing, we find it surprising that the Groups have not made a greater attempt to secure uniformity in costing to enable them to measure the true spread of costs of the machines which, they contend, are justifiably sold at common prices.

768. Finally, the manufacturers have advanced the general argument that the least efficient manufacturer whose capacity is needed to meet demand should be able to sell at a price high enough to afford him a livelihood. As we have already pointed out, it is wrong to assume that when a manufacturer fails, his factory and plant necessarily cease to be available to meet demand or that new capital will not be forthcoming in response to rising demand, and we cannot agree that prices generally should be held at a higher level than would otherwise prevail in order to keep inefficient and redundant capacity in being against a revival of trade. One of the avowed purposes of the common price system is to protect the participants in a weak market, when manufacturing capacity is in excess of demand; but it appears to us that the system is designed in practice to afford a livelihood to the least efficient existing manufacturer in both strong and weak markets, that is to say regardless of whether his capacity is always needed.

769. The general case put forward by the manufacturers in defence of their common price system has not convinced us that the degree of stability they aim at is in the public interest, that the dangers they fear from price competition are real, or that the standards by which they propose that their system should be judged are the right ones. We are satisfied that, after making all possible allowance for differences in costing methods, the true costs of the manufacturers who sell at common prices differ widely. Whether or not these differences in cost are due principally to variations in manufacturing method and actual product or in manufacturing efficiency, we think that the common price system could not have been maintained unless the higher cost producers exerted considerable influence on the level of price, and the lower cost producers agreed to sell at higher prices than they would otherwise be prepared to accept. In such circumstances the system must weaken the incentive to the individual manufacturer to reduce his costs and to expand his business for that purpose. The system, therefore, tends to create rigidity not only in the price structure but also in the division of the trade between the various manufacturers. Having regard to the great opportunities which are open to this industry in the long term all of these effects are extremely undesirable; they create inflexibility where flexibility is most needed, and a defensive and cautious attitude in manufacturers whose main concern should be with their ability to meet future demands upon them. We see no harm, and some advantage, in collaboration on technical matters provided it does not involve collaboration on prices; the BEAMA provides services of this kind for its members whether or not they are parties to common price arrangements, and we see no reason why it should not continue to do so. But in our opinion the common price system under each of the six heads of our reference operates against the public interest unless it can be shown that in any cases there are countervailing advantages arising from conditions peculiar to those cases. We proceed to consider in paragraphs 770 to 790 the arguments which are special to the different cases.

(ii) *Large Machinery : Home Market*

770. In this section we are concerned principally with the operation of the common price system in relation to the supply in the home market of machinery in class (a) and a large part of that in class (c). In as much

as each unit of this machinery is designed and built to the buyer's requirements, the operation of the common price system is more complex than when applied to the smaller machines, but the purpose and effect of the system are substantially the same in both cases. The distinguishing features which make it necessary to give separate consideration to large machinery are in the market conditions in which the system is operated rather than in the system itself. In the first place the machinery we are considering is bought almost exclusively by the CEA and the Area Boards so far as the home market is concerned. Secondly, the manufacturers in the common price system have practically no independent competitors in this country.*

771. The unification of the electricity supply industry has created a situation which is different from that which prevailed before 1948 in the market for large machinery and from that which prevails now in the market for small machinery. The manufacturers were operating a common price system long before the CEA was set up, and it is obvious from their general arguments that they would be prepared to justify their system even if there were no dominant buyer. In their view, however, the advent of the CEA has made the system more than ever essential to the well-being of their own industry and to the public interest. They have told us that the concentrated buying power of the CEA and the Area Boards is capable of seriously depressing the level of prices and is constantly applied for that purpose, and that, unless the manufacturers themselves combined to set up pressure in the contrary direction, they would be confronted permanently with the conditions of a weak market. They say that if the manufacturers did not co-operate the Authority could at any time break any one of them by withdrawing its orders, and that it could, therefore, go from one manufacturer to another beating down the price. They add that the Authority already does this whenever the opportunity is offered, and that if any manufacturer for reasons of his own were to offer a low price on one contract the Authority would regard that as the standard price for future contracts. The manufacturers believe that the common price system is the best defence against such tactics. They say, too, that the CEA is always under pressure to accept the lowest tender regardless of technical considerations and that common prices are therefore in its ultimate interest.

772. Because we regard this matter as of the greatest importance we have described the negotiations between the manufacturers and the CEA and recorded the views of both sides in some detail (see Chapters 9 and 26). The CEA has told us that, having been faced in 1948 with a situation in which it could buy these products only from manufacturers who were parties to the common price system, its efforts since then have been directed towards obtaining either a justification of the common prices on the basis of disclosed costs or a measure of price competition. Having met initial resistance on the question of obtaining costs, the Authority has taken every opportunity open to it to foster price competition, and it contends that this has had some effect not only on the level of prices but also in inducing the manufacturers to make some disclosure of their costs. As far as machinery in class (a) is concerned, the Authority has welcomed the resignation of Parsons from the principal price agreements and has guaranteed to place a certain volume of orders with the company in consideration of the lower prices offered. With regard to machinery in class (c), the Authority has told us that the existence of independent competitors in the field of small transformers has enabled it to buy them at competitive prices, and that this has kept the level of prices

* Although Parsons conducts separate negotiations with the CEA on prices for turbo alternator plant, the prices it offers are closely related to the Group prices, and the company remains in association with the Groups concerned for many purposes.

lower than it would otherwise have been. It has told us, too, that reductions in the Group's prices for small transformers have sometimes been followed by similar reductions on the part of independent manufacturers, and that manufacturers who want a larger share of its orders are often reminded that competition in price might help them to get more business. The CEA also says that it has encouraged some independent manufacturers to undertake the manufacture of large transformers with a view to providing a check on the Group prices. The Authority claims that it is the practices of the Groups which have forced it to adopt all these measures. It says that if there were full price competition between the manufacturers it would invite competitive tenders from all manufacturers whose products were technically acceptable and place its orders with the lowest tenderers provided it was satisfied that they had capacity available to give the required delivery. It says that it does not wish to encourage anything in the nature of "cut-throat competition", and that if, as a result of price competition, tenderers made offers which were consistently substantially below those of their competitors it would wish to be assured that they were genuine offers carrying a fair expectation of reasonable profit to the tenderer, and not designed to "knock out" a competitor. With regard to the contention that it cannot easily reject the lowest tender on technical considerations the Authority says that "the reverse is in fact the case", since all technical factors are regularly calculated and taken into account in assessing the merits of competing tenders.

773. The CEA is, of course, right in saying that the common price system existed before the Authority came into being; and we do not see how, confronted with a system of common prices, it could have done otherwise than adopt tactics designed to avoid paying more than it would have had to pay in conditions of price competition. We also think it natural that the manufacturers should fear the power placed in the hands of the single buyer, and we can understand why the Authority's tactics have strengthened their conviction of the need for common prices. It is proper that both manufacturers and buyers should be shrewd bargainers. The negotiations which have been going on since 1948 do not appear to us to have resulted so far in a victory for either side. The CEA has apparently obtained a number of concessions by way of discounts or *ad hoc* reductions in price which were not available to its predecessors. It says that these are no more than are its due by reason of the economies in manufacture arising from the measures of standardisation it has introduced and the orderly programming of its orders. The manufacturers say on the other hand that these economies are largely illusory, that the average rate of profit they earn on sales to the CEA is very moderate for machinery in class (a), and that, though the rate has been higher in the case of class (c), it remains to be seen whether it will be adversely affected by the latest terms agreed with the CEA. We have noted (see paragraphs 628 and 636) that the rates of profit in relation to cost earned by the Group manufacturers have been higher for large than for small turbo alternators, and higher for large than for small transformers. Although, as the manufacturers have pointed out, these differences may be justified by differing rates of turnover of capital, the figures at least suggest that profits on sales to the CEA had not been unduly depressed up to the end of 1952. The moderate level of profits on turbo alternators referred to by the manufacturers is largely attributable to the omission of the figures for Parsons from the average because of that company's resignation from the price agreements. As long as that company's costs remain markedly lower than those of other manufacturers, it should hardly be a reason for surprise if the profits of the higher cost manufacturers remain at a low level, whether they have to deal with one or many buyers.

774. As we have also recorded, the CEA does not confine its criticisms of the common price system to the level of prices, but asserts that in specific instances the system has retarded the achievement of some of its aims in technical matters. Although we have invited both sides to present their arguments about these matters, we do not feel competent to judge conclusively between them; in some cases there is not complete agreement as to the facts, and all of them raise difficult technical issues. We think insofar as the two parties have failed to co-operate fully over some of these matters, this is because each of them feels that in striking any kind of bargain with the other he needs to be exceptionally wary.

775. We doubt whether the unification of the electricity supply industry has greatly affected the balance of bargaining power between seller and buyer. The manufacturers know that the CEA has a duty to maintain a public service and that, for practical purposes, it has no other source of supply of the machinery it requires; and they are themselves large public companies who are fully capable of holding their own with a nationalised industry. If the common price system were to remain in being, we should see no reason to expect that either side would gain a permanent advantage over the other; but we also find it difficult to believe that the abolition of the system would tip the balance decisively against the manufacturers. We have to consider moreover, that the public interest is more than the sum of the interests of the parties immediately concerned in the negotiations. As we have said in paragraph 769, our examination of the manufacturers' general arguments in favour of the common price system has led us to the conclusion that the system operates against the public interest, subject to any countervailing advantages which may arise from conditions in particular sections of the industry. Having considered the conditions which are peculiar to the supply in the home market of those large machines which are bought principally by the CEA and the Area Boards, we do not find that any such advantages arise or are likely to arise in the future. We, therefore, conclude that, as at present operated and as applied to these machines in the home market, the common price system operates against the public interest.

776. Large machinery in class (b) is not bought by the CEA, but consists of specialist equipment required by a few public utilities and purchasers of corresponding strength. None of these buyers has bargaining power in any way comparable with that of the CEA, and we have not received any evidence which suggests that the manufacturers' position is weak in this field. On the contrary the rates of profit earned on those types of large machinery in class (b) which are subject to common price arrangements have generally been above the average for the class (see paragraph 632 and Appendix 11). The conclusion reached in paragraph 775, therefore, applies to the supply in the home market of all large machinery in classes (a), (b) and (c).

(iii) *Small Machinery : Home Market*

777. So far as supply in the home market is concerned, it remains for us to consider the small motors and generators which constitute the greater part of the machines in class (b), and the small transformers in class (c). The market for the small motors and generators is a very wide one, and there is no one dominating buyer or organised group of buyers. Many of these machines are bought for incorporation in, or coupling with, other products. One of the principal distinguishing features of the manufacturers' arrangements in this field is a rather elaborate system of discounts and quantity rebates for various categories of listed buyers; we deal with differential price arrangements separately in paragraphs 802 to 810. The market

for small transformers is not as wide as that for small motors and generators, and the CEA and the Area Boards have a considerable, though by no means exclusive, interest in this field as buyers. Apart from the fact that the manufacturers are concerned with a variety of buyers, the market conditions for small machinery differ from those for large by reason of the volume of independent competition. This competition is particularly vigorous in the case of small motors.

778. The Group manufacturers have not suggested to us that the existence of independent competitors increases their own need for a common price system; and their case for the system as applied to small machinery, therefore, rests very largely on the general arguments with which we have dealt already. Some of these general arguments are, however, given a rather different emphasis in this context. In particular, the manufacturers say that there are bound to be exceptionally wide variations in the costs of small motors according to the range of requirements which the manufacturer caters for, and that in the absence of a common price system the prices of "special" motors would be prohibitive.

779. Although the manufacturers have not said it in so many words we can only understand their argument to mean that because the cost of a special machine made to order is very much higher than that of a standard machine made in quantity, and because there is a wide demand for special as well as for standard machines, the manufacturer who makes special machines ought to be able to recover part of the cost from the price of the standard machines he sells and to fix his price for standard machines accordingly; and so that he may be able to obtain this price the manufacturer who makes mainly standard machines ought to sell them at the same price. We cannot agree with this reasoning. It assumes that the public interest requires that the demand for certain types of machines should be met regardless of their true cost, and that, if the true cost is "prohibitive" so far as the particular purchaser is concerned, it is proper for purchasers of other machines to contribute towards the cost. We think the public interest would be better served if the purchasers of "special" machines had to choose between paying the full economic price and doing without them. Some of the purchasing industries would, no doubt, have to face an increase in their capital costs, while others would benefit from the reduced prices of standard machines; if, as a result, the costs of all concerned were more in line with their demands upon the national economy, we consider that this would be in the public interest.

780. It is significant in this connection that there is considerable independent production of electric motors. A number of independent manufacturers concentrate on standard motors and, having chosen to remain outside the common price system, sell their machines profitably at prices which are generally lower than the Group prices. As we have recorded in paragraphs 430 to 433, the opinions of buyers about the quality of the independent manufacturers' machines differ. There is no doubt, however, that the Group manufacturers are sensitive to the competition which the independent manufacturers offer and have had to take account of their prices when fixing the prices of their own standard machines. We have noted also that one Group manufacturer who concentrates principally on standard machines has earned a higher rate of profit on small motors than any other Group manufacturer who makes small motors on a substantial scale. It is obvious that the common price system, as applied to small motors, covers two different types of business, one of which is much more profitable than the other at the prices fixed by the Group concerned.

781. We consider that, so far from serving the public interest, the common price system has the effect of distorting the demand for small motors. Although this particular disadvantage does not apply to the same degree to other small machines, we have found no positive advantages peculiar to the common price system as operated in relation to small machinery. Having regard to what we have said in paragraph 769 about its general disadvantages, we conclude that, as at present operated and as applied to small machinery in the home market, the common price system operates against the public interest.

(iv) *Export Market*

782. We do not find it necessary to differentiate between large and small machines in reaching a judgment on the effects of the common price system in the export market. There are no dominant buyers, and the British manufacturers have to meet formidable competition from foreign manufacturers. Although the common price system in the export market is operated partly under Group agreements and partly under those of the IEA, there is little difference in principle between the two sets of arrangements, and the foreign manufacturers who are members of the IEA do not participate in the common price system.

783. In considering the export market, we have borne in mind that practices which are apparently similar to those operated in the home market may, nevertheless, have different effects on the public interest when applied to exports. In both markets the manufacturers' arrangements may alter the level of prices and affect the distribution of orders. If the level of prices in the home market is higher than it would otherwise be, the costs of the purchasing industries are increased; but if an unduly high level of prices has the effect of diverting orders from the manufacturers in the common price system, the national economy does not, in the absence of any significant imports, suffer a loss in this respect. If prices in the export market are higher than they would otherwise be, there is on the face of it a net gain in this country's earnings provided the volume of orders is not affected; if, however, some orders are diverted to foreign manufacturers in consequence there may be a net loss. Should it be thought on the other hand that the common price system actually attracts orders to the manufacturers concerned, the system might be thought to be justified in the export market though condemned in the home market. Some purchasers in both markets dislike common prices and try to place their orders as far as possible with independent manufacturers. The effect of such resentment, whether reasonable or not, on the goodwill of the manufacturers concerned is not a factor to which we have needed to pay attention in regard to the home market; orders lost to them on this account are placed with other United Kingdom manufacturers. If dislike of common prices should lead to loss of orders in the export market, on the other hand, this would be a serious disadvantage of the system, however beneficial it might be in other respects.

784. It is not possible to draw any hard and fast line in these matters, and to say that certain considerations applicable to the one market can be entirely disregarded in the other. Whichever market we are considering we must pay regard to the effects of the practices on the efficiency of the industry as a whole. The public interest in the export field cannot be measured solely in terms of immediate gains or losses in currency earned. In the long run the public interest is best served, in the export market as in the home market, if the level of prices is reasonable for both seller and purchaser and if neither market subsidizes the other.

785. The manufacturers' case is, briefly, that, because of foreign competition, the export market is, permanently, a weak market. They say that in these circumstances a common price system which is confined to United Kingdom manufacturers cannot be an absolute remedy but provides a check against panic price-cutting. They believe that by pooling their information they can determine the best level of price at which to quote, and that this collective judgment of the situation must be more accurate than that of any individual manufacturer. They are aware that by collaborating they risk incurring resentment from purchasers who—wrongly, as they think—assume that the system is intended to exploit them; but they say that, with the possible exception of the recent Snowy Mountains contract, they know of no case where an order has been lost to this country for that reason, and they believe the advantages of the system to the public interest far outweigh any disadvantageous effect of this kind. They say that their system achieves the best possible balance between price and volume of orders.

786. While we can see advantages in the pooling of export market information, we think it essential that each manufacturer should be competent to act on that information independently, and we are not convinced that the best balance between price and volume of orders will be achieved by making identical offers in the light of the collective judgment. The right level of price to quote depends at any time, but particularly in a weak market, not only on common market factors but also on the circumstances of the individual manufacturer. At any given time what would amount to "panic price-cutting" for one manufacturer might be shrewd business for another; each manufacturer should be free to judge at what price he can afford to accept an order, having regard among other things to his available capacity and the fixed overhead costs he has to meet. In any event we are not impressed by the argument that in conditions of price competition the United Kingdom manufacturers would be forced to sell at increasingly low prices because purchasers are unduly concerned with first price; we have dealt with this in relation to the home market in paragraph 760, and we have no reason to think that conditions in overseas markets generally are sufficiently different to call for a different judgment.

787. It is true that the manufacturers have no such dependable source of export orders as the CEA provides in the home market. The export market they serve is expanding, but they may at any time lose ground to foreign competitors, or the purchasing countries may set up manufacturing industries of their own. The export market must be more fluctuating and speculative than the home market. Our investigation of costs and profits did not reveal any marked difference in the levels of profit on home and export business as a whole in the years examined; for some products a higher rate of profit was earned on home than on export business in a particular year, for others the reverse was true, and these relationships varied from year to year (see paragraphs 628, 633 and 636, and Appendix 11). The manufacturers tell us that export business is at present much less profitable than it was in 1952, and have pointed to the various modifications they have made in their export arrangements to enable them to obtain orders by reducing the agreed price. We are asked to infer that at present the collective judgment is maintaining the volume of overseas orders at a higher level, and maintaining it at less expense in reduction of price and loss of profits, than would be the case in conditions of price competition. We know of no evidence which can show whether the collective judgment is right or wrong. The detailed account of their preparations for tendering for the Snowy Mountains contract (see Appendix 7) shows that the manufacturers did indeed make every effort according to their own system—and

we have no doubt of their good faith—to obtain the contract by quoting the lowest possible common price. The purchaser has made it clear that the Group price was, in fact, sufficiently low to obtain the contract; and it is possible that in conditions of price competition no individual United Kingdom manufacturer would have quoted as low a price. The decisive factor in determining the award of the contract to a foreign competitor whose tender was in fact the lowest was stated to be the practice of level tendering by the United Kingdom manufacturers (see paragraph 663). In this instance, at least, the collective judgment appears to have defeated its own purpose by failing to foresee, or give sufficient weight to, the purchaser's dislike of collective tendering. It is clear that, whether United Kingdom manufacturers compete in price or observe common prices, the export market for their products will weaken periodically and both the volume of orders and the level of prices will be depressed. We doubt whether the common price system materially affects these movements, except that when other considerations are equal so far as the purchaser is concerned it may, as in the instance of the Snowy Mountains contract, tip the balance against the United Kingdom manufacturers and lead to the loss of an order.

788. Although we are aware that in other instances level tendering has been criticised, sometimes publicly, in some of the Commonwealth markets, none of the Governments concerned was prepared to express any views to us on the subject. In the circumstances we are left with the impression that purchasers are sometimes irritated by evidence of collaboration between the manufacturers on prices and become suspicious of their motives, but we have not sufficient information to enable us to assess the strength of this feeling or its effects on the goodwill of the United Kingdom industry. It is obvious that the common price system frustrates one of the purposes of inviting suppliers to tender, namely to enable the purchaser to compare products and prices and award the contract to the supplier who, when price, quality and reputation are taken into account, appears on balance to offer the best bargain. The manufacturers' assumption that there is a "best" level of price for every contract, ascertainable through their collective judgment, disregards from the purchaser's point of view the differences between the products offered at that price, and from their own point of view the differences in cost and available capacity which ought to be factors in the individual manufacturer's assessment of the situation.

789. Having regard to what we have said in paragraph 769 about the general disadvantages of the common price system, we do not find that, as applied to the export market, it has any advantages peculiar to it which outweigh those disadvantages. We conclude that, as at present operated and as applied to exports, the common price system operates against the public interest.*

790. We have said that we see no reason why collaboration in technical matters of the kind that is provided through membership of the BEAMA should not continue (paragraph 769), and we believe that this is at least as important in the export as in the home market. We also see no harm and some advantage in the pooling of export market information, but in our opinion it is undesirable that the manufacturers should discuss, or give one another any indication of, the prices they propose to quote or collaborate in any other way in matters of price and tendering. We deal further with the sharing of export market information under the notification arrangements in paragraph 801.

* See Note of Dissent as to Exports by Mr. Wrangham (paragraphs 837 to 841).

(v) *Proposed Modifications of the Common Price System*

791. We have recorded in Appendix 8 a number of modifications of their existing arrangements which the manufacturers told us they would be prepared to consider as additional safeguards to ensure that prices and profits under the common price system were reasonable. These proposals would principally have the effect of relating all common prices to the average of the costs of the lower cost producers, which would be determined regularly and accurately with some independent supervision.

792. Had we felt able to accept the manufacturers' arguments about the desirability of common prices we should have regarded these proposals as at least providing a basis for further consideration. If the common price system were to continue, we should expect the modifications to make the system rather more satisfactory than at present inasmuch as the relation between prices and costs would be closer and it would be more difficult for the highest cost producers to influence the level of prices. The proposals as they stand nevertheless leave much to be explained, including (i) the functions of the "independent authority" which would receive copies of all agreements and annual reports on the average rates of profit achieved by the various Groups, (ii) the considerations which would determine the number of low cost producers to be taken as representing "a reasonable proportion of the trade", and (iii) the level of the profit to be added to the average of the costs of those low cost producers.

793. We have not pursued these questions with the manufacturers because, in our view, as long as common prices are retained neither these nor any other modifications of the system can overcome the principal objections to the existing arrangements which have led us to the conclusion that they are against the public interest. Whatever methods might be used to arrive at the common price, it would still be applied to products which vary widely in design, in manufacturing method and in cost; and the system would still tend to weaken the incentive to the low cost producer to expand his business, to deprive the individual manufacturer of room for manoeuvre in negotiation, and to create rigidity in an industry which ought to be characterised by flexibility and enterprise. The manufacturers' proposals do not, in our view, offer any grounds for concluding that the common price system could be retained without operating against the public interest.

(vi) *Summary*

794. In view of our findings in regard to the common price system as applied to both large and small machinery in the home market and to all machinery in the export market, we conclude that the system operates, and may be expected to operate, against the public interest under each of the six heads of our reference, namely in relation to both the supply and the exports* of machinery in each of the classes (a), (b) and (c) described in our reference. We see advantage in the manufacturers co-operating with one another in technical matters and pooling market information in relation to exports as they do at present through the BEAMA, provided that they refrain from any kind of collaboration in matters of price and tendering (see also paragraph 801).

* See Note of Dissent as to Exports by Mr. Wrangham (paragraphs 837 to 841).

(B) *Other Group and IEA Arrangements*

795. Of the subsidiary practices of the Groups and the IEA, some fall to be considered under all six heads of our reference, but others are operated only in relation to particular products or markets. In the following paragraphs we indicate the context in which each practice falls to be considered before stating our conclusions about its effect on the public interest.

(i) *Compensation for Tendering Expenses*

796. There are arrangements for giving unsuccessful tenderers some compensation for their tendering expenses in respect of home and export sales of most machinery in class (a) and certain large machines in class (b). The amounts paid by the successful tenderers are small in relation to the prices involved (see paragraphs 170, 171 and 339) and are not related to ascertained tendering expenses; since they are calculated by reference to the output of the machines tendered for and do not vary with the number of tenderers the amount of compensation received by each unsuccessful tenderer for a particular enquiry is largely fortuitous. The amount due from the successful tenderer is a specific item in the build-up of the minimum price for some but not all steam turbo alternator plant, but, as far as exports of large steam turbo alternator plant are concerned, the amount actually paid over by the successful tenderer is calculated by a different formula from that used in building up the price. Compensation is not specifically added in arriving at the minimum prices of machines in class (b). Methods of distributing the compensation differ; in some cases it is confined to those signatories of the relevant agreement who tender for the particular contract, in others all signatories benefit.

797. The manufacturers say that the arrangements provide some contribution towards the expenses incurred by unsuccessful tenderers, that the amount for which the successful tenderer is liable is usually ignored in preparing tenders, and that the price is not, therefore, increased. They argue that the contribution is too small to provide an inducement to any manufacturer to tender for a contract he does not want, more particularly since there is a shortage of specialist staff of the kind that is employed in preparing tenders. As regards the export market the IEA says that, as now practised, compensation does not serve the purpose for which it was originally designed. Before the United Kingdom manufacturers entered into common price arrangements for exports the compensation arrangements in which both United Kingdom and foreign manufacturers participated were on a larger scale, were intended to raise the level of prices, and, according to the Association, were successful in doing so. This, the IEA says, is no longer either the intention or the effect.

798. The compensation arrangements in their present form appear to us to have very little practical effect. We can see no reason why the partial redistribution of costs between manufacturers which is effected should be any fairer than the normal process by which each manufacturer absorbs in his own general overheads those of his costs which are not attributable to particular sales. Although the amount provided for compensation is, in some cases, specifically added in calculating the minimum price, the build-up of the prices of the machines concerned contains so many arbitrary factors that it cannot be assumed that in the absence of compensation arrangements the prices would be lower. The cost of administering the arrangements is a small additional expense but is negligible in relation to prices. We agree, also, that no manufacturer is likely to be tempted to tender for a contract solely by reason of the amount of compensation he will obtain: probably this is always less than the cost of tendering.

799. The compensation arrangements could exist without the common price system, or the common price system without the compensation arrangements.* It can be held against the compensation arrangements that they involve some collaboration between tenderers, and that the price quoted by each tenderer is not necessarily precisely what it would be if there were no collaboration. In relation to export markets in particular this criticism has some force; any form of collaboration which affects, or might be thought to affect, the prices quoted by the individual suppliers may give rise to a loss of goodwill on the part of the purchaser. We have no evidence that the arrangements have caused dissatisfaction, but we do not know how far buyers are aware of their existence. Moreover, although the direct effects of these arrangements may be negligible at present, the manufacturers are open to the temptation to extend them so long as they are operated at all; and in the light both of past experience and of what the IEA has told us about the attitude of its foreign members in this matter (see paragraphs 87 and 88) it is likely that the absence of a common price system would encourage their extension. For these reasons we conclude that, particularly in conditions of price competition, the compensation arrangements may be expected to operate against the public interest.

(ii) *Notification of Enquiries and Orders*

800. Arrangements for the central notification of enquiries and orders are operated in relation to both the home and export markets for practically all machines (in all three classes) which are likely to be the subject of invitations to tender; the principal exceptions, that is to say, are some small machines in classes (b) and (c). Notification arrangements are generally, but not always, applied in conjunction with common price arrangements.

801. We regard the notification arrangements as operating against the public interest in so far as they support the common price system. Since they may exist by themselves we have to consider whether they would operate against the public interest in the absence of a common price system. The manufacturers have told us that the arrangements provide them with useful market information and statistics. We see some advantage in this in relation to exports, provided, as we have said in paragraph 790, that the sharing of information is not accompanied by discussion or communication of proposed prices or by any other kind of collaboration in matters of price and tendering. So long as information about specific enquiries from prospective purchasers is shared, there is a danger that understandings about prices or "protection" arrangements (see paragraphs 811 to 813) will follow; and as far as the home market is concerned we think this is a disadvantage which is not balanced by any advantage to the public interest that the arrangements afford. As far as the export market is concerned there is, as we have already indicated, a stronger case for the exchange of market information between the United Kingdom manufacturers who are in direct competition with powerful overseas suppliers; and in our opinion the advantages in this case are sufficient to outweigh the risks involved in the practice. We conclude, therefore, that in the absence of a common price system (i) all the notification arrangements applicable to the home market may be expected to operate against the public interest, and (ii) the notification arrangements

* Compensation arrangements are not, in fact, operated in the absence of price arrangements at the present time, but there are cases where the parties to the two kinds of arrangements are not identical; thus Parsons participates in compensation arrangements for large machinery in class (a) even when not a party to the Group price arrangements, and there are certain manufacturers in a similar position in relation to some machines in class (b) (see footnote † to paragraph 337).

applicable to exports may also be expected to operate against the public interest in so far as overseas manufacturers participate in them, but not if they are confined to United Kingdom manufacturers.

(iii) *Discounts, Rebates and Other Differential Price Arrangements*

802. The arrangements providing for minimum prices are intended to ensure that, except in certain cases which we deal with in paragraphs 811 to 813 below, the price quoted or charged by each party to the arrangement for the sale of a machine of given specification and performance to a particular person at a particular time shall be not less than a given amount. The given amount may vary from purchaser to purchaser. In the field of exports the prices of many machines in all three classes are determined *ad hoc* for each contract, and there are no standing rules for differentiating in price between one kind of purchaser and another. Most of the price agreements concerned with the home market, however, contain some provision for percentage variations in prices for particular buyers, by way of discount, rebate, handling charge or, in one instance, a percentage addition. We are concerned here with those regular arrangements for differential prices which are applied in the home market in relation to most machines in classes (a), (b) and (c).

803. For larger machines the provisions are simple. Insofar as these machines are bought by the CEA or the Area Boards there are specially negotiated discounts and rebates; apart from these the only differentiation normally made is in favour of main contractors for composite machines, who are allowed a handling charge or discount. Such an allowance to a main contractor does not result in any differentiation in price to the ultimate buyer; it is paid by the supplier of the subsidiary machine—sometimes, but not always a sub-contractor—to the main contractor in consideration of the latter's responsibility for co-ordination. Charges of this kind have long been customary; in some cases they are provided for, sometimes on a mutual basis, in agreements between groups of manufacturers of the component machines. The only other form of specified price differentiation for large machines is a scale of quantity discounts which may be allowed on certain machines in class (a) for marine use if six or more identical units are covered by one order.

804. The arrangements for small transformers in class (c) are a little more complex. There is an allowance for main contractors and resellers. There are also special discounts and rebates for the CEA and the Area Boards; the rebates in this case are based on the aggregate purchases of the CEA and each Area Board individually from all manufacturers in the Group. In addition there is a scale of quantity discounts for other purchasers who buy several identical units in one order. For small motors and generators in class (b) there is a much more elaborate system of differential prices involving the listing of buyers entitled according to their functions, to various rates of discounts on particular kinds of machines; certain buyers, provided they buy a specified proportion of their machines from Group manufacturers, may be allowed additional discounts and, in some cases, quantity rebates on a scale which varies with their aggregate annual purchases of the machines concerned from Group manufacturers. Finally, in the case of certain machines in class (b) for marine use certain quantity discounts are allowed but, on the other hand, the price is enhanced by a specified percentage on supply direct to a shipowner.

805. These arrangements are an integral part of the common price system, since they are intended to ensure that any variations in the minimum price shall be common as between the parties to the system. We regard the

arrangements as operating against the public interest insofar as they support the common price system. We think it unlikely that the more elaborate arrangements for differential prices could be operated in conditions of price competition, but we have, nevertheless, to consider whether any of them might be expected to operate against the public interest if there were no common prices.

806. The manufacturers say that the various price differentials are allowances for services rendered or in recognition of the common interest of manufacturers of related machines in securing orders for composite machines, or, in the case of quantity allowances, represent a sharing with the customers concerned of the economies of production resulting from quantity orders. They do not argue that any of these allowances are, or could be, precisely related to the value of the service performed or the saving in cost but assert that they are generally recognised as fair. They justify the arrangements for small motors and generators which depend on the customers buying a high proportion of their requirements exclusively from members of the Group concerned on the ground that this is a means of meeting the challenge of outside competition.

807. We see advantage in quantity discounts allowed by individual sellers in consideration of economies in production or in selling. It is another matter, however, when a Group of manufacturers allows a special discount or rebate based on aggregate purchases from the Group, or in consideration of the purchaser buying most of his requirements from members of the Group. These arrangements, since they encourage the buyer to spread his orders between the members of the Group, do not make for economy of production. Moreover, some of the independent manufacturers of electric motors have suggested that, although the Group manufacturers do not by any means control the whole market, the arrangements have the effect of directing business into a limited channel; and it does appear to us that they tend to divert business into the hands of the Group manufacturers in cases where, in the absence of such arrangements, the purchaser would prefer to buy outside the Group.

808. To the extent that costs are incurred in co-ordinating or assembling composite machines, it is clearly right that these should be charged in the price to the ultimate purchaser and be recovered by the particular contractor who incurs them. Where there is a main contractor and sub-contractor, we see no reason to suppose that the allowance made to the main contractor is not, generally, a proper payment for work done, or that it inflates the price to the purchaser.

809. So far as differential price arrangements other than those dealt with in paragraphs 807 and 808 are concerned, we think the customary observance of a simple system of discounts for certain classes of buyers would probably do no harm provided the system were not made rigid and that there was room for negotiation between individual sellers and buyers. We would regard a contractual obligation on the part of manufacturers to observe a specified scale of allowances and the listing of individual buyers entitled to such allowances as making for an undesirable degree of rigidity even in the absence of common price arrangements.

810. We conclude that all the arrangements for differential prices in the home market in respect of machines in each of the three classes operate against the public interest in as much as they support the common price system; that the arrangements, in relation to small machines in class (b) sold in the home market and small machines in class (c) sold to the CEA and the Area Boards, for discounts and rebates based on the aggregation of

purchases from Group members or on the purchasers buying a given proportion of their requirements from Group members may also be expected to operate against the public interest in the absence of a common price system; and that so long as they are obligatory or involve the listing of individual buyers entitled to allowances the other differential price arrangements may be expected to operate against the public interest in the absence of a common price system.

(iv) *Discrimination between Manufacturers*

811. There are some special arrangements under which certain of the smaller manufacturers may quote prices lower than the minima applicable to the other parties; they occur in relation to small turbines in class (a) for home and export supply, small alternators in class (a) for export, and transformers in class (c) for home and export supply. These arrangements are simply variants of the common price system and could not continue in its absence. As far as the home supply of machines in class (c) is concerned, the arrangements are linked with the system of "averages", the general application of which has been suspended since 1947. This is, in effect, a quota system which, when operating, permits manufacturers who are failing to achieve their quotas to charge prices lower than the normal minima; this system also could not be revived in the absence of common price arrangements. The only existing practice involving discrimination between one manufacturer and another which might be operated without common prices is "protection" as applied occasionally to exports of water driven turbo alternator plant in class (a). If a manufacturer claims a prior interest in a contract for such plant—usually because he has already supplied plant to the site concerned—other manufacturers may agree to protect him by quoting a higher price or longer delivery, or by refraining from quoting.

812. The manufacturers defend this practice on the ground that each hydro station has its own engineering peculiarities; the contractor who has supplied the first generating sets for the station is, therefore, at a considerable advantage over competitors, who can hope to obtain orders for subsequent sets only by quoting very low prices. This, the manufacturers say, would be embarrassing both to the initial supplier and to the purchaser.

813. If a manufacturer sees advantage to himself in quoting a very low price, we see no reason why the purchaser should be deprived of the opportunity of considering the offer. The manufacturers' argument appears to rest on the belief that purchasers cannot be trusted to look after their own interests, and that it is, therefore, proper to take the decision out of their hands. As we have already indicated, we do not accept this view of the purchasers. It also seems to us that, other things being equal, the purchaser will prefer to buy subsequent sets from the initial supplier, who should be in a better position than anybody else to put in a competitive tender and should not need the additional advantage of protection. We conclude that the practice of giving protection, as applied to water turbo alternator plant in class (a) supplied for export, operates and may be expected to operate against the public interest.

(v) *Common Conditions of Sale and Contract*

814. We have recorded already (see paragraph 568) our conclusion that the BEAMA's practice of recommending to its members certain standard forms of conditions of sale and contract does not by itself restrict competition. The Groups, however, prescribe uniform conditions based largely on those recommended by the BEAMA, and uniform conditions are also adopted in practice in conjunction with price arrangements under IEA

agreements. Common conditions of sale and contract are thus mandatory, by written agreement or mutual understanding, in relation to the home and export supply of all machines in each of the three classes for which there are common price arrangements.*

815. The BEAMA does not contend that its members should be obliged to adopt the conditions it recommends, but it holds strongly that "a set of fair Conditions of Contract is necessary" and that its own arrangements in this respect are beneficial to both seller and buyer. The Association says that the standard conditions have been drawn up after consultation with buyers, and that they are particularly valuable to small manufacturers and buyers, who can neither foresee the legal pitfalls in any set of conditions they may be asked to accept nor afford to take legal advice on every contract. It also points out that its arrangements are older than the common price system and contends that they are essential whether or not such a system exists; "there is no industry of anything like comparable size that has been blessed with such freedom from litigation". The Groups and the IEA support these arguments, but the former add that the common price system would collapse if adoption of uniform conditions were not obligatory for the signatories of price agreements.

816. We are satisfied that it is of benefit to all concerned to have available model conditions of contract which can be relied on as fair to both sides. Insofar as adoption of the standard conditions has been made obligatory, however, the only purpose appears to be to support the common price system by preventing competition through the offer of more favourable contract conditions. In the absence of common prices, the manufacturer would still be able to rely on the model conditions for the avoidance of legal pitfalls, but we think he should not be under any obligation to refrain from varying them at his own discretion in the course of striking a bargain with the purchaser. We have noted that there is some complaint about the clauses in the model conditions dealing with contract price adjustment and progress payments, but we feel that in the absence of a common price system and of any obligation on the part of the sellers to adopt the recommended conditions these are matters which are best left for adjustment by negotiation between the buyers and the sellers. We conclude that obligatory arrangements operate and may be expected to operate against the public interest, but see no objection to the BEAMA's practice of recommending model conditions.

(vi) *Minor Arrangements*

817. There are a number of practices of minor importance which are operated in conjunction with the common price arrangements; these include collective arrangements to maintain resale prices,† arrangements for quoting delivered prices, and the fixing of prices for goods which are not subject matter of a particular agreement when supplied with goods which are. We think that all these minor practices operate against the public interest insofar as they support the common price system for the machines with which we are concerned. It is most improbable that they would be continued in the absence of a common price system, but in that event they would create an undesirable degree of rigidity in the industry and might be expected to operate against the public interest.

* There are occasional instances where conditions are agreed without common prices.

† There is no collective enforcement and the arrangements have little practical relevance in this industry.

818. The condenser makers have also had two arrangements with suppliers of components used in the manufacture of condensers in class (a). The Commission were called upon to consider these arrangements during their inquiry into the supply and export of certain semi-manufactures of copper and copper-based alloys; they concluded that both arrangements operated against the public interest and should be brought to an end.* We see no reason add to or qualify this conclusion.

(3) The Central Electricity Authority

819. We have found that the CEA is a "party concerned" with the prevalence of the conditions to which the Act applies in relation to the supply of machinery in class (a). Although the CEA's position as the dominant home buyer of this machinery is not explicitly authorised by statute, it is an inevitable consequence of its statutory duties. We do not, therefore, feel called upon to determine whether the fact that more than one-third of all machines in class (a) supplied in this country are supplied to the Authority is itself against the public interest, but only to consider whether any of the things done by the Authority as a result of this position are against the public interest.

820. The arguments which have a bearing on this matter have been set out fully in dealing with the position of the manufacturers (paragraphs 770 to 775).† The manufacturers' principal criticisms of the Authority are that it pays too much regard to first price, and that it uses its dominant position to beat down prices by playing off one manufacturer against another; and the manufacturers contend that the ill effects of these methods would be more serious in the absence of a common price system. The Authority, on the other hand, says that the common price system has compelled it to use the tactics which it at present employs and that they are not designed to reduce prices to a level which would deprive the manufacturers of a fair reward.

821. We have recorded in paragraphs 773 to 775 our view that neither side has been able to dictate terms to the other so far, and that the abolition of the common price system would not be likely to tip the balance decisively against the manufacturers. As we have said in paragraph 760, we do not believe purchasers would buy products of inferior quality for the sake of an apparent saving on first cost; least of all is this likely to be done in the case of turbo alternator plant bought by the CEA. We cannot, therefore, endorse the manufacturers' criticisms of the Authority, and we have received no evidence of any other practices of the Authority which are a result of its dominant position as a buyer and are harmful to the public interest. Since the Authority told us that its reason for seeking justification of the manufacturers' prices by reference to costs was the absence of any competitive prices, we assume that the question of examination of costs by the Authority would not arise in conditions of price competition.

822. We have taken note of the report of the Committee of Inquiry into the Electricity Supply Industry (Herbert Report),‡ and in particular of the recommendation, with regard to purchasing from abroad, that the Authority should not circumscribe its commercial freedom to buy in the most advantageous market by assuming limitations of the national interest which have

* Report on the Supply and Export of certain Semi-Manufactures of Copper and Copper-Based Alloys (H.M.S.O., 1955), paragraphs 106, 110 (d) and 317 to 319.

† In dealing with the manufacturers' position we had to consider their relations with the CEA in respect of machinery in class (c) as well as class (a); our consideration of the CEA's own position is confined to class (a) for the reasons given in paragraph 571.

‡ Cmd. 9672: January, 1956. The passages which are specially relevant to the subject of our own inquiry are paragraphs 111 to 119 and 427 to 431 and item 95 of the "Summary of Main Conclusions and Recommendations".

not been directly determined by the Minister. We see no reason for modifying our own conclusions in the light of the possibility that the Authority may invite tenders from abroad for machinery of the kinds covered by our reference.

(4) The Subsidiaries of Associated Electrical Industries Ltd.

823. Metropolitan-Vickers Electrical Co. Ltd. and The British Thomson-Houston Co. Ltd. are both subsidiaries of Associated Electrical Industries Ltd. and were responsible between them for approximately 39 per cent. of home supplies of machinery in class (a) in 1952, and 45 per cent. in 1951. The companies have told us that up to 1945 their joint proportion of the home trade usually exceeded 50 per cent. and that they hope to regain that position when the expansion of BTH's works has been completed.

824. The two companies participate fully in all Group arrangements for machinery in class (a) sold in the home market. They say that in doing so they act independently of one another, and we are aware that they have sometimes taken opposing viewpoints in discussions within the Groups concerned. They maintain that apart from co-operating as fellow members of the Groups they compete with one another, as with other manufacturers, in design, technical performance, delivery and service, and that each company has its autonomous sales organisation. The Chairman of the holding company is also Chairman of each of the subsidiary companies but they say that, although aware of the broad lines of policy pursued by each, "he does not give overriding instructions either directly or indirectly".

825. Neither company has earned as high a rate of profit on steam turbo alternator plant as Parsons, and we are satisfied that their costs for these machines are higher than Parsons'. They have told us that they would not expect to be the lowest cost producers, since they make steam turbo alternator plant of every size while some other manufacturers confine their trade to the sizes most profitable to them.

826. We have noted already (paragraph 765) that some specialist manufacturers earn relatively high rates of profit. Metro-Vick and BTH are not the only companies with wide interests whose costs generally appear to be higher than those of the lowest cost producers. We think it likely that the common price system, by removing a stimulus to reduction of costs, has encouraged some of the larger companies to spread their interests rather than concentrate on the goods they can produce most efficiently. We see no reason to suppose that by reason of the share of the market they enjoy the subsidiaries of AEI have done this more than some of the other companies. In conditions of price competition the two companies, in common with their competitors, might feel compelled to consider whether their costs should be reduced by specialising to a greater degree than at present; but any criticism they are open to on these grounds is associated with their participation with other manufacturers in the common price system rather than with anything they have done as a result of or for the purpose of preserving their own share of the trade.

827. We have seen no evidence which suggests that the two companies have dominated any of the Groups to which they belong or that either jointly or separately they have played a bigger part in evolving the policies of the Groups than other large manufacturers. As far as steam turbo alternator plant is concerned, it is clear that in matters of price Parsons rather than either of these companies has taken the initiative in recent years. Although the two companies still have between them a larger share of the market for turbo alternator plant than any one of their competitors, some of the

latter are also of great strength in this field, and there is no reason to think that in conditions of price competition the subsidiaries of AEI, if they continued to pursue independent commercial policies, would increase their share substantially at the expense of these competitors. If the commercial policies of the two companies were to be brought under close common direction so that they operated virtually as a single unit, it is possible that they might play a more dominating part in the industry than at present. We have been assured on the contrary that such a development is not contemplated, that "both traditions [Metro-Vick's and BTH's] are needed to satisfy the market", and that "any attempt at rationalisation, or limitation of the commercial autonomy of the two companies, could only result in a serious loss of total business". We believe, moreover, that the principal competitors are strong enough to hold their own in any event. Nevertheless, although we accept the companies' statements as to their present intentions, it seems to us that they might find themselves compelled to reconsider their policy in conditions of price competition; and should they in future secure a considerably larger share of the market than they at present enjoy, this would call for fresh consideration.

828. We do not find that there are any "things done" by the subsidiaries of AEI, as a result of or for the purpose of preserving their position as suppliers of more than one-third of the total home supplies of machinery in class (a), which are against the public interest.

(5) Individual Agreements

829. Two United Kingdom suppliers have undertaken in agreements with foreign manufacturers to restrict their exports of certain machinery in class (a); and two manufacturers have an agreement concerning their trade in a particular type of equipment in class (b) in certain overseas territories. These agreements are not associated with the Group or IEA arrangements. They are of minor importance by comparison with the other matters involved in this inquiry, but since they restrict competition we have to consider whether they operate against the public interest.

830. Both of the companies which have undertaken to restrict their exports of certain machinery in class (a) have done so in consideration of the provision by the foreign manufacturers concerned of designs and manufacturing information and experience (see paragraphs 299 and 300). There is no reason to doubt that this has been of great value in developing the business of the two companies. We think that the introduction of foreign methods is likely to act as a stimulus to British designers, and there is no evidence that as a result of the agreements business has been lost which might otherwise have come to the United Kingdom. In these circumstances we do not find that either of the agreements operates against the public interest.

831. The two companies which have an agreement concerned with certain equipment in class (b) (see Chapter 21) say that they entered into this arrangement to protect their long-standing interests in this business in the particular territories because foreign manufacturers were exerting extreme pressure to take the trade from them by offering alternative equipment. In fact, one of the companies has almost ceased to supply these products, and the agreement appears to have little practical effect. We conclude that it does not operate against the public interest.

(6) Summary of Conclusions : Recommendations

832. We have found that the common price system of the Groups and the IEA operates, and may be expected to operate, against the public interest in relation to the supply and exports* of machinery in each of the classes (a), (b) and (c) (paragraph 794). We have found that the other Group and IEA arrangements we have dealt with in this chapter, except compensation and the arrangements between the condenser makers and suppliers of components, operate against the public interest in as much as they support the common price system, and that in the following cases they would operate against the public interest in the absence of a common price system :—

- (i) the compensation arrangements in relation to the supply and exports of most machinery in class (a) and certain machinery in class (b) (paragraph 799) ;
- (ii) the notification arrangements in relation to the supply of machinery in classes (a), (b) and (c), and also in relation to exports of such machinery insofar as overseas manufacturers participate in them (paragraph 801) ;
- (iii) all the differential price arrangements in relation to the supply of machinery in classes (a), (b) and (c) insofar as they are obligatory or involve the listing of individual buyers entitled to allowances, and the arrangements in relation to the supply of certain machinery in classes (b) and (c) for discounts and rebates based on the aggregation of purchases, or on buying a given proportion of requirements, from a number of manufacturers (paragraph 810) ;
- (iv) the protection arrangements in relation to exports of certain machinery in class (a) (paragraph 813) ;
- (v) the arrangements for common conditions of sale and contract in relation to the supply and exports of machinery in classes (a), (b) and (c) insofar as they are obligatory (paragraph 816) ;
- (vi) a number of minor practices in relation to the supply and exports of machinery in classes (a), (b) and (c) (paragraph 817).

833. We recommend that all the Group and IEA agreements in which are embodied the common price arrangements or any of the arrangements which we have found operate or may be expected to operate against the public interest should be terminated, and that the United Kingdom manufacturers should not in future enter into any agreements or arrangements with one another, or set up any other organisation, for these purposes.*

834. With regard to the arrangements between the condenser makers and suppliers of components in relation to the supply and exports of certain machinery in class (a), we have endorsed the conclusion in an earlier report of the Commission that these should be brought to an end (paragraph 818).

835. We see advantage, as regards both supply and exports of all classes of machinery, in co-operation between the manufacturers in technical matters. We also see advantage in the pooling of market information in respect of exports ; for this reason we find that the notification arrangements for exports would not operate against the public interest in the absence of a common price system, provided that overseas manufacturers did not participate (paragraphs 794 and 801). We also see no objection to recommended model conditions of sale and contract (paragraph 816) under any of the heads of our reference.

* See Note of Dissent as to Exports by Mr. Wrangham (paragraphs 837 to 841).

836. We have not found anything adverse to the public interest arising from the special positions of the CEA (paragraph 821) and of the subsidiaries of AEI (paragraph 828) in relation to the supply of machinery in class (a).

DAVID CAIRNS (*Chairman*).

T. J. BARNES.

ALAN BIRCH.

W. L. HEYWOOD.

I. C. HILL.

ARNOLD PLANT.

C. E. WRANGHAM (subject to Note
of Dissent as to
Exports below).

R. E. YEABSLEY.

J. A. R. PIMLOTT (*Secretary*).

12th July, 1956.

Note of Dissent as to Exports by Mr. C. E. Wrangham

837. I am not prepared to say that, in relation to exports, the common price system operates against the public interest.

838. General disadvantages of the system are set out in paragraph 769. Loss of one overseas order is recorded in paragraph 787. Some impressions of resentment, felt by overseas buyers, are mentioned in paragraph 788. All these militate in some degree against the public interest.

839. But, on the other hand, the public interest requires that the greatest benefits should accrue and continue from export orders. *Prima facie* this might appear to accord more closely with collective rather than individual policy. The prices and terms, that might be acceptable to a certain manufacturer at a certain time, might represent a needless sacrifice of the public interest.

840. No evidence is available to prove whether collective judgment has in fact been superior to individual judgment or not. But the industry may be presumed to consult its own interests to the best of its ability. Its interests in the export field accord largely with the public interest, namely to win ever more business on the most profitable terms that are possible and politic. Seemingly, therefore, it is at least concerned—whether or not it may be well qualified—to establish in what manner and by what means the greatest benefits can be obtained from the export trade.

841. There is evidence that on some occasions the common price system has proved an obstacle in this regard. There is unlikely in the nature of things to be direct evidence that it has proved an assistance, but this has clearly been the experience of manufacturers and I find myself with good reasons for sharing their view.

C. E. WRANGHAM.