

Consideration of the Evidence relevant to Uneconomic Prices and Whether or not they are Quoted

32. Having found that conditions to which the Act applies prevail, we are required by paragraph 3 of the reference to investigate whether the quoting of uneconomic prices calculated to drive competitors out of the business of supplying harnesses is a thing done by the parties concerned as a result of, or for the purpose of preserving, the conditions, and, if so, whether it operates or may be expected to operate against the public interest.

33. It appeared to us that the expression 'uneconomic prices' could be capable of interpretation in different ways and that the existence or absence of profits after charging all costs would not be necessarily the determining factor. A price that resulted in a normally unacceptable level of profit to the seller might be termed uneconomic but there could be a variety of circumstances, of more or less temporary character, in which such prices could be justified—at least from the point of view of the seller—and this could extend to a limited loss situation if the result was to make the whole more profitable than would otherwise be the case. The marginal accounting approach, which would regard additional business as satisfactorily priced if it provided a contribution to overheads after covering direct costs, also illustrates a situation in which only partial recovery of overheads on particular business would not cause the price charged to be viewed as uneconomic. While bearing these possibilities in mind, however, we put to each of the three harness makers, all of whom expressed their agreement to it, the proposition that an uneconomic price is one charged by a seller which does not cover total costs.

34. As to whether such prices, if found to be quoted, could be described as calculated to drive competitors out of business, it appeared to us the answer could turn on possible variations of emphasis in interpreting the word 'calculated' which, in legal terminology, is usually read as including 'likely'. As, however, the question arises only if it is established that uneconomic prices are quoted, we do not deal with the matter further at this stage, except to observe that, in considering prices, we would regard evidence of a decline in a harness maker's business that suggested the company was in danger of going out of that business as *prima facie* relevant to our inquiry.

35. For the purpose of our inquiries we examined the vehicle wiring trading figures of Rist's, the 'monopoly' supplier, and of both its harness-maker competitors. These might be expected to reveal indications of uneconomic pricing, if such were practised on any appreciable scale, and would also show the trends in the fortunes of the three companies. Details covering sales, costs and profits were obtained from Rist's and Ripaults in respect of their three financial years ended 31st July 1964 and 30th June 1965, respectively, and from Ward and Goldstone in respect of the four years ended 31st March 1965. Subsequently, we obtained additional information relating to Rist's' overall trading for the year 1964-65 and its sales to vehicle manufacturers through its fellow Lucas subsidiaries in that year.

36. We obtained a reasonably satisfactory confirmation of the vehicle wiring sales figures provided by the three harness makers, for the two years 1962-63 and 1963-64, from the main vehicle manufacturer customers, who gave us figures of their vehicle wiring purchases. Allowing for the different year-ends of the companies concerned and for probable differences in accounting procedure and analysis, the figures from the two sources showed an acceptable correspondence.

37. We did not think it necessary to make the detailed inquiries that would have been required for an accurate assessment of the harness makers' vehicle wiring profits in terms of capital employed. We were able, however, to make certain reasonably approximate allocations of capital as between vehicle wiring and other activities permitting us to make certain estimates which we believe were not misleading.

Rist's Wires and Cables Ltd.

38. *Overall and vehicle wiring trading results.* We discussed the company's trading figures in detail with the company officials concerned and satisfied ourselves on such matters as the allocation of expenses between vehicle wiring and the other activities in which the company engages. As already indicated, it was impracticable to extract figures for vehicle harnesses alone, as no distinction is made in the records between harnesses and other allied wiring, such as single leads and cables, earthing braids, etc. All normal costs of production, including the costs of cable and accessory manufacture undertaken by the company, were taken into account in respect of vehicle wiring, together with the relative distributive and administrative expenses incurred. Other than those items manufactured by itself, the company obtained none of its main material or component items from within the Lucas organisation.

39. In computing the trading results for vehicle wiring we used the actual expenses of the Lucas drawing office, selling and administrative services in place of the 5 per cent. deduction made from sale proceeds remitted to Rist's by the selling companies where sales are not made direct (see paragraph 15). We also obtained from Lucas particulars regarding the rebates which it allowed to certain vehicle manufacturers on the basis of the value of total business done or the volume of vehicle output. We were unable to do more than estimate roughly the proportion of such rebates which might be regarded as attributable to vehicle wiring supplied by Rist's but we satisfied ourselves that it was of small significance and that the amount chargeable to vehicle wiring trading would have little effect on the result. We have been assured by Lucas that there are no other items of expense or discounts or allowances which should be taken into account relative to the vehicle harness trade.

40. The trading results obtained showed that Rist's was operating profitably overall in each of the three years, 1961-62 to 1963-64, examined and that its trade in vehicle wiring was also profitable in each of those years. In spite of rising vehicle wiring sales the trend of its profit rates—both in relation to sales and to estimated capital employed—for those goods was

downwards and it appears from the less detailed information available that that trend was continued in 1964-65, although the company believes it to have been reversed in the current year.

41. *Trading with individual vehicle wiring customers.* It does not follow from such results, of course, that there are no instances of uneconomic prices being quoted. Rist's told us that neither it nor its fellow Lucas subsidiaries when selling vehicle harnesses quoted prices which they regarded as uneconomic, although it said that it had been obliged on occasions to quote prices which provided lower margins of profit than those which it aimed to achieve. Further, none of the vehicle manufacturers who dealt specifically with the question was able to recall any instances of quotations by Rist's or Lucas (or by the other two harness makers) which, on the basis of their own cost estimates, they would have regarded as uneconomic. Rist's, however, prepared annually for its own purposes an analysis of its vehicle wiring business with individual vehicle-manufacturer customers, showing the estimated margin after total estimated costs in each case and we were able to make an approximate reconciliation of the sales and cost figures on these statements with the company's trading figures. The analysed figures showed that, subject to the grouping of the business with the smaller customers (accounting for only a minor part of its total vehicle wiring sales), a net profit was achieved, in each of the years 1961-62 to 1964-65, on the total business done with each customer.

42. At this stage it had been shown that the company's business had been profitable overall, that its vehicle wiring trade as a whole had been profitable and that its business with individual customers also had been profitable. We then turned our attention to individual transactions.

43. *Individual transactions.* For this purpose we obtained particulars of the costing system and estimating procedures followed by the company and the methods it used to arrive at the prices quoted when tendering for orders. We were able to satisfy ourselves that the system, procedures and methods were satisfactory and appeared to be consistently applied. We also found that the methods used resulted over each financial year in the effective recovery of all the costs actually incurred.

44. With regard to the company's purchasing and usage of copper, the figures showed that, at least up to the latter end of 1964, Rist's charged its copper out at its average cost and up to that time had effected a full recovery of the cost to it of that metal. Thereafter the steep rise in copper prices has had its effect in that it has obliged Rist's (as well as its competitors) to seek increases in the prices of harnesses on this account. The company said that it takes the opportunities presented by the introduction of new vehicle models, and the requirements of modifications to harnesses, to review its prices and adjust for cost increases generally, and evidence has been seen of higher copper costs charged in its quoted prices. Rist's pointed out, however, that the opportunities to adjust prices do not occur on any regular basis and if they were fewer in any particular period (as it thought was the case in 1963-64 and 1964-65) then the time elapsing before additional costs were covered could be longer than would be the case where opportunities were more frequent. It said that the incidence of these opportunities was

more important to the achievement of its profit target than re-negotiation during the currency of a contract. As to the latter, it said that this was not a 'natural' occasion for price adjustment and met with resistance; further, the most opportune times for approaching the various customers had to be judged, with the result that generally it took some time to complete the negotiations with all of them.

45. In the course of this examination of Rist's procedures and individual transactions we considered in detail a selected number of cases where quotations in respect of the same items had also been submitted by one or both of its competitors. For some of them we attempted inter-company comparisons of the multitude of items which comprise the estimated total cost. In all, we inspected about 250 cost estimates and found no divergencies from the system normally followed. In all cases a profit margin was added to total estimated cost to provide the price quoted. It was not practicable, however, to check the cost estimates and profit provisions in individual quotations against actual realisations; Rist's makes no attempt to do this as its records are not designed to produce the necessary information.

46. In certain of those instances where we made detailed comparisons of the cost estimates, we found some marked differences between the total costs of Rist's and those of its competitors where they were quoting for the same order, with the result that the companies' prices were very different. Generally, Rist's prices were lower than, and in some cases well below, those of its competitors, although this was not so in every case. There were some striking differences in the same direction between the amounts added for profit but these additions when expressed as percentages of cost were less at variance. The differences in costs were spread over all the cost elements but were generally most marked in the field of indirect costs, where Rist's charge in every case was by far the lowest in relation to total costs; Rist's also appeared to have an advantage, in some cases, in that the estimated time on which its charge for direct labour was based was comparatively low. A detailed comparison of labour and overhead charges, however, was impracticable, partly because Rist's applied a composite recovery rate and partly because some, at least, of the production methods estimated for by the three competitors were different.

47. As already mentioned, it did appear that there was scope for satisfying a vehicle manufacturer's specification in more than one way and we questioned Rist's (and each of its competitors) as to the possible effect of this. While it (coupled with Rist's relatively lower overheads) did offer a partial explanation we were unable to explain entirely the reasons for some of the more striking differences we found in particular instances. In two of them a partial explanation (accounting for a relatively small proportion of the difference) lay in misinterpretation of the customer's requirements which resulted in under-estimates of costs; in these instances Rist's accepted this result of its error and made no correction of its prices. It said the possibility of error was small and it knew of no other similar occurrences. As we could not check the actual outturn of individual transactions, it may be that in some instances actual realisation diverged from the provisions made for costs and profits. The company's procedures,

however, were consistently applied and costs in total were fully recovered. In the circumstances, we are satisfied that Rist's quotations were based on acceptable cost factors and that in each case it was intended to include a normal margin for profit.

The other harness makers

48. From our examination of the trading figures obtained from Ward and Goldstone and from Ripaults it was clear that both these companies made profits overall and that both made profits on their vehicle wiring operations, although Ward and Goldstone emphasised to us the degree of estimation required to obtain its vehicle wiring figures. As with Rist's it was not practicable in either case to extract figures for vehicle harnesses alone. Again, as with Rist's the vehicle wiring sales of both companies showed substantial increases over the periods examined but were accompanied in each case by falling rates of profit.

49. Our examination of Rist's trading figures and those of its two competitors showed that each company was operating profitably overall in each of the years examined and that each company also operated profitably in each of those years so far as vehicle wiring was concerned. Expressed as percentages of sales the profits on vehicle wiring varied round a median of 10 per cent. and ranged from about 7 per cent. to about 16 per cent. Although for all three companies the profit rates showed a downward trend and the differentials appeared to be narrowing, the background was one of relatively steeply rising sales (sales rose from £4.5m. in 1961-62 to £7.7m. in 1964-65). In this rise each company participated more or less proportionately to its share of the total trade. Those respective shares, therefore, were much the same in 1964-65 as they were in 1961-62. It was not possible to assess how much of this rise in sales was due to increases in prices and how much to increased volume but it seems probable that all three companies were affected by both factors in much the same way; we have seen nothing to suggest any marked shift in the balance.

50. Both Ward and Goldstone and Ripaults said that they quoted prices which they regarded as economic, in the sense that they aimed to cover all their costs and provide themselves with reasonable margins of profit. Both, however, like Rist's, were obliged on occasion to quote prices which provided lower profits than those at which they aimed. Neither company prepared a customer analysis on the lines of that prepared by Rist's but from such examination of their estimating procedures and methods as we made, we confirmed that their systems were applied without discrimination and made provision for a profit on each transaction; we also found that their cost estimates, at least in total, resulted in the approximate recovery of the costs they actually incurred. We were unable for individual quotations to check the cost and profit make-up against actual realisations.

51. Both companies said they have been able, by increased efficiency, and to some extent because of the increased volume of business, to absorb a large part of the rise in costs which has been experienced in recent years. The steep rise in the cost of copper since 1964, however, has caused both to seek increases in the prices charged for vehicle wiring, apart from the normal covering of their estimated costs when quoting for new or modified specifications. As mentioned earlier, Ward and Goldstone says that it has

sought (and generally obtained) an increase in its harness prices each time its buying price of copper rose and we have seen evidence of this. Ripaults is seeking to make an arrangement with its principal customers for automatic price adjustment on this account.

Conclusions

52. We are satisfied that Rist's intends to operate profitably in the vehicle harness field and does so, that its estimating procedures are applied consistently and that provision was made for a profit margin in each of the individual quotations which we examined. We have no reason to believe that had we extended the checks we made we would have found otherwise. We were unable to ascertain whether the outturn of individual cases matched the estimates on which the prices quoted were formed but, having regard to the achievement of a profit in total and on its business with individual customers, we think it is likely that, except by accident or in unforeseen circumstances, such would be the case. We conclude, therefore, that uneconomic prices are not quoted by Rist's.

53. Having reached this conclusion we need not be concerned whether the prices charged are such as could be regarded as calculated to drive competitors out of the vehicle wiring business and therefore consideration of whether the thing is done as a result of, or for the purpose of preserving, the conditions is not required. We would add in parenthesis that, in the light of the upward trend of the trade of the three companies and the profits achieved by them, we see no likelihood of any of them being driven out of the vehicle wiring business in the foreseeable future.

54. We conclude that the quoting of uneconomic prices calculated to drive competitors out of the business of supplying vehicle harnesses is not a thing done as a result of, or for the purpose of preserving, the conditions. Therefore no question as to the public interest arises.

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