

8 Conclusions

INTRODUCTION

The terms of reference

8.1. We are required by our terms of reference (see Appendix 1.1) to investigate and report on the questions whether a monopoly situation exists in relation to the supply within the United Kingdom of structural warranty services in relation to new homes (the reference services) and, if so:

- (a) by virtue of which provisions of sections 6 to 8 of the Fair Trading Act 1973 (the Act) that monopoly situation is to be taken to exist;
- (b) in favour of what person or persons that monopoly situation exists;
- (c) whether any steps (by way of uncompetitive practices or otherwise) are being taken by that person or those persons for the purpose of exploiting or maintaining the monopoly situation and, if so, by what uncompetitive practices or in what other way;
- (d) whether any action or omission on the part of that person or those persons is attributable to the existence of the monopoly situation and, if so, what action or omission and in what way it is so attributable; and
- (e) whether any facts found by the MMC in pursuance of their investigations under the preceding provisions of this paragraph operate, or may be expected to operate, against the public interest.

8.2. The reference itself defines 'home' as meaning any residential property but does not include any mobile dwelling. In the light of the evidence we have received, we have interpreted 'new homes' to include both newly built homes and those made by converting buildings not previously used as homes or by subdividing existing homes into two or more new homes (conversions). In our view, however, mere extensions of existing properties are not included within the terms of reference.

8.3. 'Structural warranty services', as defined in the reference, are services supplied by a person other than the builder or developer of property pursuant to a scheme under which the property is inspected and guaranteed against structural defects. In the light of the evidence we have received, we have interpreted these services as meaning arrangements under which the supplier:

- (a) requires builders and developers¹ wishing to join the scheme to register with it;
- (b) sets standards which the registered builders and developers¹ have to meet;
- (c) has the right during construction to inspect each home notified to the scheme;

¹For convenience in the rest of this chapter we use the terms 'builder' and 'builders' to cover both builders and developers.

- (d) underwrites the builder's liability to put right defects or damage which are reported to him during a specified period after construction;
- (e) subsequently, provides for a further specified period a warranty in respect of structural defects in such a home; and
- (f) backs the warranty with insurance cover.

8.4. As to defining the structure of a home, we have considered two possible definitions, bearing in mind, in particular, the views of the National House Building Council (NHBC) and Municipal Mutual Insurance Ltd (MMI). The first is broad and includes everything in the home other than fittings and finishes; it also, however, includes these fittings and finishes, where they affect the integrity of the structure, for example the rendering finish on external walls, or sanitary fittings and their related plumbing. The alternative definition is stricter and says that the structure of a home refers only to:

- (a) the internal and external load-bearing structures essential to the stability or strength of the property including, but not limited to, foundations, walls, columns, floors and beams;
- (b) other non-load-bearing parts of the property forming part of the external walls and roofing; and
- (c) all fixed joinery, services and permanent fittings which form part of the fabric of the home.

We favour the first broad definition but the second serves equally well as a basis for our conclusions, and our conclusions would not be affected whichever is preferred. We note in any case that NHBC's Buildmark scheme contains additional elements such as security requirements which form part of a builder's obligations under the scheme but do not fall within either of the definitions. The core of the scheme is, however, the provision of structural warranties for new homes and any such additional elements are merely ancillary to this main purpose.

The monopoly situation

8.5. We have first considered the question, in our terms of reference, whether a monopoly situation exists in relation to the supply within the United Kingdom of the reference services and also questions (a) and (b). We have shown in paragraph 5.12 that NHBC supplied over a quarter, indeed over 90 per cent, of the reference services in 1989. There has been no material change since then. We conclude therefore that a monopoly situation exists by virtue of section 7(1)(a) of the Act. We further conclude that this situation exists in favour of NHBC.

The market

8.6. Before considering specifically the remaining questions in the terms of reference, we believe it necessary to deal, in some detail, with the background. We have taken the relevant market to be the supply of the reference services. We have identified three organisations which supply such services: NHBC, MMI with its Foundation 15 scheme, and Housing Association Property Mutual Ltd (HAPM), which (as the name implies) specialises in the housing association sector of the market, which for the most part builds homes for rental (see paragraph 5.41). Up to 1989 NHBC was to all intents and purposes the sole supplier of warranty services. MMI entered the market in 1989 and HAPM in 1990.

8.7. HAPM faces competition from NHBC and MMI in the housing association sector of the market. However, bearing in mind the specialised nature of its activities, we do not believe that it is in competition with NHBC or indeed with MMI in the wider reference services market. Housing associations are informed purchasers which normally commission their own buildings and there is an exemption contained in NHBC's rules which allows its members to build for such non-members without providing NHBC's

warranty. We note that HAPM requires its members to place all their new homes with it in the first five years of membership.

8.8. We were also made aware that a firm of insurance brokers, Gibbs Hartley Cooper Ltd, provides insurance for homes not covered by other warranties, on the basis of a survey after completion. Such insurance would not therefore fall within the definition of the reference services, since there is no inspection in the course of construction.

8.9. There is no legal requirement on a builder to provide a structural warranty for a new home. Nevertheless, the Defective Premises Act 1972 imposes certain obligations upon him (see paragraphs 2.8, 2.13 and 2.14), and his contract with the purchaser will normally also contain obligations relating to the quality of materials and workmanship. Not all new homes, however, are covered by the type of structural warranty that is contemplated by the reference, and only a small proportion of conversions are so covered. The housing market can be divided broadly into three sectors: private, housing association and public (including local authorities). The great majority of the 212,000 homes completed in 1989 were in the private sector. This sector included some homes commissioned by individuals for their own use and usually built under the supervision and responsibility of an architect or surveyor, but most were built speculatively, ie in effect as stock for sale to future purchasers as they came along. The great majority of new homes covered by structural warranties are in this category and competition in providing them is presently limited to NHBC and MMI.

8.10. In 1989 there were over 30,000 builders on NHBC's register and of these some 11,700 actually notified the proposed construction of new homes in that year. Some 84 per cent of NHBC's active builders each registered between one and ten homes in 1989, representing in aggregate 15 per cent of all homes notified to NHBC in that year. By contrast a few large builders each notified 100 or more homes and together accounted for nearly 60 per cent of all homes so notified to NHBC. MMI had under 300 registered builders by the end of 1989 and this had risen to 745 by the end of September 1990. By comparison with NHBC therefore MMI's share of the market is very small, taking into account that MMI's membership is largely composed of relatively small builders.

The working of the market

8.11. The reference services market has a number of special characteristics which have an important bearing on how it works. Some of them are discussed in Chapter 5 and are repeated here in view of their importance.

8.12. First, the task of ensuring quality control in the construction of new homes is particularly demanding and differs in many respects from the equivalent task in factory or workshop. Much of the work involved in building a new home is carried out in the open air (often in adverse weather conditions) by a wide variety of employees and subcontractors from a number of different trades, having in all probability quite different levels of skill and commitment. The complex product for which they are responsible is built normally over a period of some three or four months: its final quality is dependent on the work of each trade having been properly carried out. Overall supervision and co-ordination of their work is demanding. In one sense it is often a mass production operation, yet every site has its own unique characteristics of soil conditions, layout and surroundings. The construction of new homes is subject to inspection under the Building Regulations, which focus on the health and safety aspects of the home.

8.13. Second, purchasers of new homes and their professional advisers have difficulty in judging the quality and standard of construction of a home once it has been completed, since much of the work is by then covered over. Both NHBC and MMI inspect during construction to see that standards are maintained. For the purchaser of a new home, the structural warranties supplied by NHBC and MMI provide both confirmation that the house has been constructed to a specified standard by the builder and a guarantee, backed by insurance, to put right any defects causing major structural damage which do appear within 10 or 15 years respectively. The builder is himself required to put right defects or damage which are reported to him during the first two years of the warranty period or up to one year after purchase,

whichever is the longer. This liability arises if he has failed to build in accordance with the detailed technical requirements of the scheme and is not limited to items of structural damage. This liability and the risk of his insolvency during the period are underwritten by the scheme. Home owners are likely to put a higher value on prevention rather than cure, but inspection and warranty stand together in providing the assurance that the purchaser and mortgage lender both need.

8.14. Third, both MMI and NHBC warranties must be applied for before the start of construction. In nearly all cases this means that the builder chooses which warranty to provide to the first purchaser, the warranty passing on (under the rules of the scheme) to subsequent purchasers of the home within the warranty period. Competition between schemes is therefore mainly directed at attracting builders. For the purchaser of a home a warranty comes as part of the 'new home package' provided by the builder. In this market, therefore, the person who chooses and initially pays for the warranty is not the ultimate beneficiary.

8.15. Fourth, to have value for the builder and purchaser structural warranties must provide cover for a lengthy period. Most claims occur after the first five years, long after the builder's original two-year liability has terminated, and it is not until the end of the period of cover that a full picture of claims emerges. This creates considerable uncertainty about the potential liabilities faced by the warranty provider. Our understanding is that it is not generally considered to be an attractive market for insurers even where an integrated warranty scheme is available providing both registration and inspection. Up to 1978 NHBC's warranty was fully insured by outside insurance companies but they withdrew their cover on the grounds that they had sustained heavy losses. Since 1978 NHBC has provided its own primary insurance backed by reinsurance, on which so far there has been no claim, to cover part of the risk of exceptional losses. NHBC says that it has tried to find an insurance company to take on the primary insurance but without success. MMI provides its own insurance cover for its warranty and says it does not see any need for reinsurance.

8.16. Fifth, mortgage lenders have an important role in the warranty market. The Council of Mortgage Lenders (CML) estimates that approaching 90 per cent of private sector new homes are purchased with the aid of a mortgage; and mortgage lenders usually require those which are less than ten years old to have either a structural warranty or an architect's (or surveyor's) certificate providing equivalent protection for the borrower. It follows that a speculative builder must expect at least some of his prospective purchasers to need a mortgage and will therefore see the advantage of being in a position to offer a warranty to them. A cash purchaser may well require a warranty not least against the possibility that he will himself wish to sell the home within the warranty period to someone who cannot complete the purchase without a mortgage. It is not therefore surprising that 90 per cent of new homes constructed in 1989 in the private and housing associations sectors were provided with a warranty.

8.17. CML has told us that it expects mortgage lenders to continue to require a warranty on new homes. Although it is not its policy to require its members to insist on such warranties as a precondition for granting loans on new homes, it has issued guidance to its members on the criteria that members may wish to take into account when considering any warranty schemes (see paragraph 2.48). As the guidelines are based on the current NHBC and MMI schemes, any new scheme offering warranties to speculative builders would probably need to be substantially similar to these existing schemes and offer no less protection to purchasers.

8.18. Sixth, purchasers of new homes will normally have professional advisers to handle the legal aspects of the transaction. These advisers have the obligation to make appropriate relevant enquiries as to the builder's contractual obligations including the existence of structural warranties. Even when purchasers act without legal advice, there are publications available to them, which point to the need to investigate this aspect of the transaction.

8.19. The market is also influenced by the terms of the rules adopted by the warranty schemes to which their members are subject and the manner in which the rules are interpreted and enforced. We deal with these matters in our consideration of the public interest.

NHBC's fee structure

8.20. NHBC has told us that its current fee structure is intended to be simple and easy to understand. It does not believe that there is any significant degree of cross-subsidisation, but has accepted that there may be room for relating the fee structure more closely to costs. At present inspection charges are linked to selling prices of homes and not directly to the costs of inspection. While we sympathise with NHBC's objective of a simple easily understood pricing system we doubt whether charges for inspection services that are so closely related to property values rather than to the costs of supplying the services can be conducive to efficiency. In this connection we are glad to note that NHBC is presently undertaking a review of its inspection costs and has told us that if any significant cross-subsidisation is revealed, the fee structure will need to be reconsidered.

THE PUBLIC INTEREST

8.21. We initially identified a number of potential public interest issues and put them to NHBC for comment. In the light of all the evidence we have received and on further consideration, we have found it necessary to pursue only the following matters and to consider the remaining questions in the terms of reference in relation to these:

- (1) the vertical integration of NHBC's scheme;
- (2) the effect of NHBC's Rule 12 on its members wishing to sample or dual source warranty schemes, and on barriers to entry; and
- (3) the effect of NHBC's Rules 38 and 41, and related omissions from the rules, on those members wishing to transfer completely to other schemes.

8.22. First we comment on NHBC's role in the provision of structural warranty schemes. Such warranty schemes undoubtedly assist builders to sell new homes but their underlying and most important function is consumer protection. The need for such protection was recognised by the Government in the 1960s when it faced NHBC with the choice of improving that aspect of its scheme or being subjected to statutory regulation. That need has not diminished. Purchase of a home remains for a large number of people the most important financial transaction they undertake in their lives. The financial, social and personal consequences of structural failure can be disastrous both for the owner and his family. The purchaser of a new home is particularly vulnerable (see paragraph 8.13) and common law remedies may prove inadequate (see paragraph 2.12).

8.23. As we have indicated in paragraph 2.42 NHBC has in recent years improved its scheme to a marked extent. The evidence we have received indicates that Buildmark is highly regarded as a model warranty scheme in other countries and that its fees are, on the basis of international comparisons, relatively low (though such comparisons are difficult to make). We note that the pace of change at NHBC quickened in the late 1980s when the substantive terms of its scheme were improved and that this roughly coincided with the emergence of MMI as a competitor. We also note that NHBC appointed a new Chief Executive on 1 January 1985 and a new Chairman on 1 January 1988 who themselves provided impetus for change. NHBC has expressed the view that if the threat of competition has had an effect, this has probably operated by making it more receptive to proposals for change and in speeding their implementation. We also believe that the emergence of competition from MMI in the market has had that beneficial effect.

The vertical integration of NHBC's scheme

8.24. NHBC has told us that the different aspects of its warranty scheme are so closely interdependent that they must be considered as an integrated whole. Moreover, this system of registration of builders, building standards, inspection and insurance operating in a 'virtuous circle' enable a higher standard of service at a relatively low cost.

8.25. In considering our conclusions on the vertical integration of NHBC's scheme, we have to examine and answer the remaining questions, (c) to (e), in the reference. To avoid repetition, we would add that this applies also to our consideration of the other matters of potential public interest which we have identified (paragraph 8.21), in paragraphs 8.76 and 8.77, and 8.85 to 8.88 respectively.

8.26. In NHBC's view the register is central to the operation of its scheme. It provides a general assurance to home buyers that registered builders and developers are financially sound and reliable in meeting warranty claims and commits the builders to constructing homes to approved standards. Its standards go beyond the health and safety requirements of the Building Regulations in covering such matters as the quality and durability of materials, workmanship and finish, and the provision of services and facilities in the home. Inspection, in its view, does more than ensure that particular homes comply with the standards. By helping more generally to prevent defects from occurring by providing valuable feedback on problems, its system of inspection recognises that from the home buyer's standpoint prevention is better than cure. Prevention also plays an important role in reducing the number of claims, the cost of repairs and insurance cover, and hence the fees payable. The conciliation and arbitration procedures integral to the warranty ensure that builders honour their obligations in most cases without recourse to the law, while the information gained from the claims procedures provide further feedback for the continuing process of improving building standards and inspection procedures. Finally, NHBC has claimed that the provision of insurance cover at minimum cost is based on a thorough understanding of the risks involved, including nearly universal inspection of a builder's output which gives underwriters a complete picture. NHBC regards reinsurance as an essential element in its scheme because in its view the business cannot prudently be run without some disaster cover.

8.27. We note that MMI agrees with NHBC that the different aspects of a warranty scheme, namely registration of builders, building standards, inspection and insurance, are part of a whole. In its view, the public interest will not be best served by breaking up these aspects of NHBC's service; it is better served by competition between schemes which provide all these aspects.

8.28. We considered whether the interests of home buyers and of the promotion of competition required the splitting up of the various elements within NHBC's warranty scheme. In our view the advantages of integration in this case are real, and we therefore accept the arguments of NHBC and MMI on the value of fully integrated structural warranty schemes.

8.29. We conclude that in providing a vertically integrated scheme, NHBC has not taken any steps for the purpose of exploiting or maintaining the monopoly situation. Nor, in this respect, are any actions or omissions on NHBC's part attributable to the existence of the monopoly situation. Nor are there any facts which operate or may be expected to operate against the public interest.

8.30. Nevertheless, with its long-standing position in the market for warranty services, where it still retains a share of over 90 per cent, NHBC remains dominant, and we have accordingly looked with some concern at MMI's complaint that its progress in the market and its ability to provide competition to NHBC is constrained by the restrictive nature of some of NHBC's rules. The terms, interpretation and implementation of these rules are the central issues of our inquiry.

NHBC's rules

8.31. NHBC's current rules are summarised at paragraph 3.21. At an early stage in the inquiry NHBC told us that it recognised that certain of its rules required some clarification and expansion, and it

submitted the draft amendments shown in Appendix 6.1. We now discuss these rules with particular reference to (2) and (3) of paragraph 8.21.

Rules 9, 10 and 12

8.32. The provisions of Rules 9, 10 and 12 are as follows:¹

9. You must ensure that every Home built or sold by you or on your behalf is designed and constructed in accordance with the NHBC's Requirements in force when the concreting of the foundations is begun.
10. You may employ only a Registered Builder as the main contractor for the construction of a Home for sale.
- 12 (a) You must make an Application for inspection if you are:
 - (i) A Developer (or a Builder acting as a Developer) and you intend to arrange for the construction of a Home;
 - (ii) A Builder and you intend to build a Home under a building agreement with a person who intends to use it as a residence for himself, his tenants or licensees.
- (b) You may make an Application for inspection if you are a Builder and you intend to build a home for sale by a person or organisation not registered with the NHBC. In this case, you must give the name and address of that person or organisation in the Application for Inspection.
- (c) You must not make an Application for Inspection in any other circumstances or if the NHBC instructs you not to do so.

NHBC's arguments concerning Rules 9, 10 and 12

8.33. NHBC has not acknowledged any essential connection between Rules 9 and 10 on the one hand and Rule 12 on the other hand. It has told us of its conviction that Rule 12, which requires registered builders and developers to submit all their new homes (with certain very limited exceptions) to its scheme, is vital to the operation of its integrated system. It enables it to ensure the full meaning and value of registration. In NHBC's view, abolition of Rule 12 would be detrimental to the interests of home buyers because:

- (a) It will make registration meaningless, if it no longer means that all the builder's homes have been built to NHBC standards and have been inspected for compliance with those standards.
- (b) NHBC's reinsurers will be concerned if the registration system is changed in any way, and as a result they are no longer able to see the whole range of a builder's output as a basis for risk assessment. There will be a danger of adverse selection (see paragraph 6.23). The result is likely to be an increase in premiums and some properties being uninsurable except on stringent terms.
- (c) The number of homes built without warranty will increase significantly and as a consequence building standards could decline.

¹These rules and Rules 38 and 41 to which we refer later on are found in similar terms both in NHBC's rules applying in England, Wales and Northern Ireland, and its rules applying in Scotland. The rules are set out in full in Appendices 3.3 and 3.4.

- (d) Uncertainty as to the registration of a home with NHBC will mean inspection delays and therefore a greater chance of potential defects being missed.
- (e) The obligations of builders, as a condition of registration, to allow the benefits of the warranty to pass to subsequent purchasers of the home (by not claiming lack of privity of contract as a defence to a claim) will be lost.
- (f) NHBC's costs will increase because there will be a need for advertising directed to persuade home buyers of the value of warranties, and there could be higher claims owing to builders having less incentive to carry out remedial work themselves without recourse to formal claims procedures.
- (g) NHBC will need to compete in the market on a purely commercial basis, and might have to withdraw from non-commercial activities beneficial to home buyers, such as the 'Pride in the Job' award.

8.34. In NHBC's view Rule 12 does not constitute a barrier to market entry for other warranty schemes, or to expansion of their market share. Competitors are free to compete on a scheme-by-scheme basis. Too much should not be read into the limited level of success so far achieved by MMI's Foundation 15 scheme, given the short time it has been operating and the downturn in the housing market during this period. NHBC also thinks that, if Rule 12 were removed, reliance cannot be placed on mortgage lenders continuing the policy of lending only on new homes that are covered by suitable warranties or architects' or surveyors' certificates, and that an additional factor, even if less significant, is the growing proportion of home buyers who do not need a mortgage.

8.35. NHBC confirms that under Rule 12 its registered builders are free to submit homes to another scheme, provided they also apply and pay for inspection of these properties under NHBC's scheme. It acknowledges that letters were sent to perhaps no more than two NHBC registered builders in the early days of Foundation 15, notifying them that they were actually in breach of NHBC rules in submitting some homes to Foundation 15, and risked being struck off NHBC's register if this conduct was repeated. It says that its staff were in error in issuing the letters, without authorisation, and assures us that there will be no repetition.

8.36. NHBC has told us that it follows that any builder can thus sample another scheme without undue cost, while for its part NHBC will continue to inspect the whole of that builder's output. Furthermore, a builder is free to set up a new company to build particular homes and he can register it with another scheme even if it is a subsidiary or associated company of the registered builder. NHBC has admitted, however, that this last exception to Rule 12's basic principle is an anomaly which might have to be remedied in the future.

8.37. NHBC has contended therefore that Rule 12 should not be viewed in isolation as anti-competitive, because it sees the rule as an essential part of its whole scheme. NHBC further contends that if the rule can in any degree be regarded as anti-competitive, it nevertheless operates in the public interest in the benefits it offers to home buyers and their successors in title by way of the assurance of building standards which are sensitive to claims experience, universal insurability, and very low costs.

Other parties' arguments concerning Rule 12

8.38. As set out in Chapter 6, the majority of builders' organisations, including representative bodies in Scotland and Northern Ireland, believe that NHBC should retain Rule 12. In general they take the view that to avoid confusing purchasers of new homes, builders should decide which warranty scheme to join and then abide by the scheme's rules. On the other hand, the Federation of Master Builders, primarily representing small and medium-sized builders, has told us that its members consider Rule 12 effectively restricts competition and is a barrier to their sampling the service offered by MMI.

8.39. Individual builders who have written to us generally echo the views of their representative organisations. However, the telephone survey, which we commissioned, by a market research company of a sample of builders registered with either NHBC or MMI has revealed that there are within both groups a number of builders who do wish to have a choice of warranty schemes.

8.40. A variety of views were received from the various professional bodies who have provided evidence. Nevertheless, the majority feel that NHBC should retain Rule 12 in its present form.

8.41. In the Consumers' Association's view Rule 12 is anti-competitive but should only be removed if this change is accompanied by major alteration to the system of housebuilding regulation (in the interests of consumer protection). It would be necessary to set up a single regulatory body for the private housing industry as a whole, which would oversee warranty schemes to ensure that they meet basic requirements.

8.42. We discerned some difference in emphasis amongst the Government departments most directly concerned with private sector housing. The Department of the Environment (DoE) has informed us that it sees competition in both building control and warranty schemes as healthy, and likely to achieve greater efficiency and benefits for the consumer. So far only NHBC Building Control Services Ltd has been appointed an approved inspector under the Building Act 1984 for the purposes of building control (in which area it competes with local authorities) but even on this limited scale, DoE has seen firm indications that the competition engendered by private certification is improving efficiency. The Scottish Development Department has told us that it welcomes warranty schemes for the encouragement they give to the provision of housing of good quality and workmanship. The Department of the Environment for Northern Ireland, commenting directly on Rule 12, has told us that the rule is fundamental to the success of NHBC in attaining and maintaining the highest available standards of design and construction in the private housebuilding sector, and preventing a builder from building to different standards but creating the illusion that all homes are equal and covered by warranty.

8.43. The Association of Metropolitan Authorities and the Association of District Councils together represent local authorities in England and Wales which exercise planning and building control functions in relation to housing (other than county councils' responsibilities for strategic planning). The Associations played some part in the launching of Foundation 15. They have told us that some builders have shown that they are prepared to consider splitting their output between NHBC and local government for building control purposes, and the Associations believe that they will be equally willing to split their output between warranty services. The Associations consider that Rule 12 is anti-competitive in restricting builders' freedom to choose between warranty schemes. They think fears that competition would encourage builders to build some houses without warranty are groundless.

8.44. Minet Insurance Brokers (UK) Ltd, insurance brokers to NHBC, told us that if Rule 12 were abandoned, there is a risk of an increase in rates and the possibility that some houses, which can now be insured, will become uninsurable.

8.45. In the view of Munich Reinsurance Company (Munich Re), the principal reinsurer of NHBC's scheme, which negotiates terms and conditions on behalf of all members of its consortium of reinsurers who provide an important part of the reinsurance of the scheme, both Rule 12 and the feedback of claims experience into standards and inspection are essential elements of its risk management. It would be concerned if Rule 12 were amended so as to allow builders to choose which homes they put into NHBC's scheme. It would need to look closely at its involvement in the scheme, including the possibility of withdrawing. If it were to withdraw, the other reinsurers in the consortium would almost certainly withdraw, and it could prove very difficult for NHBC to find another reinsurer.

8.46. We have taken note also of the views of M Claude Mathurin, Engineer General of Bridges and Roads in the Ministry of Housing and Public Works of France, who discussed with us the background to his recent report to the European Commission. His report is concerned with possible regulation of the construction industry generally and he has made proposals for harmonisation at Community level. He has a high opinion of NHBC's scheme, and considers it a model for other countries.

8.47. Finally, we come to the views of MMI on Rule 12. It believes that the option for a builder of registering some of his new homes with both NHBC and an alternative scheme (and paying for both) is unlikely to be attractive to a builder who wishes to offer MMI's 15-year guarantee to some of his home buyers on a regular basis. The 'all or nothing' alternative is difficult for a builder to contemplate, because Rule 12 denies him the opportunity of an adequate trial of Foundation 15. Rule 12 therefore makes it difficult for Foundation 15 to establish itself as a competitor to NHBC on any viable long-term commercial basis. The benefits to competition arising from its entry to the market have been, and are likely to continue to be, better value for money, greater innovation, and improvement in the quality of service to the builder and home buyer.

8.48. MMI considers that there is no strength in the argument that NHBC needs Rule 12 to regulate builders because it will not otherwise have an overview of all their activities. If either Foundation 15's standards, or those of NHBC, were to fall below an acceptable standard, then mortgage lenders would cease to accept the warranty of the company concerned. In MMI's view the market is sufficiently sophisticated to regulate itself.

8.49. MMI has also argued that there is no indication that Rule 12 confers benefits which would be threatened if it were removed, on the following grounds:

- (a) it is difficult to envisage a set of circumstances in which the home buyer or mortgage lender will ever rely on the fact that the builder is registered with NHBC as sufficient evidence by itself that the home which he is purchasing or lending against is covered by an NHBC certificate;
- (b) speculative builders and developers will not risk building homes without warranty in the hope that they might be bought by cash buyers doing their own conveyancing without adequate advice;
- (c) there is little opportunity for low risk builders and developers to opt out of structural warranty insurance, and there could not be any significant adverse selection arising from competition;
- (d) it is reasonable to rely on mortgage lenders to continue their policy of lending on new homes only if covered by warranties;
- (e) the abolition of Rule 12 would not result in any general decline in the quality of housing in the United Kingdom since the minimum technical standards required by warranty schemes are effectively approved by the mortgage lenders;
- (f) the abolition of Rule 12 would not result in an increase in the price of warranty services. On the contrary, competition from Foundation 15 would act as a constraint on NHBC's ability to increase prices; and
- (g) its belief that current premium levels offer attractive rates of profitability for Foundation 15 with a market share considerably less than 50 per cent indicates that, if NHBC does have access to a lower cost base than MMI, it has not seen fit to share the advantages of this with its customers.
- (e) the abolition of Rule 12 would not result in any general decline in the quality of housing in the United Kingdom since the minimum technical standards required by warranty schemes are effectively approved by the mortgage lenders;
- (f) the abolition of Rule 12 would not result in an increase in the price of warranty services. On the contrary, competition from Foundation 15 would act as a constraint on NHBC's ability to increase prices; and
- (g) its belief that current premium levels offer attractive rates of profitability for Foundation 15 with a market share considerably less than 50 per cent indicates that, if NHBC does have access to a lower cost base than MMI, it has not seen fit to share the advantages of this with its customers.

Conclusions on the effect of Rules 9, 10 and 12

8.50. Notwithstanding NHBC's view, Rule 12 does not stand in isolation. Its function is to ensure that the members of NHBC comply with their obligations under Rules 9 and 10 that every home developed by a member is built in accordance with NHBC's current technical requirements and by a builder as main contractor who is himself registered. The purpose and effect of Rule 12 is to require the builder to prenotify all his new homes to NHBC (subject to the minor exceptions referred to in paragraph 8.58) and thereby render them subject to inspection and warranty by NHBC and to payment of the current fees. We note that in practice Rules 9 and 10 are interpreted as subject to Rule 12(b) (though this is not explicitly stated), because the exceptions applied to Rule 12 are applied by NHBC also to Rules 9 and 10.

8.51. In our consideration of Rule 12, it is first necessary to look at the role of competition in the provision of the reference services. In doing so, however, we must take account not only of the effects of competition on the market but crucially, its effect on the protection of the consumer, which NHBC came into being to secure. There is no doubt in our minds that NHBC has fulfilled its primary purpose of consumer protection, and that it has done so at reasonable cost. Competition of a kind which led to a reduction in that consumer protection would defeat the main objective. If, on the other hand, consumer protection can be preserved in a competitive environment with freer choice and the spur to efficiency that competition can provide, the public interest would be further advanced.

8.52. We have been presented with two different views of how a warranty scheme for new homes should operate. Both MMI and NHBC supply warranties on each individual home they cover. MMI supplies warranties home by home to its registered builders. By contrast NHBC in effect warrants the entire new home output of a builder, with some minor exceptions. In what follows, we take account of these respective approaches.

8.53. Neither NHBC itself, nor many of the bodies connected with the building industry who submitted evidence to us, believe that NHBC should necessarily be the sole provider of the reference services, although there is some support for a single register of builders and a common set of standards. It is clear that during the period since the provision of competition to NHBC's scheme was first publicly discussed, and especially since Foundation 15 was launched as a rival scheme at the beginning of 1989, actual competition and the perceived threat of competition have been to the benefit of the public. Not only have builders for the first time had the possibility of choice as to the source of the structural warranty services to be provided for new homes, but the improvement in the coverage and scope of NHBC's scheme has been marked.

8.54. These recent major improvements to NHBC's scheme came into effect after a number of years in which only relatively marginal revisions or improvements had been made to the substance of the scheme (see paragraph 8.23). It is clear that so long as MMI continues to provide competition through its somewhat different technical approach, but with an equivalent high standard in terms of consumer protection, NHBC will remain under competitive pressure to maintain its own high standards.

8.55. As a result of the introduction of competition in the provision of building control services (see paragraph 2.52), since 1985 NHBC Building Control Services Ltd, as an approved provider of such services, has obtained a substantial part of that market. It has caused local authorities to 'sharpen up their act' with the result that it appears now to be generally agreed that the overall quality of building control services has been improved. We have certainly heard no suggestion that in the provision of such services the existence of competition as a result of the Building Act 1984 has led to any fall in standards. Competition, however, in the provision of building control services takes place on the basis that it necessarily involves the application of the provisions of a detailed statutory instrument, the Building Regulations (SI 1985 No 1065), which provide common requirements for implementation.

8.56. MMI for its part has urged upon us that such competition could also take place in reference services on a house by house basis. Builders in its view should be free without restraint to choose on an individual basis the scheme with which their individual new homes are to be placed for such coverage, regardless of whether this means that a builder might be selling homes under both schemes at once. MMI believes that builders who wish to dual source their provision of warranties would, as a matter of common sense, be inclined to group homes in ways convenient both to themselves and to the providers of reference services.

8.57. It has been argued to us by NHBC in contrast that competition in the provision of reference services could lead to lower standards, unless this takes place on a 'scheme-by-scheme' basis (for which retention of Rule 12 is in its view essential) rather than on a 'house-by-house' basis. The whole purpose of its own scheme is to ensure that any competition should take place on a 'scheme-by-scheme' basis under which a builder has to make a choice as to which scheme he prefers and then place all his properties with that scheme, accepting fully the standards which it lays down. On this basis a member of NHBC could not 'pick and choose', by having the Buildmark scheme apply to certain properties which it is constructing, whilst putting the remainder of its output into another scheme (or even no scheme at all). NHBC believes that the entire integrity of its scheme, and in particular the value of its register of builders, will be threatened if exceptions to Rule 12 were allowed, other than the two minor exceptions already in existence.

8.58. These two minor exceptions represent, in its view, special situations; first where a purchaser of an individual property is using an architect or surveyor to supervise the construction and requests that the property be taken outside the NHBC scheme and protection is already provided for him by certification and insurance cover against professional negligence. Second where a non-NHBC member, possibly a local authority or housing association, has chosen an NHBC builder for a development but does not require the protection of the NHBC scheme. In neither case is the exception liable to damage consumer protection since the purchaser is well informed and elects to proceed with the benefit of other protection. NHBC's fear is that to extend the exceptions further, however, at the discretion of builders rather than customers, would immediately open the door to the major risk that some builders would be able to lower their standards, and that it would lose its overall control over their output.

8.59. If an NHBC member wishes to submit new homes to another scheme either on a sampling basis or on a long-term basis as a second source of warranty services, the effect of Rule 12 is roughly to double the unit warranty costs because inspection and insurance costs are incurred in both schemes. For all but the smallest builders inspection and insurance account for most of the costs of obtaining warranty cover on a home, the only other unit cost being a proportion of the annual renewal of registration fee (see paragraphs 5.44 and 5.45).

8.60. MMI maintains that this need to submit homes to both schemes deters second sourcing of reference services by a builder and has therefore been a serious impediment to the growth of its own scheme. In its view, for the same reason, Rule 12 deters other new entry into the housing warranty market. It claims that these effects have been reinforced by the steps NHBC has taken in certain cases to enforce Rule 12 by threatening to withdraw membership from builders who submitted new homes to Foundation 15. For its part, NHBC contends that MMI and any other entrant to the market is not prevented by Rule 12 from competing on a scheme-by-scheme basis, which should be a satisfactory basis for establishing a viable presence in the reference services market.

8.61. As to NHBC's threats to withdraw membership from one or two builders who submitted new homes to Foundation 15, we accept NHBC's assurance that these were isolated and unauthorised actions by its employees, and that there will be no repetition. We do not regard these threats, unauthorised as they were, as steps taken by NHBC to maintain the monopoly situation, or as actions by NHBC attributable to this situation. We deal further with the question of steps, actions and omissions in paragraph 8.76.

8.62. NHBC has argued that the abolition of Rule 12 would lead to a significant increase in the number of homes built and sold without warranty because the overall control of a builder's output would be lost. As a consequence building standards could decline. This argument is especially important because of the

implications for consumer protection. It would not be in the public interest if a rule change in the interests of competition had that result. While there may be some increase in the number of homes built without the benefit of a warranty we are not convinced that there would be a significant increase because, first, we believe the purchasers and their advisers would demand warranties and, second, we do not think it would be in the interest of builders to offer homes for sale without the benefit of a warranty. Purchasers who are buying a home with the aid of a mortgage or with the benefit of legal advice (and the majority will have both) can expect to receive details of the warranties available, whether the home is brand new or second-hand within the warranty period. Currently the great majority of mortgage lenders insist on warranty schemes on new homes as a condition of advancing a loan on that home. There is little reason to believe that mortgage lenders will in the future change their current policy and cease requiring cover on new homes by warranty schemes.

8.63. Purchasers taking legal advice will also seek evidence of a warranty since, according to current conveyancing practice, structural warranties for new homes are the norm and are expected, and legal advisers will wish to satisfy themselves that such a warranty exists or, at least, advise their clients on this issue. Indeed even purchasers doing their own conveyancing are likely to seek warranties since they are advised by guidance leaflets, articles and other publications to ensure that a structural warranty covers the home they propose to buy. Moreover, cash buyers (whether legally advised or not), who are not concerned to obtain a mortgage themselves, are unlikely to wish to take the risk of buying a new home without it being covered under a structural warranty as this will reduce the marketability of the home on resale during the warranty period. We believe that as competition develops purchasers and their advisers will become more aware of the need to seek evidence of warranties on each home.

8.64. But even if there were an increase in the number of purchasers not seeking a warranty, we believe that builders will still see the need to supply warranties. The vast majority of new homes are not built for a specific purchaser but are built speculatively; and therefore builders are unlikely to wish to take the risk of building a home without such a warranty, which may later turn out therefore to be much more difficult to sell. In fact, builders are likely to build in a way that maximises their chances of a quick sale. If the homes they offer for sale do not have a warranty, they are reducing their ability to sell them because their potential customers are only those who do not need a mortgage, do not take legal advice and who do not consider difficulties which might arise on reselling.

8.65. It has also been argued that any change in the present terms of Rule 12 is likely to increase the cost of providing insurance and reinsurance for a builder who elects to obtain his cover from two or perhaps more schemes, since it could be said that he is allocating his new homes to the different schemes in a manner that might be adverse to the level of risk taken by the insurer or reinsurer. It has even been suggested that if sufficient builders were to seek to act in this way NHBC might find it difficult to get any measure of reinsurance.

8.66. We do not agree that there is a significant risk of such adverse selection (and furthermore while NHBC remains by far the dominant scheme operator it is most unlikely that any adverse selection would operate against NHBC). In the supply of reference services it is clear that the degree of site inspection is such that the insurer is unlikely to be placed in a position where he can be selected against. Furthermore, while NHBC and MMI told us their current practice is not to decline any house that is offered in accordance with their rules, ie with a minimum period of prenotification of 21 days before construction starts, the basis on which all such properties can be accepted is that a careful and extensive risk assessment has already been undertaken. Where high prospective risks have been identified, the course of action taken by both scheme operators is to ensure that the builder undertakes the necessary action, for example in the form of additional works, to remove the high risk element. Thus adverse selection seems less likely to occur in the structural warranty market than in many other areas of insurance.

8.67. The argument has been put to us that if a builder is freely allowed to dual source this will deny the provider of reference services the opportunity to oversee all his building work so as to assess overall quality and hence risk. We do not believe that it is necessary for such a provider to oversee the whole of a builder's output for the purposes of risk assessment. At present it seems builders are asked to indicate to the scheme operator their insurance status (which is a consequence of their claims record) with the operator

of any other scheme. Furthermore, we understand that practically all United Kingdom insurance companies belonging to the Association of British Insurers agree to release the claims experience of customers to other insurance companies quoting for a particular account. We see no reason why this should not apply also between the providers of structural warranty schemes.

8.68. There is a tranche of insurance cover which NHBC obtains by reinsurance. We received evidence from both NHBC and its main reinsurer, Munich Re, suggesting that if the scheme did not cover the builders' whole output there would be a possibility that reinsurance would not be available. It follows, however, from what we said in paragraphs 8.66 and 8.67 that adverse selection seems less likely to take place in this area of insurance than in many others and that information exchange is likely to operate between insurers so as to provide an overview of the claims record and output of builders who change schemes. Whilst any change to the existing pattern of providing reference services, and in particular the introduction of additional competition, is likely to be given very careful consideration by insurers and reinsurers, we do not believe that overall the balance of risk will be changed to a degree sufficient to lead to a widespread withdrawal of insurance cover.

8.69. NHBC has argued that ending Rule 12 would mean that the obligation on builders to allow the benefits of the warranty to pass to subsequent purchasers of the home would be lost. We do not accept that this would be the case. NHBC would be free to continue to require builders to accept such an obligation and we note that MMI, without an equivalent to Rule 12, imposes the same requirement on its builders. NHBC has also argued that without Rule 12 it would need to compete in the market on a purely commercial basis and might have to withdraw some of its non-commercial activities which benefit home buyers. We believe that within the supply of reference services an increase in competition would help promote the level and quality of the services provided and that it would be in NHBC's interests to promote the particular benefits of its service. We do not therefore accept that there would be any inevitable loss of benefits to home buyers.

8.70. NHBC has told us that the removal of Rule 12 would lead to the loss of economies of scale. Without necessarily accepting all the details of NHBC's cost estimates we observe that only some of the extra costs it has identified are the result of a loss in scale; the others arise out of the ending of Rule 12 and NHBC's competitive response. NHBC's evidence on the effects of economies of scale on costs do not suggest to us that there are any significant additional economies of scale at NHBC's level of activity nor that there would be major adverse effects on unit costs if its scale of operations were to decline even to a marked degree. MMI suggested that most of the economies of scale could be achieved at a much lower level of activity of some 45,000 warranties a year. Taken together the evidence from NHBC and MMI suggests that there is enough activity in the market to enable two or three competitors to realise all the significant economies of scale.

8.71. NHBC believes that increased competition without the retention of its present Rule 12 will lead to significant increases in its costs of recruiting members, promotion and reinsurance. Reinsurance has been discussed separately in paragraphs 8.65 to 8.68. We would accept that the increase in competition faced by NHBC, particularly if Rule 12 were removed, may well result in its spending more on recruitment and promotion. We believe, however, that this will have direct benefits through leading to better informed builders and house purchasers and that any additional costs need also to be weighed against the resulting benefits from the spur to efficiency, cost minimisation and innovation likely to result from competition.

8.72. We believe that the effect of Rule 12 in discouraging dual sourcing and effectively doubling the unit warranty costs incurred by a builder wishing to obtain warranty services from a second source whilst still remaining a member of NHBC is anti-competitive, especially given NHBC's high market share.

8.73. This has adverse consequences for the public interest, through its effects on builders and operators of other structural warranty schemes. As regards builders, the effect of Rule 12, supported by Rules 9 and 10, is to restrict the exploration of the competitive quality and/or cost of alternative sources of supply.

8.74. This constraint on the ability of a builder to sample or to dual source, and hence the necessity to make the fundamental decision of transferring his entire output between schemes in order to have any experience of another scheme (unless he is prepared to bear the additional cost of paying for both schemes simultaneously), also has an adverse effect on actual or potential new entrants.

8.75. The growth of existing and potential new entrants (eg MMI) is hindered since many builders will only wish to move part rather than the whole of their business at least in the first instance and perhaps permanently. For similar reasons, potential new entry may be deterred altogether. In both cases such limitations on the level of demand, especially in the context of NHBC's high market share, would make it difficult for competitors since they would be unlikely to achieve the volume of business required to allow sufficient economies of scale to be achieved in their operations to justify the financial commitment required in this market.

8.76. In reaching our conclusions on Rule 12 (and in doing so we take account of the effect also of Rules 9 and 10), we deal first with questions (c) and (d) in the reference. We do not consider that NHBC adopted Rule 12 deliberately for the purpose of exploiting or maintaining the monopoly situation and we do not regard the rule as a step taken by NHBC for such purpose. Nor do we believe that there has been an omission, on NHBC's part, in relation to this rule which is attributable to the existence of the monopoly situation. We do, however, consider that Rule 12, in its content and implementation, constitutes an action, on NHBC's part, which is attributable to the existence of the monopoly situation, bearing in mind that the rule was drawn up at a time when NHBC had no competition in the provision of reference services and is one reflection of its position, as at that time, the sole provider of these.

8.77. As regards question (e), we believe and conclude that Rule 12 represents a fact which operates and may be expected to operate against the public interest, by reason of the particular effects adverse to the public interest:

- (a) that the ability of a member of NHBC to use the services of a competitor is restricted, the rule having, except in the two limited cases referred to in paragraph 8.58, the effect of preventing, without financial penalty, dual sourcing and the sampling of alternative schemes; and
- (b) that actual or potential new entrants to the market for reference services are thereby impeded or deterred;

with the result, in each instance, that competition in the supply of reference services is restricted.

Other rules of NHBC

8.78. NHBC's present rules were drawn up at a time when it had no competition for the provision of reference services. They reflect its position as the sole provider of such services and, as NHBC has acknowledged, require in any case some clarification and amendment in order to become appropriate for the present situation in which, since the beginning of 1989, direct competition in the provision of these services has been provided by MMI.

8.79. We must now consider the group of rules which relate to the terms upon which an NHBC member can cancel his membership with NHBC to transfer to another scheme. Members of NHBC should be free to cancel their registration with it in order to move to another scheme, so long as purchasers of individual new homes from them are not thereby confused or misled as to the warranty protection which such homes enjoy: these members should not incur commercial disadvantages or penalties as a result of such a decision, so that they are deterred from switching membership to another scheme.

8.80. A builder or developer who at present seeks to cancel his registration with NHBC will find that no rule at present fully sets out the applicable procedure. Although Rule 38 (taken with Rule 30(b), to which it refers) sets out a number of circumstances in which registration is automatically cancelled, eg bankruptcy or liquidation, it makes no reference to cancellation at the option of the member. NHBC has informed us that in practice it will accept voluntary cancellation of membership by a builder on the same basis as cancellation by NHBC, that is to say that the builder continues to receive Buildmark cover for any homes in respect of which contracts have been exchanged (for which Buildmark documents have therefore been handed over already to the purchaser at exchange of contracts) but for no other new homes. NHBC tell us that this has not hitherto been a problem, since cancellation has usually occurred on a builder's insolvency or for other financial causes, when unsold homes are normally taken over by another registered builder, under whom cover will continue. However, we consider that in the new competitive situation following the entry of MMI the resignation of a builder who is intending to continue in business is more likely to happen.

8.81. This means that while such cancellation of registration presents little difficulty to a small builder who builds his homes one at a time, it presents greater problems to those builders who at any one time will have a number of new homes under construction at different stages or completed but unsold which (especially at times when the market is slow) may not yet be subject to contracts with purchasers. Withdrawal from NHBC membership in these circumstances will therefore render the position of the builder difficult, since he will not normally be able to obtain coverage from any other scheme for those houses the construction of which has been completed or is at an advanced stage, and in respect of which no other scheme will have had the opportunity of carrying out inspection. Such considerations may deter him from switching his future output to another scheme.

8.82. A further omission from the rules of NHBC is any provision protecting the premium rating from a previous period of membership of a builder who cancels his NHBC registration in order to transfer to another scheme and then seeks to return at a later date. We understand that normally an insurance company will accept that a party previously insured can retain the benefit of his original premium rating upon returning to it for cover after a period of absence, provided that his claims record with other insurance companies during that period is fully disclosed and that other changes in his circumstances do not indicate that he represents a different or worse risk. At present omissions from the rules may result in a member returning to NHBC in this situation receiving no benefit at all from a previous period of membership; and NHBC could deprive the member of the entire benefit of his previous membership. NHBC acknowledges that this does present a further disincentive to transfer, and we are satisfied that this is another respect in which the present terms of the rules, taking into account both their content and omissions, restrain competition.

8.83. Rules 39 and 40 deal with the obligations of the builder after his registration has been cancelled. In particular it follows from Rule 40 that existing obligations for homes still within the Buildmark scheme at the date of cancellation continue, as well as his obligation to make payments to the NHBC or to customers arising out of obligations existing at the effective date of cancellation.

8.84. Rule 41 appears to allow NHBC to claim a payment (unspecified in amount) as of right in return for taking over any existing obligations of the builder for the remainder of his two-year obligation to the purchaser of individual homes covered by the Buildmark scheme. NHBC explained that in practice the rule is interpreted as simply an option for the builder to enable him to retain his existing obligations if he wishes or alternatively to have them terminated and transferred to NHBC in return for payment of a lump sum. NHBC has acknowledged that Rule 41 has been misunderstood since it does not specifically refer to the builder's option and can be read as giving NHBC the right to demand a sum of an unspecified amount in return for the exercise of this option.

Conclusions on the effect of Rules 38 and 41

8.85. We have considered the implications of Rule 38 and the omission, from the rules of NHBC, of the matters described in paragraphs 8.80 to 8.82, ie (respectively) the absence of provision for

cancellation of registration at the option of a member and for the protection of the premium rating of a former member of NHBC, who is permitted to cancel his registration but subsequently seeks to resume membership. We consider that the content and implementation of Rule 38 represents an action, on the part of NHBC, which is attributable to the existence of the monopoly situation and that the omissions on its part to which we have referred are also so attributable. We believe this to be the case because these were, respectively, provisions included or omitted from the rules at a time when NHBC was the sole provider of reference services and there was no apparent need to provide for members transferring between schemes. We also conclude, for the reasons given in paragraphs 8.81 and 8.82, that these omissions represent facts which operate and may be expected to operate against the public interest.

8.86. We further consider that in its content and implementation Rule 41 constitutes an action on NHBC's part which is attributable to the existence of the monopoly situation because its drafting in the ambiguous manner described could not have taken place in a more competitive market. We conclude, for the reason given in paragraph 8.87, that the rule represents a fact which operates and may be expected to operate against the public interest.

8.87. We conclude also that the facts which we have identified as operating, or which might be expected to operate, against the public interest have the particular effect adverse to the public interest that they restrict competition in the supply of the reference services by discouraging builders from voluntarily seeking cancellation of their membership of NHBC in order to transfer to another scheme.

8.88. For completeness, we add that we have not found that any of the matters set out in paragraphs 8.85 and 8.86 represent steps being taken by NHBC for the purpose of exploiting or maintaining the monopoly situation.

Summary of conclusions on the public interest

8.89. We have concluded that:

- (a) In providing a vertically integrated scheme, NHBC has not taken any steps for the purpose of exploiting or maintaining the monopoly situation. Nor, in this respect, are any actions or omissions on NHBC's part attributable to the existence of the monopoly situation. Nor are there any facts which operate or may be expected to operate against the public interest (paragraph 8.29).
- (b) Threats to withdraw membership from one or two builders who submitted new homes to Foundation 15 are not steps taken by NHBC to maintain the monopoly situation, nor actions attributable to this situation (paragraph 8.61).
- (c) NHBC did not adopt Rule 12 deliberately for the purpose of exploiting or maintaining the monopoly situation and the rule is not a step taken by NHBC for such purpose. Nor has there been an omission, on NHBC's part, in relation to this rule which is attributable to the existence of the monopoly situation (paragraph 8.76).
- (d) Rule 12, in its content and implementation, constitutes an action, on NHBC's part, which is attributable to the existence of the monopoly situation (paragraph 8.76).
- (e) Rule 12 represents a fact which operates and may be expected to operate against the public interest, by reason of the particular effects adverse to the public interest, that the ability of a member of NHBC to use the services of a competitor is restricted, the rule having the effect of preventing without financial penalty dual sourcing and the sampling of alternative schemes; and that actual or potential new entrants to the market for reference services are thereby impeded or deterred; with the result in each instance that competition in the supply of reference services is restricted (paragraph 8.77).

- (f) The content and implementation of Rule 38 represents an action, on the part of NHBC, which is attributable to the existence of the monopoly situation and omissions on its part described in paragraphs 8.80 to 8.82 are also so attributable. For the reasons given in paragraphs 8.81 and 8.82, these omissions represent facts which operate and may be expected to operate against the public interest (paragraph 8.85).
- (g) In its content and implementation Rule 41 constitutes an action, on NHBC's part, which is attributable to the existence of the monopoly situation, and the rule represents a fact which operates and may be expected to operate against the public interest (paragraph 8.86).
- (h) The facts set out in (f) and (g) have the particular effect adverse to the public interest that they restrict competition in the supply of reference services by discouraging builders from voluntarily seeking cancellation of their membership of NHBC in order to transfer to another scheme (paragraph 8.87).
- (i) None of the matters set out in (f) and (g) represent steps being taken by NHBC for the purpose of exploiting or maintaining the monopoly situation (paragraph 8.88).

Recommendations

8.90. Having identified (paragraphs 8.77 and 8.87) particular effects adverse to the public interest, we have to consider what action (if any) should be taken for the purpose of remedying or preventing these. We may, if we think fit, include in this report recommendations as to such action.

Rule 12

8.91. NHBC has told us that it understands, but does not share, our concern that Rule 12 operates as a barrier to entry to the market. It vigorously denies this both at the level of principle and by reference to experience. It doubts whether any claim could be made that Rule 12 has operated in practice as a barrier to entry, if only because of the short period of relevant experience since Foundation 15 entered the market, and the extraordinarily poor commercial environment for the construction industry since then. Under these circumstances, whatever might be the theoretical consequences of Rule 12, its practical effect must necessarily be speculative, and it would be undesirable to make irrevocable and profound changes on the basis of a paucity of information. Accordingly, NHBC would be willing to assent to a period of scrutiny by the Director General of Fair Trading and if, after a reasonable and representative period, he came to the view that Rule 12 did in practice constitute a barrier to entry, NHBC had little doubt that it could accede to any reasonable request to amend the rule after consultation with the Director General.

8.92. On the other hand, MMI has told us that in the absence of a significant change to NHBC's rules it is doubtful whether it can obtain a viable market share, and it would therefore have to give serious consideration to withdrawing from the reference services market. If it withdraws, in its view, there must be some doubt whether other companies would seek to enter the market in the foreseeable future.

8.93. We believe that the existence of Rule 12 has in the past helped to raise building standards. However, in the new and changing situation of emerging competition its rigidity is anti-competitive. We believe it would be inappropriate at this stage to recommend the total abolition of Rule 12 but some significant amendment is clearly required.

8.94. In our view, Rule 12 should be amended so as to allow a builder to source from other bodies providing the reference services but only where the standards of those bodies are broadly comparable to those of NHBC's Buildmark scheme. The standards of Foundation 15 are broadly comparable to those of Buildmark and, indeed, the Foundation 15 scheme is closely modelled on Buildmark. We recommend therefore that Rule 12 should additionally permit two forms of exception which would apply only to those new homes which:

- (a) have been accepted for cover by Foundation 15 or any other scheme of broadly comparable standard to NHBC's scheme; and
- (b) comprise an entirely separate housing unit, for example a block of flats, a sheltered home development covered by a single management agreement or an individual home not sharing common parts with any other home. (This would prevent, for example, the placing of one flat in a block with one scheme and the rest with another.)

Under the terms of the amended Rule 12 members of NHBC would no longer be in breach of NHBC's rules if part of their output of new homes had not been notified to NHBC but placed with another scheme as defined at (a) above. This, of course, implies that they would inform NHBC of new homes covered by such other schemes.

8.95. These exceptions to enable dual sourcing would be simply a limited amendment to Rule 12 to assist in remedying the adverse effects which we have identified, and would provide sufficient flexibility to enable a member of NHBC to use an alternative scheme while remaining a member of NHBC. We also recommend, however, that NHBC should adopt a rule equivalent to that possessed by Foundation 15 (Rule 20a) requiring members adopting this option to notify purchasers or potential purchasers that while the builder remains an NHBC builder the individual property is not covered by the Buildmark scheme.

8.96. We do not believe that such limited exceptions from Rule 12 would either prevent NHBC retaining sufficient control over the output and performance of its members to make a builder's registration meaningless nor impose any unnecessarily heavy burden of documentation or administration either on the builder himself or upon the providers of the alternative scheme. These providers would of course have a considerable incentive to facilitate the operation of the arrangements by providing swiftly to the builder concerned the documentary evidence required to be produced to NHBC in respect of individual units. Whilst this would give NHBC precise information about the activities of MMI or any other competitor, and this is MMI's view, we believe that NHBC's comprehensive network of inspectors would in due course acquire this knowledge anyway. Moreover, as the properties concerned would already, at the time of the notification, have been accepted for warranty by the competing scheme, it is hard to see how such notifications would give NHBC a competitive advantage. In our view it is important that in the interests of consumer protection all homes which an NHBC member places outside the NHBC scheme should indeed be covered by another scheme broadly comparable to Buildmark.

8.97. In making our recommendation at paragraph 8.94(a), we have not lost sight of the fact that in our review with NHBC of hypothetical remedies, it clearly indicated that such a procedure was in its view unsuitable (see Appendix 8.1). Nevertheless it remains our view that the procedure we have recommended is both desirable and practicable. We note that we received support from MMI as to its practicability.

8.98. We appreciate that NHBC may wish for reassurance that other warranty schemes are of broadly comparable standard to its own, given the inevitable differences of detail between schemes. We have sought information from the British Standards Institution (BSI) about the relevance of company and sectoral quality assurance schemes operating under BS 5750 to this sector. One possibility is that NHBC might accept certification of a competing scheme under BS 5750, by one of the bodies accredited by the National Accreditation Council for Certification Bodies, as evidence that it both is and remains of adequate standard to safeguard the interests of home buyers. Alternatively NHBC, MMI, and any other competitor which may enter the market, could together draw up a sectoral scheme, with agreed criteria against which their performance would be monitored on a continuing basis by one of those certification bodies. Clearly there would need to be detailed discussion between all interested parties on the best way of utilising this approach for determining the broad comparability of structural warranty schemes.

8.99. The question of the use, without breach of NHBC's rules, of subsidiary or associated companies not registered with NHBC to build or develop new homes outside the Buildmark scheme should also be considered. The present practice of NHBC in not prohibiting (but not expressly permitting) such practices leaves its builder members in a rather ambiguous position. In our view if the above exceptions to Rule 12

were permitted the need for such arrangements becomes less necessary. If on the other hand the exceptions to Rule 12 were not as fully permitted as we have suggested, then we recommend that the present ability for NHBC's members to take individual properties outside the Buildmark scheme in this way should be expressly recognised by the rules in order to go some way towards alleviating the adverse effects we have identified as resulting from the present terms of Rule 12.

Rules 38 and 41

8.100. We recommend that the adverse effect which we have identified in paragraph 8.87 should be remedied in the following manner:

- (a) NHBC should introduce a new rule confirming the right of a builder to cancel his registration with effect for all homes not yet notified to it. Any homes already notified to NHBC under the rules prior to notice of cancellation of a builder's registration being received by NHBC would remain covered by Buildmark, so that normal documentation would continue to be issued for them to their purchasers, and in respect of which the builder would retain all his liabilities under the scheme.

This change would be particularly helpful to medium- or large-size builders with a large number of homes in the course of construction at any one time. NHBC has told us that such a change would be acceptable and in any event it would propose to amend its rules in this way.

- (b) An additional new rule should be introduced under which a member cancelling registration with NHBC would be allowed to rejoin it at a later date without prejudice to his previous length of membership with NHBC.

Quite independently, NHBC would be free to take account of the member's claims record during his period of absence.

- (c) Rule 41 should be clarified to make clear that it is for the builder withdrawing from membership to decide whether to exercise his option to pay the lump sum to NHBC (as notified to him by NHBC) to cover his existing liabilities or to choose to retain his liabilities for the remainder of the initial two-year period for each new home.

8.101. If these changes were introduced to NHBC's rules we believe the adverse effects which we have identified would be sufficiently remedied. We do not believe that these changes would cause any detriment to the purchaser of new homes. We have noted (see paragraph 8.31) that NHBC itself has recognised that certain of its rules require some clarification.

Consequential changes to NHBC's rules

8.102. A number of consequential changes to NHBC's rules would be necessary as a result of the implementation of our recommendations.

Overview

8.103. Our report has been critical of certain of NHBC's rules and of some omissions from them. They are long-standing and require clarification and amendment, especially in the relatively new situation where direct competition is being provided by MMI, and to ensure that they do not deter further entry to the reference services market. We also received some complaints from purchasers of new homes about the operation of NHBC's scheme. It seems to us to be inevitable that a nation-wide scheme of this kind will not always work perfectly at the local level. Overall, however, we have been impressed by NHBC's achievements, which have been actively encouraged by the Government over the years, in improving

housing standards and providing much needed safeguards for the purchaser of a new home, and which we are anxious to preserve.

8.104. Our recommendations necessarily apply only to NHBC but we trust that the principles on which they rest, both in respect to the ability of members of a warranty scheme to remain in membership whilst placing new homes with alternative schemes of broadly comparable standard, and to transfer membership to other schemes, will be respected by present and future participants in the market.

D G GOYDER (Chairman)

P BRENNAN

J F PICKERING

S WAINWRIGHT

Mr J D Montgomery, being a member of the Group, dissents from certain of the conclusions for the reasons set out in the note of dissent included in this report.

S N BURBRIDGE (Secretary)
14 December 1990