PRIVATE MOTOR INSURANCE MARKET INVESTIGATION

Theory of harm 5: Analysis of vertical agreements for the supply of paint (excluding foreclosure)

Introduction

1. This paper considers the contracts between private motor insurance (PMI) providers and paint manufacturers or distributors, and their possible effects on competition. There is a range of such agreements. In general, the agreements provide for referral fees or rebates to be paid to insurers in return for them recommending (or mandating) the use of a particular paint brand to their network of approved repairers.

2. The main question we assess in this paper is whether these contracts lead to an increase in the billed cost of paint, which may increase the cost of non-fault claims if the billed cost is passed to the fault insurer without taking into account the referral fee or rebate income received. This may harm final consumers through higher PMI premiums. This issue is part of our analysis of theory of harm (ToH) 1, as it is a potential mechanism by which the separation of cost liability and cost control in the management of non-fault claims can lead to higher costs for fault insurers (see also the working paper 'ToH 1: Overcosting and overprovision of repairs'). We also consider in this paper some of the other concerns relating to the supply of paint which have been raised by various parties.

3. Another potential issue with paint supply contracts is whether they lead to vertical foreclosure, ie whether they provide a means for paint manufacturers or insurers to raise rivals' costs in a way that leads to a reduction in effective competition. We discuss this issue separately in the working paper 'ToH 5: Analysis of potential foreclosure as a result of vertical relationships'.

Summary

4. The contracts between insurers and paint manufacturers can be divided into two groups:

   (a) Non-exclusive contracts: Under these agreements, the insurer recommends a paint brand, and possibly a distributor, to its network of repairers and, in return, the paint manufacturer (and distributor) pays a fixed fee and/or per-repair fee to the insurer. The repairers retain some control over which paint to use. Such contracts exist between [✂], as well as between some claims management companies (CMCs) and paint marketing associations (PMAs).

   (b) Exclusive contracts: Under these agreements, the insurer mandates a paint brand, and possibly a distributor, to its network of repairers. [✂].

Non-exclusive contracts

5. It appears to us that repairers face slightly higher costs for paint as a result of the contracts between insurers and paint manufacturers. However, the evidence from repairers suggests that such cost increases are generally low, being not larger (and usually much smaller) than £18 per repair, which is a small percentage of the total cost of paint for insurers and around 1.5 per cent of the total cost of a repair. Moreover, we note that such cost increases are likely to be close to the level of rebates earned by insurers.

6. Since the rebates from paint manufacturers (and distributors) received by the non-fault insurer (in relation to non-fault claims) are not passed on to the fault insurer, the contracts lead to a difference between the effective cost of paint faced by the non-fault insurer (ie net of the rebate) and the cost incurred by the fault insurer (which pays the price which is higher than it otherwise would be). This difference is around [✂] to [✂] per repair. In our working paper 'ToH 1: Overcosting and overprovision of repairs' we estimate the total overcosting in repairs arising from the separation of

cost liability and cost control and this amount relating to paint supply contracts is one element of that overcosting.

Exclusive contracts: [✂]

7. [✂] This arrangement gives [✂] an incentive to set a high paint price for its repairers to pay to [✂], notwithstanding that this will result in a higher cost of paint in the repair bills it receives than would otherwise be the case.

8. When [✂] is the non-fault insurer, this structure of payments inflates the cost of repairs passed on to the fault insurer as the costs passed on are those reflected in the billed cost of paint and do not take account of the rebates received. However, our assessment finds that the cost of paint charged to [✂] by its approved repairers is in line with the prices agreed between other insurers and their approved repairers, which suggests that [✂] does not lead to a greater degree of overcosting than non-exclusive paint contracts (see paragraph 6). Separately, we note that, [✂] but it appears to us that this is another mechanism by which non-fault repair costs can be inflated before they are passed to the fault insurer (see the working paper 'ToH 1: Overcosting and overprovision of repairs') and is not dependent on [✂].

Other concerns

9. Currently, it appears to us that none of the other concerns which parties have raised in relation to paint supply contracts are likely to give rise to competition problems in relation to the supply of PMI and related services.[1]

[1] In our analysis we have considered whether such paint supply contracts might affect the provision of post-accident repair services covered by PMI. We have not considered whether such contracts might affect the conditions of competition in the paint market.

Structure of the paper

10. In the first part of the paper, we explain how the cost of paint is determined in the absence of vertical agreements between insurers and paint suppliers. We then describe such vertical agreements, distinguishing between non-exclusive contracts (with or without minimum volume requirements) and exclusive contracts (ie [✂]). We also discuss briefly agreements involving car manufacturers. We consider the implications of these agreements for repairs which are handled by other parties and non-insurance repairs. Finally, we consider to what extent the discounts and rebates stipulated in the contracts are passed on to fault insurers.

11. The second part of the paper considers the rationale for such agreements, including possible efficiencies. We also discuss possible sources of harm for consumers arising from them. Here we discuss whether such contracts contribute to overcosting (ie our hypothesis under ToH 1). We consider whether payments to insurers have a significant effect on the cost of paint and the extent to which they generate differences between the costs faced by different insurers. Finally, we discuss briefly other concerns parties have raised.

Background

12. Refinish paint accounts for around 20 per cent of the average billed cost of a post-accident repair.[2] Its price is determined by complex interactions between paint manufacturers, distributors, repairers, insurers or CMCs, and car manufacturers. We can distinguish between:

(a) the trade price of paint (ie the published list price);

(b) the wholesale price paid by paint distributors to paint manufacturers;

(c) the retail price paid by repairers to paint distributors; and

(d) the billed price, charged by repairers to insurers or final customers.

[2] See the working paper 'ToH 5: Analysis of potential foreclosure as a result of vertical relationships'.

13. In addition, rebates are sometimes paid by paint manufacturers or distributors to insurers, CMCs or car manufacturers (referred to by some parties as 'influencers') or to repairers.

Paint sourcing in absence of vertical supply contracts

14. Although there is a published trade price for each paint product, repairers do not typically pay this price. Paint distributors commonly offer large discounts to repairers, either reducing the price or establishing a parallel rebate.[3]

15. The cost of paint charged by a repairer to an insurer, is typically neither the trade price nor the price paid by the repairer but rather is based on the Audatex 'weighted average paint price'. This price is calculated by Audatex using a basket of trade prices and weighting them according to their respective market shares.[4] The repairer's price to the insurer is usually a percentage of this weighted average Audatex price, in particular where the repairer is part of the insurer's approved repair network (having had to compete to become part of this network).

16. We can illustrate the different prices for paint in an example.[5] Suppose that the paint needed for a repair has a trade price of £230 but the paint distributor charges a retail price to the repairer of £100. Suppose that Audatex calculates that the cost of paint for the repair, based on the weighted average paint price, is £250. When billing the insurer, the repairer will use the Audatex paint price as a reference but will apply a discount of, say, 20 per cent, resulting in a price billed of £200 (with the repairer making a profit of £100).

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[3] [✂] told us that its approved repairers [✂] negotiated rebates with paint suppliers independently. The rebates earned by [✂] totalled just under £[✂] in 2012.
[4] The paint brands included in the Audatex paint basket are PPG, Nexa Autocolor, Sikkens, Standox, Spies Hecker, DuPont, Glasurit and R-M.
[5] Please note that the prices are illustrative only and are not meant to reflect real prices.

17. It appears that the difference between retail prices and the prices billed to insurers is substantial. Repairers told us that the cost of paint was between 20 and 40 per cent of the Audatex weighted average paint price, while insurers were usually charged between 70 and 80 per cent of this price.[6] In absolute terms, it appears that repairers spend, on average, around £80 to £90 on paint per repair (less when they are free to choose their supplier) but bill insurers, on average, around £200 to £350.[7] According to TrendTracker, repairers, constrained by low labour rates and narrow margins on replacement parts, rely on the high margin they achieve on paint.[8]

Vertical supply contracts to source paint

18. Currently, five of the ten largest insurers have contracts with paint manufacturers: [✂]

19. Some of these agreements also involve PMAs (see Appendix 1). In addition, some CMCs (eg [✂] and [✂]) have similar paint supply agreements.

20. Such contracts are not standard practice as five of the ten largest insurers do not have them and we have seen no evidence that other insurers (outside of the ten largest) have them. However, the five insurers with such agreements had, in 2012, a combined share of [✂] per cent of the PMI market in the UK.[9]

Structure of the contracts

21. Although each paint supply contract is different, they can be divided into three groups:

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[6] [✂] told us that it paid 25 per cent of the Audatex price and received from insurers 70 per cent of this price. [✂] told us that it paid between 20 and 32 per cent of the Audatex price and usually charged 80 per cent of this price (although the amount could be as low as 50 per cent with some insurers). [✂]said that[✂]

[7] A repairer told us that it paid between £80 and £90, while charging around £180. It said that it would be able to save around £15 if it were free to choose its supplier. In [✂] if the repairer were free to decide on the paint used. [✂] seemed to suggest that average costs were even lower. For their average paint costs invoiced to insurers, repairers gave us the following values: [✂] (£243–£328), [✂] (£360), [✂] (£228), [✂] (£235–£250), [✂] (£275).

[8] 'The Future of the Car Body Repair Market in the UK', 2012–2017, p27.

[9] Based on data from the insurers. The estimated total market size is from Datamonitor report, p30, based on ABI data.

(a) *Non-exclusive contracts:* an insurer (or CMC) recommends a paint brand to its approved repairers for use on its repairs in return for a rebate ([✂]).

(b) *Non-exclusive contracts with minimum volume requirements:* an insurer (or CMC) recommends a paint brand for use on its repairs but the rebate is conditional on a minimum volume being purchased ([✂]); and

(c) *Exclusive contracts:* an insurer mandates a paint brand to its approved repairers for use on its repairs in return for a rebate ([✂]).

We discuss each in turn.

Non-exclusive contracts without volume restrictions

22. Table 1 summarizes the main characteristics of the [✂] non-exclusive contracts without volume requirements.

TABLE 1 **Paint supply contracts involving** [✂]

[✂]

Source: [✂]

23. The main characteristics of these contracts are:

- Insurers recommend a paint manufacturer (and possibly a distributor) to their repairers but the repairers are free to choose from which supplier to buy their paint. A typical clause specifies that the insurer shall 'use its best endeavours to persuade its approved repair network to utilise the supplier's refinish materials'.[10] In practice, it could be that this recommendation is interpreted by repairers as an effective mandate.[11]
- There is typically a flat fee and/or a rebate paid [✂].
- The fee is [✂].

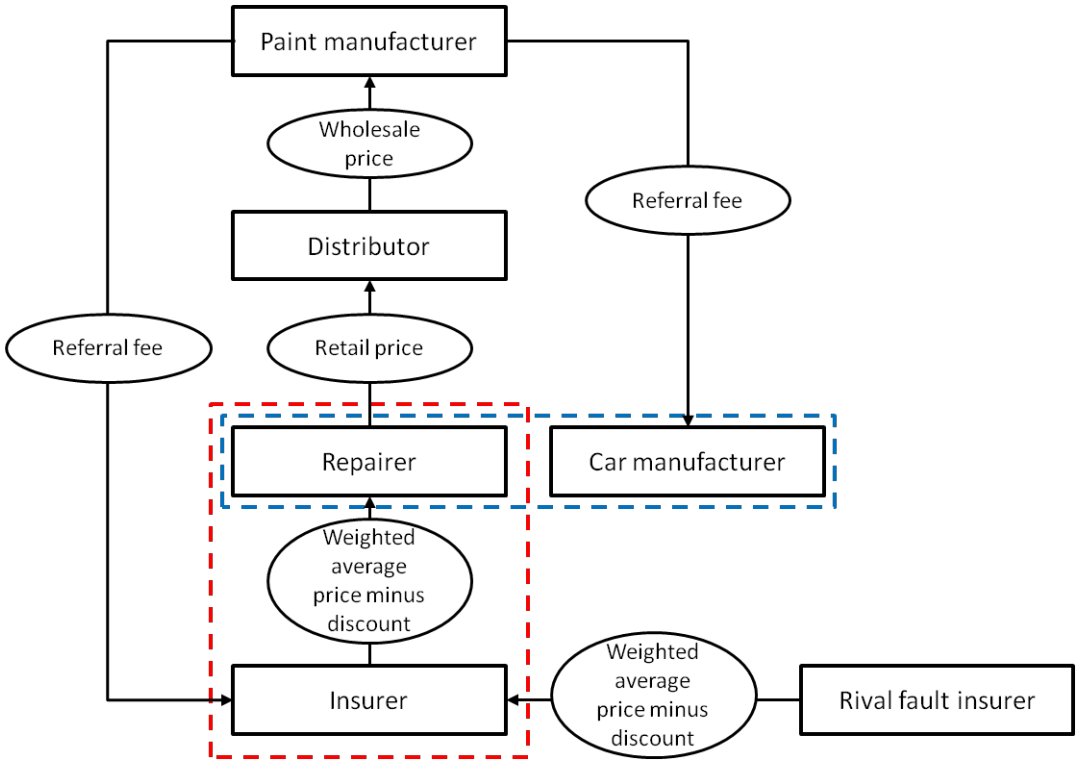
[10] [✂]

[11] For example, [✂] told us that [✂] mandated [✂] paint. [✂] said that 'often the recommendation is such that the business considers it to be mandated'.

24. Figure 1 shows a stylized example of such a contract between a paint manufacturer and an insurer, and the resulting payments. It also shows a concurrent contract (and referral fee payment) between the paint manufacturer and a car manufacturer. Figure 2 represents the case in which an insurer has agreements with both a paint manufacturer and a PMA.

FIGURE 1

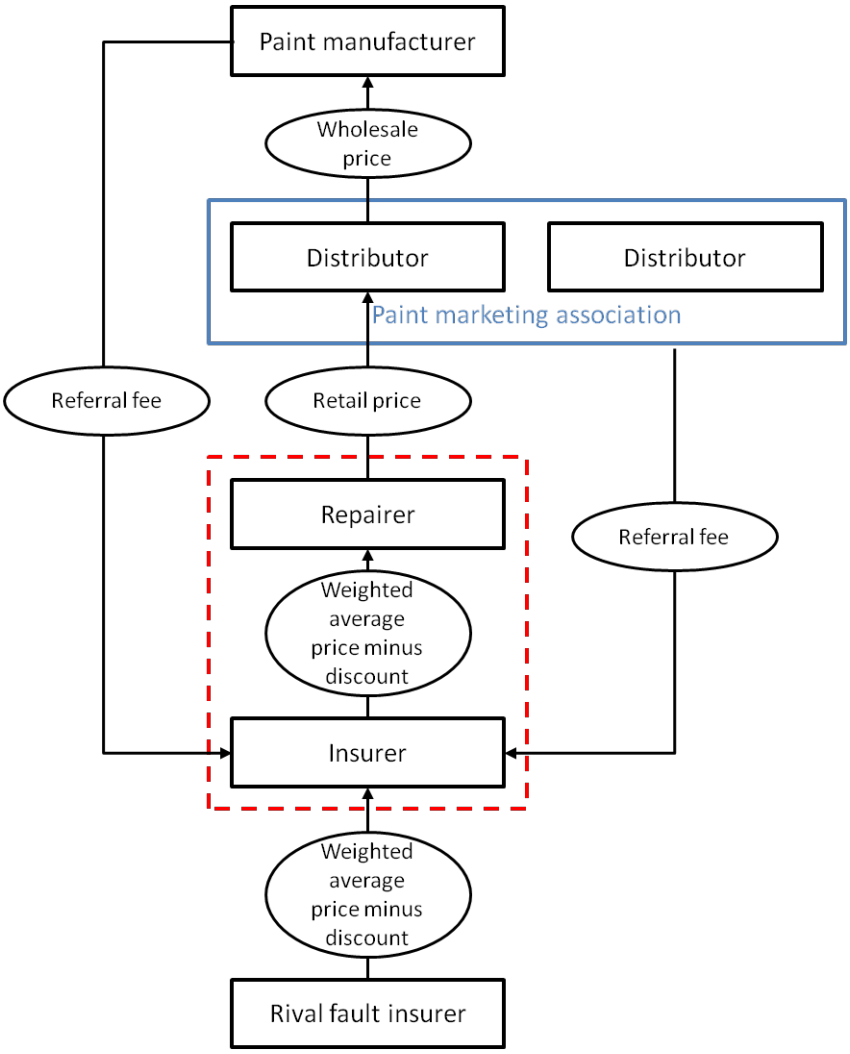
Contract between an insurer and a paint manufacturer



Source: CC analysis
Note: The repairer in the figure is approved by both the insurer and the car manufacturer.

FIGURE 2

Contracts between an insurer and both a paint manufacturer and a PMA



Source: CC analysis.

25. We can again illustrate the flow of funds in an example (using the numbers from paragraph 15).[12] Suppose that, for each repair in which the recommended paint is used, the paint manufacturer pays a rebate of £5 to the insurer. When the insurer is in the fault position, the net cost of a repair is £195 (ie it pays £200 to the repairer but receives a rebate of £5 from the paint manufacturer); but when the insurer is in the

[12] Please note that the prices are illustrative only and are not meant to reflect real prices.

non-fault position, it still receives the £5 rebate but bills the fault insurer the full £200,[13] making a profit of £5.

Non-exclusive contracts with minimum volume requirements

26. [✂] similar to the non-exclusive contracts described above. However, [✂] the rebate is conditional on a minimum spend per repair on paint and related consumables. Table 2 summarizes [✂] characteristics. The table also shows for comparison details [✂].

TABLE 2 **Paint supply contracts involving**[✂]

[✂]

Source: [✂]

27. In the [✂][14] This is equivalent to [✂]. One repairer told us that this minimum amount was in general substantially in excess of what it needed per repair.[15]

Exclusive contracts

28. The [✂] introduces a different system of rebates from the non-exclusive contracts discussed above.

29. [✂]. Table 3 shows the [✂].

TABLE 3 [✂]

[✂]

Source: [✂]

[13] We note that there are some exceptions, for example when the fault and non-fault insurer have signed a bilateral agreement.
[14] [✂].
[15] [✂] told us that 'you need to commit to the volume of spend of 3 jobs to [✂] for every [✂] job repaired'. However, another repairer provided an estimate of the average cost of paint in the absence of vertical agreements, on the basis of which it seems that the minimum volume requirement set by [✂] would be sufficient for at most 1.5 repairs.

30. [✂].

31. [✂] Figure 3 illustrates [✂].

FIGURE 3

[✂]

Source: CC analysis

32. We can again illustrate the flow of funds in an example (using the numbers from paragraph 15).[16] Suppose that the amount of paint required for a repair costs [✂]. In this case, [✂].

33. Figure 4 illustrates [✂]

FIGURE 4

[✂]

Source: CC analysis
Note: [✂]

34. We can again illustrate the flow of funds in an example (using the numbers from paragraph 15).[17] Suppose that the amount of paint required for a [✂]. Figure 5 illustrates this numerical example.

FIGURE 5

[✂]

Source: CC analysis

35. [✂].

36. [✂].

[16] Please note that the prices are illustrative only and are not meant to reflect real prices.
[17] Please note that the prices are illustrative only and are not meant to reflect real prices.

Contracts involving car manufacturers

37. Contracts similar to those between paint suppliers and insurers (and CMCs) also exist between paint suppliers and car manufacturers. Car manufacturers have their own networks of approved repairers to which they may recommend the use of specific paint brands, in return for a fee.

38. Some car manufacturers have agreements with paint manufacturers (eg [✂]), some have agreements with paint distributors or PMAs (eg [✂]) and some have agreements [✂]. The fees earned may be either fixed or proportional to the value of the refinish paint sold to the manufacturer's approved repairers. In 2012, the fees received by [✂] from two paint manufacturers totalled £[✂], while [✂] received a total of £[✂] from [✂].

39. As these fees accrue to car manufacturers, the potential cost increases affect all insurers, irrespective of whether they are in the fault or non-fault position (ie the separation of cost liability and cost control applies to both fault and non-fault claims).

40. The same repairer can belong to the network of more than one insurer and car manufacturer, and different insurers/manufacturers might have agreements with the same paint supplier. In this case, a fee would be paid by the paint supplier to all the insurers and manufacturers entitled to it; however, some adjustments are usually applied to take into account the presence of multiple work providers. (For example, [✂] records sales against each repairer and allocates them to different work providers in order to calculate a theoretical maximum number of paint jobs, which may be lower than the amount claimed by each insurer/manufacturer ([✂]). Similarly, [✂] crosschecks the number of repairs reported to it by work providers with the sales volumes to repairers communicated to it by its distributors.) It appears to us that, due

to these controls, rebates are not usually paid to multiple insurers and manufacturers for a single repair.

Implications for repairs handled by other insurers or non-insurance repairs

41. Although repairers are free to choose the paint they use for all repairs they conduct for parties which do not have paint supply contracts, an effect of the paint supply contracts which exist might be to restrict this choice in practice, especially if the repairer is small, for the following reasons:

(a) each paint requires the use of specific equipment so using multiple paint brands is costly (in terms of physical infrastructure and training);

(b) repairers can obtain better retail prices if they purchase larger volumes of paint so they would prefer to use a single brand;[18] and

(c) where there are volume requirements in a paint supply contract [✂], the paint purchased under the contract might be more than is needed, with the excess used in other repairs.

42. Different repairers adopt different strategies: some use only the brands which they are required (or encouraged) to use by some of their work providers; others use a different brand of paint when they are free to choose.

Costs passed on to fault insurers

43. In general, insurers told us that they passed on to the fault insurer the repair bill as they received it from the repairer. Moreover, repairers told us that when they were an approved repairer and they calculated a repair bill for their work provider, they did not take into account whether the customer was a fault or non-fault claimant. On the basis of this evidence, it appears to us that non-fault insurers generally pass on the

[18] In 2012, [✂] used paint only from those suppliers which were mandated by insurers, in order to achieve volume discounts. However, it told us that it was moving away from this model.

discounts (on invoice) they obtain from repairers but do not pass on the rebates they receive from paint manufacturers or distributors (or others, including the repairers themselves).[19]

Business rationale for paint supply contracts

44. We asked insurers about their incentives for entering into vertical paint supply contracts. All the insurers mentioned similar reasons:

(a) to ensure that the paint used is of an appropriate quality;[20] and

(b) to achieve cost savings.[21]

45. [✂] told us that, using its bargaining power, it believed it was able to negotiate better terms with suppliers than each repairer could gain individually. [✂] said that, moreover, it was confident that it was achieving the most competitive price that it could for the paint used [✂] added that there were also administrative efficiencies from using a single supplier, though it could not quantify these savings.

46. [✂] told us that it entered into an agreement with [✂] because [✂] could negotiate better discounts, due to its collective purchasing volume, and then pass on these discounts to [✂]. However, we noted that [✂] negotiates directly with individual distributors (not with [✂]).[✂] said that it estimated it saved [✂] per cent in its purchasing of certain non-paint goods due to using [✂] as its distributor, but it did not provide an estimate of its savings on paint costs from this agreement.

47. Paint manufacturers told us that their rationale for vertical supply contracts was to facilitate their access to large repair networks. Similarly, [✂].

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[19] We note that there are some exceptions, for example when the fault and non-fault insurer have signed a bilateral agreement (eg where [✂] is the non-fault insurer and [✂] is the fault insurer, [✂] passes on to [✂] (with which it has a bilateral agreement) the rebates it receives from [✂]).

[20] This rationale was mentioned by [✂].

[21] This rationale was mentioned by [✂].

48. We noted that [✂].

49. We did not see any efficiencies arising from minimum purchase volumes per repair (such as [✂]).

Allegation of raising costs for rival insurers

50. In this section we discuss whether the vertical paint supply contracts might have the effect of raising costs billed to rival insurers. We consider non-exclusive and exclusive contracts separately.

Non-exclusive contracts

Reduced competition leads to higher costs for repairers

51. It appears to us that, as a result of the contracts between paint suppliers and insurers (and CMCs), repairers face higher retail prices for refinish paint than would otherwise be the case (see paragraph 59). One repairer told us that it could procure paint for around £15 less per repair if it were free to choose its supplier. [✂] made a similar remark.

52. It appears to us that the fact repairers buy the brands of paint recommended to them by insurers (and CMCs), despite them being more expensive than the paint they would otherwise choose, is indicative of the pressure put on them by insurers. [✂] told us that 'often the recommendation is such that the business considers it to be mandated'.

53. We note that the contracts between insurers and paint suppliers reduce competition at the retail level, changing the relative bargaining power of repairers and paint suppliers in favour of the suppliers. In the contracts involving [✂], competition between distributors appears almost completely eliminated as repairers are

recommended to buy a specific brand through a specific distributor; however, the contracts involving [✂] appear to preserve competition between distributors, with only the paint brand being specified. The rebates paid to insurers could be seen as the way in which insurers extract from paint suppliers the additional profits they enable them to make.

Higher costs for repairers may be reflected in the bills invoiced to insurers

54. Higher paint costs for repairers may (or may not) be reflected in the bills they charge to insurers. At one extreme, if the higher cost is not passed on, paint suppliers and insurers (through the rebates they receive) may be benefitting from reducing repairers' profits. In this case, the contracts could be beneficial to PMI consumers, as insurers might be expected to pass on their additional income in lower PMI premiums. At the other extreme, if the higher cost is passed on, insurers' claims costs might be expected to increase by as much as they make from the paint supply contract, or possibly even more.[22,23] The reason why an insurer may prefer rebates from the manufacturer, notwithstanding a higher billed cost of paint from the repairer is due to the separation of cost liability and cost control, as it achieves the benefit in all cases and only incurs the higher cost when it is liable for the cost of the claim.

55. The extent to which the increase in paint cost is extracted from the paint supplier by the insurer as a rebate depends on the relative bargaining power of insurers and paint suppliers. If paint suppliers are in a strong bargaining position, they will increase the retail price as much as possible and pay a small rebate; however, if

[22] The increase in the cost of paint billed to an insurer might be higher than the rebate it receives from the paint supplier. For example: suppose that a paint supply contract results in a £7 increase in the retail price of paint to a repairer and this higher cost is fully passed on, and suppose that the paint supplier pays the insurer £5 for each repair conducted by one of the insurer's approved repairers. If the insurer is at fault, it then loses £2 per repair compared with the prior situation; however, in all other cases it gains £5. (Please note that these prices are illustrative only and are not meant to reflect real prices.)

[23] The extent to which costs are passed through the supply chain will depend on the relative bargaining power of paint suppliers, repairers, and insurers, and the competitive pressure in the paint and repair markets. It will also depend on whether payments to insurers are fixed or on a per-repair basis ([✂]) Per-repair payments have a direct impact on the suppliers' marginal cost and a profit-maximizing supplier would respond by increasing its prices; fixed fees do not change the marginal cost of producing and distributing paint, so they are unlikely to determine price increases in the short term.

insurers are in a stronger position, they will extract a high rebate. We note that if all of the higher cost to repairers is passed on to insurers and paint suppliers retain some of the additional revenue (ie it is not all extracted by insurers in rebates), then paint supply contracts are unlikely to be beneficial to PMI consumers overall as there is likely to be some 'leakage' of value to paint suppliers and claims costs overall are likely to have risen.

56. Overall, we note that the amount by which some insurers benefit when in the non-fault position due to their paint supply contracts (typically around £[✂] to £[✂] per repair) is small relative to the average billed cost of paint and even smaller relative to the average total cost of a non-fault repair.

Minimum volume requirements

57. The minimum volume clause in [✂] introduces an additional potential source of cost increase. This clause appears to set the sales volume higher than is needed, causing some of the paint bought under the agreement to be used on repairs for work providers other than [✂], including non-insurance repairs.[24] We note that the costs billed to insurers are related to the actual volume of paint used for the repair, and not the, potentially higher, minimum purchase level, but it appears to us that the surplus paint may lead to a higher paint cost for other repairs if the repairer would otherwise have sourced the required paint more cheaply (and the customer does not have the bargaining power to avoid the cost increase).

Direct effect of contracts on PMI consumers[25]

58. In order to estimate the direct effect of the paint supply contracts on consumers, we considered:

[24] A similar effect arises if repairers prefer to use only recommended brands because of the additional cost associated with the use of multiple brands (see paragraph 41).
[25] In our analysis we have considered whether such contracts might affect the provision of post-accident repair services covered by PMI. We have not considered whether such contracts might affect the conditions of competition in the paint market.

(a) the magnitude of the increase in the billed cost of paint;

(b) whether the increase in the billed cost of paint is higher than the rebates earned by insurers (to assess the extent of 'leakage' to paint manufacturers);

(c) whether any saving to a repairer from not having the paint supply contract would be passed on to insurers.

59. Using the data from Tables 1 and 2, we estimate that rebates are, on average, between [✂] and [✂] per repair.[26] We asked repairers to estimate the effective cost increase due to the contracts and they told us that, using a paint brand different from that recommended by insurers but of comparable quality could generate savings of up to between £[✂] and £[✂] per repair, or between [✂] and [✂] per cent of the cost of paint in a repair.[27] Repairers told us that the saving would be mostly due to higher volume discounts from using only one paint brand. Most repairers told us that using recommended distributors would not give rise to significant cost increases (and any cost increase would be difficult to quantify). However, one repairer told us that using different distributors could save it up to [✂] per cent of its total cost of paint.[28]

60. Overall, it appears to us that the cost increases due to the paint supply contracts are likely to be close to the level of rebates earned by the insurers which are party to those contracts. There might be cases in which the cost increase is higher than the rebate earned, but the difference is likely to be very small. In other words, it appears that insurers extract the vast majority of the additional profit generated by paint suppliers from the paint supply contracts.

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[26] [✂].

[27] For example, [✂] told us that it could save up to £18, corresponding to 30 per cent of its paint costs. [✂] estimated savings of £6.40, out of an average spend on paint of £80 per repair. [✂] and [✂] told us that no significant savings could be achieved.

[28] According to [✂], savings would not be significant. Similarly, [✂] was not able to quantify them. However, [✂] estimated that it could save up to [✂] per cent of costs were it not to use the distributors recommended to it [✂].

61. We considered whether, were a repairer free to choose its paint supplier, and so generate a saving, it would pass on this cost saving to insurers. This would require insurers to renegotiate their repairer agreements, which we understand currently happens infrequently (see paragraph 72). Moreover, the fact that repairers usually make reasonable margins on paint (compared with labour and parts (see paragraph 17)) suggests that insurers may not go to great lengths to appropriate the savings. One repairer told us that savings on paint would amount to an additional [✂] per cent profit, which seems to imply that gains would not be passed through.[29]

62. We also note that the contracts between paint suppliers and insurers may generate efficiencies along the supply chain (see paragraph 44), some of which might result in reduced costs to consumers.

63. Overall, since cost increases arising from paint supply contracts are small relative to the average repair bill, and similar to the level of the rebates paid to insurers,[30] and given that it seems unlikely that repairers would pass on fully to insurers any savings from not having these contracts, it appears to us that harm to PMI consumers is unlikely to arise directly from these contracts. We note that harm to consumers might still arise indirectly due to these contracts inflating non-fault repair costs (see paragraph 54).

Exclusive contracts (with a specific referral fee structure)

64. Under the [✂]. We have investigated whether this leads to an inflation of costs of repairs passed on to fault insurers [✂] over and above the effects identified in paragraphs 54 to 56. There are two ways [✂] might achieve this: *(a)* its repairers

[29] On the other hand, [✂] estimated that a potential £18 saving would translate into an average reduction in the invoiced bill of £[✂]. However, this was based on the assumption of a fixed percentage profit margin. [✂] recognized that this may not be the case.
[30] [✂].

might give less of a discount off the Audatex weighted average paint price; and/or *(b)* it might 'inflate' the Audatex weighted average paint price. We discuss each in turn.

Raising costs to rivals through giving less of a discount off the Audatex weighted average paint price

65. One way to 'inflate' repair bills is to give less of a discount off the Audatex weighted average paint price. [✂][31]

66. Similarly, [✂][32]

67. However, we also note that there may be reasons for [✂].

68. It appears to us that the data suggests that [✂].

69. An analysis of billed paint costs [✂].

70. Overall, it appears to us that [✂] does not lead to [✂] repair bills from repairers which are significantly inflated compared with those where there is a non-exclusive contract through [✂] less of a discount off the Audatex weighted average paint price.

Raising costs for rivals through manipulation of the Audatex weighted average paint price

71. An alternative way to 'inflate' repair bills is to increase the Audatex weighted average paint price. However, we note that this would only have an effect if insurers could not quickly renegotiate their contracts with repairers to take into account the new base price. Therefore we considered the nature of these negotiations.

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[31] [✂].
[32] [✂]

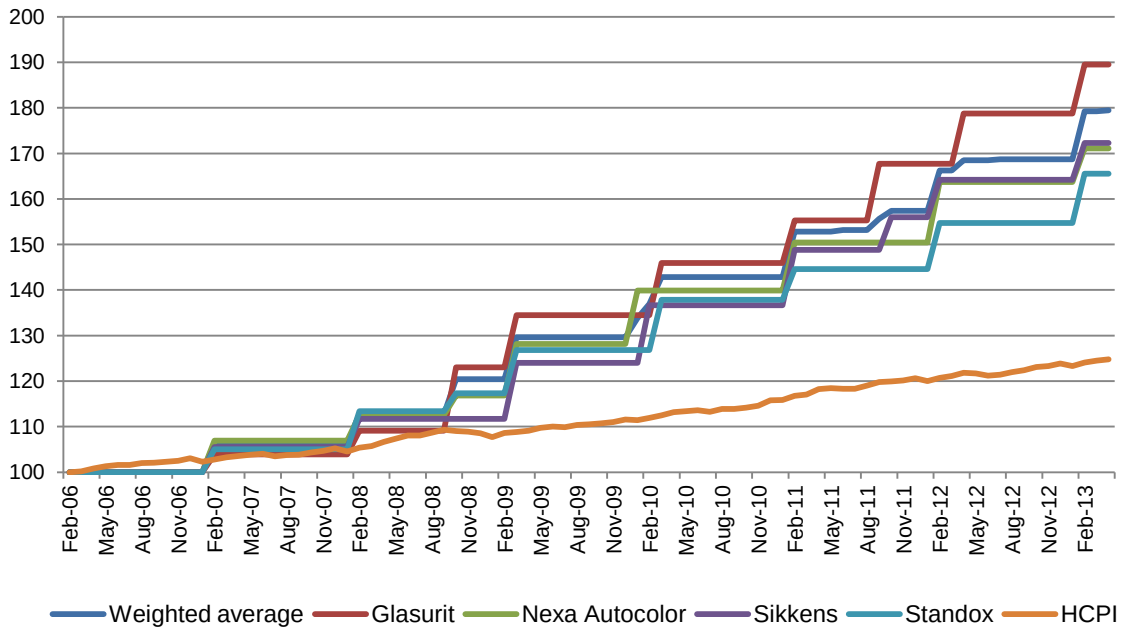
72. We found that insurer practice varied. Some insurers, like [✂] and [✂], told us that they would not renegotiate the discount in their contracts with repairs were there to be an increase in the Audatex weighted average price, assuming the increase was justifiable. Other insurers told us that they would consider renegotiation if it increased by 5 per cent. [✂] told us that, if there were a 10 per cent increase, it would immediately renegotiate its discount. In general, however, we found that renegotiations are infrequent. On this basis, the strategy of inflating rival costs through increasing the weighted average paint price could be effective, so we considered it further.

73. We noted that [✂].

74. However, we considered the change over time of the trade price [✂]. Figure 6 compares the trade prices of the bestselling brand of each of the four main paint manufacturers for the last seven years.

FIGURE 6

Increase in trade prices since 2006



Source: Audatex, Eurostat.

75. We recognized that the impact of the price increase of a given paint brand on the weighted average paint price did not depend on the percentage increase but on the absolute increase, as a similar percentage increase of a more expensive brand would have a greater effect. We noted that [✂][33]

76. Overall, it appears to us that the change in trade price of [✂] and the impact of [✂] on the Audatex weighted average paint price has been similar to that of other leading paint brands.

Further concerns

77. Through the course of our inquiry so far, we have heard a number of other concerns in relation to paint supply contracts. In this section, we consider some of these concerns.

78. RML and the VBRA have argued that the DLG/Akzo paint supply agreement reduces competition between paint distributors, resulting in higher prices for repairers and to consumers. We have considered their concern from the perspective of any effect on the provision of post-accident repair services covered by PMI (we are not, in our investigation, examining the conditions of competition in the paint market). Within this context, it does not appear to us that a retail price negotiated directly between an insurer and a paint manufacturer will necessarily lead to higher prices compared with a situation where each repairer is free to choose a distributor from which to source a mandated paint brand (in particular given the bargaining power of insurers).

79. Hex told us that paint manufacturers forbid distributors from purchasing paint from outside the UK, which, it said, amounted to a restriction on parallel trade. However, it appears to us that, if the case, this would be an issue relating to the supply of refinish

[33] [✂]

paint overall, rather than one linked to post-accident repair services covered by PMI. Therefore, we did not believe that it would fall within the focus of our inquiry and did not consider it further.

80. RML and the VBRA raised an additional concern related to the DLG/Akzo agreement, saying that [✂] paint could cause customers to lose their car manufacturer's anti-corrosion warranty (if the warranty is linked to the use of other brands of paint). They told us that the warranty offered by [✂] might not be a reasonable substitute, as it would be underwritten by the repairer and not by [✂]. DLG told us that it offered all its customers a five-year guarantee on all repairs, or the manufacturer warranty period, whichever was longer. Therefore, it appears to us that if there is a problem it would relate to [✂]. However, we note that [✂]. In those cases, the repairer is free to choose any paint brand so it is a matter for the repairer (and work provider) to agree with the customer the most appropriate paint to use. Therefore, it appears to us that this issue is likely only potentially to affect non-fault claimants captured by DLG.[34]

81. RML and the VBRA also said that a higher billed cost of paint may affect a customer's decision on whether to claim on their insurance or to pay for the repair themselves. They said that some customers, who might have preferred to meet the repair costs themselves, will end up claiming, so losing their no claims bonus, resulting in a higher PMI renewal price. However, it appears to us that the small increase in the billed cost of paint because of vertical paint supply contracts is unlikely to 'tip the balance' of whether to claim or not in most cases. The increase in the cost of paint is a very small fraction of the average total repair cost (see paragraph 59).

[34] In our analysis we have considered whether this agreement might affect the provision of post-accident repair services covered by PMI. We have not considered whether this agreement might affect the conditions of competition in the paint market.

82. NAB raised an additional concern, saying that the way in which Audatex established the weighted average paint price used for its cost estimates could skew paint manufacturers' pricing.[35] It said that every year the UK's four principal paint suppliers provided Audatex with details of their proposed price increases. This data was then embedded in the Audatex estimating system. NAB told us that these increases could often be significantly above the rate of inflation and that the insurers' use of the weighted average paint price led to large annual increases in the price of paint. However, as far as we are aware, repairers do not usually charge the Audatex weighted average paint price to insurers, but use it as a reference point when agreeing a price (see paragraph 15). Also, although renegotiations are not frequent and there may be a lag between an increase in the Audatex price and a resetting of the discount, insurers told us that they would renegotiate discounts, especially if they considered an increase in the Audatex price to be unjustified (see paragraph 72). Moreover, we see no reason why insurers and repairers could not negotiate their paint prices without reference to an index at all, should that index become less helpful.

[35] In our analysis we have considered whether this concern might affect the provision of post-accident repair services covered by PMI. We have not considered how this concern might affect the conditions of competition in the paint market.

Paint marketing associations

1. PMAs are associations of paint distributors. There are four PMAs operating in the UK: ACIS, IRIS, NIBS, and UPD. Table A1 shows the members of each PMA.

TABLE A1 **Members of PMAs**

Distributors	*ACIS*	*IRIS*	*NIBS*	*UPD*
Autotrade Centre		x		
BeeBee refinish supplies		x		
Body & Paintshop supplies			x	
Carlac			x	
Coachfinish		x		
Cunbar			x	
Dingbro	x	x		
F&K Griffiths			x	
Fleet Factors				x
Gils			x	
Granlyn	x			
Grove Group (also known as G Mitchell)	x			x
Invicta paints		x		
JCA	x	x	x	
JS Husseys & Co			x	
Karkraft	x	x	x	
MacGregor			x	
Mallaband			x	
MKPE	x	x		
Movac	x		x	
Premier Paints		x		
Rainbow Paints		x		
Sayers	x			x
Sinemaster		x		
Supertune Automotive	x			
TRI			x	
Waregrain			x	
Wood Auto Supplies		x		

Source: PMA's websites.

2. Each PMA has agreements with paint manufacturers to represent some or all of their brands. The PMA's members must be distributors of at least some of these brands. Table A2 shows the brands represented by each PMA.

TABLE A2 **Brands represented by PMAs**

Manufacturers	*Brands*	*ACIS*	*IRIS*	*NIBS*	*UPD*
PPG	PPG		x		
	Nexa Autocolor	x	x		
	Max Meyer (B)		x		
DuPont	Spies Hecker			x	
	Standox		x		
	Dupont				x
Akzo	Sikkens	x	x		x
	Lesonal (B)		x		x
BASF	Glasurit	x		x	
	RM		x		
Valspar	Octoral (B)		x		
	DeBeer (B)				
Lechler (B)					
Sherwin Williams (B)			x		

Source: ACIS; and the other PMAs' websites.

Note: B denotes a 'budget' brand. None of these are recommended by insurers or car manufacturers.

3. The same brand can be represented by more than one PMA. Also, paint manufacturers sell the same brands of paint to other distributors which are not members of PMAs. There are many more distributors which are not members of PMAs than distributors which are.

4. Paint manufacturers usually determine the terms of the supply of their products through agreements with individual distributors, not with PMAs. However, PMAs may receive marketing fees from manufacturers. For example, [✂]. Marketing fees are also paid by paint manufacturers directly to individual distributers.

5. The main purpose of a PMA is to negotiate a national paint supply contract with a repair network or a repair work provider. PMAs have negotiated a number of such agreements with insurers, CMCs and car manufacturers. [✂] has agreements with [✂]. [✂] has contracts with [✂] car manufacturers ([✂]),[✂] CMCs and a car dealership ([✂]) which [✂].[✂] has agreements with [✂] and [✂], among others.

6. In most contracts, the PMA is given the status of a preferred distribution partner and it pays a rebate to the other party (ie the insurer, CMC, car manufacturer or dealership). In 2012, [✂]. However, paint prices are usually agreed between the

repairer and an individual distributor. Typically, the PMA will negotiate a maximum price to be paid by the repairer, but the repairer can negotiate a lower price with an individual distributor member of the PMA.

7. Members of a PMA are in theory free to compete against each other. However, in practice, competition might be limited, in particular by different members having a different geographic focus. For example, [✂] told us that it assigns each member a (non-exclusive) post code area. Moreover, when [✂] is a preferred distributor partner, unless otherwise instructed by its client, it gives a repairer the contact details of the repairer's two closest distributors (though all of its members' contact details are published on its website). We also note that, as a result of membership, there could be an implicit threat that any member which acts to the detriment of its fellow members might be expelled. [✂] added, though, that all its members still compete for business against external competition.