

Allianz Insurance plc

Finance

Inquiry Manager
Private Motor Insurance Market Investigation
Competition Commission
Victoria House
Southampton Row
London
WC1B 4AD

Direct Tel 01483 553149
Direct Fax 01483 529259
Email steven.hutchings@allianz.co.uk
Our Ref
Your Ref
Date 09 January 2013

Dear Sirs,

Competition Commission (CC) - Private Motor Insurance (PMI) Market Investigation

Allianz Response to Statement of Issues

Introduction

1. Allianz Insurance Plc (Allianz) is one of the largest general insurers in the UK with a substantial motor book of business deriving approximately 120,000 claim reports per annum.
2. Allianz has an interest in the CC investigation as both a provider of PMI and its involvement within a market where it considers that there are distortions created by some of the arrangements that are in place.
3. A recent legal challenge to one of those arrangements, a vertically integrated repair model operated by RSA Insurance (RSAI), highlights some of the difficulties arising: see the judgments of the Commercial Court in *Coles and Others v Hetherington and Others* [2012] EWHC 1599 (Comm) and [2012] EWHC 2848 (Comm).
4. Whilst this document specifically refers to RSAI's vertically integrated repair model (RSAI Type Repair Model), the way in which it is operated, and the issues it raises that is purely due to the fact that this model is known and, following the two hearings, is a matter of public record. RSAI's model therefore becomes the known example of the type that raises concerns. It may be that other insurers operate similar models, which may also include dual pricing models, of which we have no detailed knowledge. For this reason the response refers to the RSAI Type Repair Model.
5. Allianz is highly concerned by the RSAI Type Repair Model as described below. Allianz estimates,

Allianz Insurance plc
57 Ladymead, Guildford
Surrey GU1 1DB
Tel 01483 568161
Fax 01483 300952
Telex 859383 Minicom 01483 578101
www.allianz.co.uk

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is authorised and regulated by the
Financial Services Authority

Registered in England number 84638
Registered Office: 57 Ladymead
Guildford, Surrey GU1 1DB

following engineers' assessment of claims received from RSAI, that the model increases repair costs by approximately 25% on average. This estimate accords with the assessment of HHJ Platt in *Harkers v Fallows* [2011] EW Misc 16. We believe this represents the biggest unrecognised threat to premium inflation and for that reason, in the hope of highlighting this to the CC, have consciously decided to restrict our response to this single issue.

6. The structure of this response initially focuses on the impact of the RSAI Type Repair Model on the Theories of Harm (TOH). The subsequent sections describe the RSAI Type Repair Model and the key decisions in *Coles and Others v Hetherton and Others*.
7. It will assist the reader to know at this stage that Motor Repair Network Management (MRNM) is the trading name of RSA Accident Repairs Ltd. RSA Accident Repairs Limited is a company in the same group of companies as RSAI.

Executive Summary

8. Allianz welcomes the opportunity to comment on the TOH as contained and explained in the Statement of Issues. In addition to comments on the TOH, Allianz draws the attention of the CC to recent litigation, as referred in the introduction to this document, which underlines the nature and structure of the market. While the CC is likely to already have some knowledge of these challenges, Allianz believes that an understanding of the matters raised therein will be instrumental in framing the Investigation. Accordingly, a detailed overview of the legal issues that arose in the challenges will be provided below, under "The RSAI Type Repair Model".
9. According to the decision in *Coles and Others v Hetherton and Others* there is no duty to mitigate vehicle damage repair costs. This could be exploited by insurers.
10. In Allianz's view the way in which the RSAI Type Repair Model is operated differentiates between commercial and private insurance. In its evidence RSAI has specifically stated: "under its model RSAI has consistently agreed with MRNM that a different scale of rates should apply where the repairs are for a business line policyholder. For those policyholders the cost of repairs are limited to the amounts MRNM could agree with subcontractors. There are very good reasons for this different treatment. When business policyholders seek competitive quotations from other insurers, those quotations will generally be based on net claims for the particular policyholders, so it is in their interest for their particular claims costs to be as low as possible. By contrast, the rating of personal lines premiums is generally based on a much wider range of criteria, which may not necessarily reflect the claims costs of the individuals concerned."
11. The RSAI Type Repair Model may have a very significant horizontal impact if widely adopted by other insurers, which commercial pressures may dictate. It will increase claims costs and premiums. Smaller insurers with less commercial leverage would suffer the greatest impact. That could lead some insurers to exit the market reducing the level of competition.
12. Allianz estimates, following engineers' assessment of claims received from RSAI, that the RSAI Type Repair Model increases repair costs by approximately 25% on average. This estimate accords with the assessment of HHJ Platt in *Harkers v Fallows* [2011] EW Misc 16.
13. Allianz believes the RSAI Type Repair Model represents the biggest unrecognised threat to premium inflation and for that reason, in the hope of highlighting this to the CC, have consciously decided to restrict our response to this single issue.
14. Allianz suggests that the CC focus considerable attention on TOH 5.
15. The paragraph numbers cited below reflect the paragraph numbering within the Statement of Issues.

Comments on Theories of Harm – impact of the RSA Type Repair Model

TOH 1: Harm Arising from the separation of cost liability and cost control (moral hazard)

16. *Paragraph 20.* In this paragraph it is noted that the only control on cost is the non-fault party's legal duty to mitigate his loss. Allianz do not accept that on the current state of the law as interpreted by Cooke J in *Coles v Hetherton*, as further detailed below, this is a correct statement, as:
- 16.1 Cooke J decided that the loss suffered from the physical damage to the vehicle is the diminution in value and is suffered at the moment of impact – i.e. a direct loss. That loss is usually, albeit not always, measured by the cost of the repairs to that vehicle. It must only be proved to be a commercially reasonable sum to claim, so may for example be established by engineering evidence or estimates.
- 16.2 Cooke J found that issues of mitigation may apply to consequential loss, such as hire of a vehicle, but not to the direct loss itself as that loss crystallises at the moment of impact. Therefore, on the assumption that Cooke J is right, there is no control on costs delivered by "the non-fault party's legal duty to mitigate his loss", it is merely a measure of what is commercially reasonable.
17. *Paragraph 23.* Allianz notes that the explanation of Conditional Fee Arrangements (CFAs) provided in this paragraph may not be entirely accurate. For CFAs entered in to after s. 44 of the Legal Aid, Sentencing and Punishment of Offenders Act 2012 comes in to force, the success fee charged by the solicitor will no longer be recoverable from the paying party.
18. *Paragraph 26.* Whilst Allianz accepts that the model at Figure 2 is accurate, it does not indicate that, in reality, many of the payments made for repairs by at-fault insurers are made either directly, or following subrogated claims, to the not at-fault insurer. The fact that these claims are subrogated creates real difficulty in challenging behaviours, as has been demonstrated by the decision in *Coles v Hetherton*.
19. *Paragraph 27.* The scenarios and examples set out in subparagraphs 27(a) and (b) are aptly demonstrated by the scenarios considered below, where the driving ethos is the generation of profit for the insurer, rather than just putting the insured back in to the position that they would have been but for the accident.
20. *Paragraph 29.* Again, the RSAI Type Repair Model described below gives a real competitive advantage to those applying it. That competitive advantage would be eroded if all insurers were to adopt this model. Ultimately, the only party being disadvantaged would be the premium-paying public.

TOH 2: Harm arising from the beneficiary of post-accident services being different from and possibly less well-informed than the procurer of those services

21. *Paragraph 40.* The RSAI Type Repair Model demonstrates that there is a divergence of interests on this point. One point to note on the RSAI Type Repair Model is that where an insured is required to pay VAT on the repairs, no charge is made for sundry services. In their evidence on this point RSAI note "under its model RSAI has consistently agreed with MRNM that a different scale of rates should apply where the repairs are for a business line policyholder. For those policyholders the cost of repairs are limited to the amounts MRNM could agree with subcontractors. There are very good reasons for this different treatment. When business policyholders seek competitive quotations from other insurers, those quotations will generally be based on net claims for the particular policyholders,

so it is in their interest for their particular claims costs to be as low as possible. By contrast, the rating of personal lines premiums is generally based on a much wider range of criteria, which may not necessarily reflect the claims costs of the individuals concerned."

22. Clearly, therefore, keeping costs low for policyholders in personal lines cases is not a priority. RSAI subsequently observe that: "Therefore, these policyholders are best served by the RSAI model being applied in the usual way which keeps premiums low across the board".
23. It is RSAI's contention that, as commissions are paid to RSAI from MRNM, they are able to use this income to keep premiums low. This only works however, as long as they are the only company using this model, as the increased costs created by all insurers adopting this model across the board, would negate profits made.

TOH 3: Harm due to horizontal effects (market concentration)

24. *Paragraph 47.* The vertical RSAI Type Repair Model as described below may have significant horizontal effects if it were adopted more widely. Smaller insurers would be impacted most by the significant additional costs that this would generate in the system. In turn, this may reduce the viability of the PMI market for them and could lead to potential exits from the market, which would put a strain on overall competitiveness.

TOH 4: Harm arising from providers' strategies to soften competition

25. Allianz has no further comments on this TOH.

TOH 5: Harm arising from vertical relationships (vertical integration)

26. *Paragraphs 100 – 102.* Allianz suggests that the CC focus considerable attention on this TOH. Allianz sets out, below, the significant difficulties that insurers have faced in challenging such arrangements via the legal process. From the description given, Allianz would question whether it is the vertical model itself that creates harm, or the nature of the particular model described below and the additional layers of costs that it allows to be added in to the repair process.

The RSAI Type Repair Model

Factual background

27. Allianz, as part of a group of 11 insurers, challenged the vertical arrangements that RSAI put in place with their repair network. The initial reason for concern for Allianz was that both it and RSAI were party to the Reduction in Paper Exchange (RIPE) agreement.
28. The RIPE agreement is a generic and voluntary agreement that was then entered into bi-laterally between participating insurers. It established a process designed to facilitate the recovery of accidental damage outlays between participants, without the need for supporting documentary evidence at the time of the request.
29. The RIPE Agreement contained the following term:
 - 29.1 "At the time of the recovery request, the following information (where applicable) should be made available to the 'at fault' participant:

29.1.1 Vehicle repair costs (broken down to provide the split between labour, parts and paint. This figure should be net of any discounts)..."

30. Allianz therefore took it on trust that the charges made to them by RSAI were for vehicle repair costs "net of any discounts" and assumed that the sum that RSAI sought to recover from them, by way of subrogated claim on the part of the claimant, in respect of vehicle repair costs was for a sum equivalent to the amount charged by the repairing garage net of any discount that RSAI received.
31. RSAI however, set up a scheme, whereby all of the repairs to their vehicle were dealt with by RSA Accident Repairs Limited, trading as MRNM, RSA Accident Repairs Limited being a company in the same group of companies as RSAI.
32. RSAI agreed, through a service level agreement and subsequent Retail Adjustment Criteria, exactly what rates they would pay to MRNM, regardless of the rates that MRNM were charged by repairing garages. Allianz submits that, via this agreement, RSAI essentially controls the labour rates to be paid. In addition, RSAI has agreed in the vast majority of cases to pay an equivalent of 3 hours' labour charge by way of additional services (sundry services), whether those services have been provided or otherwise. RSAI also agreed that MRNM can charge for the provision of a courtesy car and for collection and delivery charges, which are usually provided by the repairing garage without charge.
33. MRNM subsequently entered into agreements with repairing garages, which carry out the repairs and invoice MRNM. MRNM then invoices RSAI for the sums agreed between them in the service level agreement. In that way, RSAI can seek sums from the paying insurer, which are on most occasions substantially higher than the sums that are charged by the repairing garage to MRNM, on the basis that that is the sum that has been charged to them by MRNM.
34. The repair costs paid by RSAI to MRNM are more than the actual cost of the actual repairs paid by MRNM. An RSAI PMI customer policy experience will therefore appear worse than it should be. It is for this reason that RSAI treat their business line and private motor customers differently (see comment on TOH 2 – paragraphs 21-23 above).
35. Allianz points out that any profit that is made out of this scheme is retained within the RSA group of companies. Clearly, if arrangements of this sort were put in place by all PMIs, the consequence would be to put an upward pressure on insurance premiums paid by the public. The insured are not receiving any better quality of repairs than they would otherwise have done if RSAI had a direct arrangement in place with the garage making the repairs.
36. The arrangement with MRNM however, means that profits generated by the repair service can be kept within the RSA group of companies, to the detriment of other insurers, which are accordingly forced to pay significantly higher repair costs than is necessary, as RSAI does not pass on the discounts that MRNM is able to negotiate.

The RSAI Type Repair Model has been considered in detail by the High Court. The rulings of Cooke J are now the subject of an application for permission to appeal to the Court of Appeal. Allianz believes that an understanding of the considerations made by Cooke J may provide the CC with further insights in the operation of the PMI market.

Coles and Others v Hetherington and Others [2012] EWHC 1599 (Comm)

37. The Commercial Court (Court) considered 3 preliminary issues and reached the following conclusions:

Preliminary issue 1: Measure of Loss

- 37.1 Under this heading, the Court considered whether the measure of the claimant's loss is taken as the reasonable cost of repair where a vehicle is negligently damaged and is reasonably repaired (rather than written off).
- 37.2 The Court held that the authorities make it plain that the loss suffered is the diminution in value of the vehicle at the time of the incident, which should ordinarily be measured by the cost of remedying the damage. However, the cost of repairs is merely a way of measuring the loss and the loss can be established in other ways, such as by reference to estimates or expert opinion.
- 37.3 The Court also found that, whilst issues of mitigation may arise where the loss is a future consequential loss, such as hire, it cannot apply to the assessment of direct loss where it uses the reasonable cost of repair as a way of assessing the diminution in market value of the vehicle, unless there is a causative link between the wrong in respect of which damages are claimed and the action or inaction of the claimant. The recovery for damage done to a chattel is not dependent on repairs being done or the cost of those repairs being paid by the claimant since compensation is for loss in value, not the cost of repairs as such.

Preliminary Issue 2– Test of 'reasonable repair charge'

- 37.4 Under this heading, the Court considered whether, if a claimant's insurer has arranged repairs, the reasonableness of the repair charge is to be judged by reference to (a) what a person in the position of the claimant could obtain on the open market; or (b) what his or her insurer could obtain on the open market?
- 37.5 The Court found that the correct answer was (a). The reasonableness of the repair charge, as a measure of the diminution in value of the damaged vehicle, is to be assessed by reference to the position of the individual claimant, without reference to his insurers or to any benefits which he obtains under his policy of insurance, for which he has paid a premium.
- 37.6 Following the relevant authorities, this means that the claimants' dealings with their insurers and their insurers' actions in relation to the indemnity granted are *res inter alios acta*, in the context of assessment of diminution in market value or costs of repair and behind the curtain for any tort-feasor who seeks to argue about mitigation of loss in payment of repair costs. As a result of this decision RSA can bring a subrogated claim in their client's name and their own actions cannot be challenged in that action. It is only their insured's actions that can be considered.

Preliminary Issue 3 – Recoverable amount

- 37.7 Under this heading, the Court considered whether in situations where (1) a vehicle is not a write-off and an insurer indemnifies the insured by having repairs performed and paying charges for those repairs; and (2) where the amount claimed is no more than the reasonable cost of repair, the amount is recoverable?
- 37.8 This issue was not argued before the Court but Cooke J did make comments as to the points that seemed the relevant consequences of his findings. Cooke J commented that an overall figure for the reasonable cost of repair of damage to a vehicle may be justified, even if the individual items in the repair costs paid are not reasonable.
- 37.9 The cost of repairing damage must be treated "in the round", because it is to be taken as the measure of the loss suffered which is diminution in the value of the vehicle. If a package deal for repairs was agreed, then it would be the reasonableness of the package as a whole which was relevant, if any issue of mitigation could arise.

Coles and Others v Hetherton and Others [2012] EWHC 2848 (Comm).

38. In subsequent judgment, Cooke J considered a number of issues raised by defendants which were subject to an application for summary judgment or strike out by the claimants. The Court held on most of the issues that if a claim in special damage is made for the cost of repairs, then the reasonableness of each individual item on the invoice could be examined and the sums may be reduced. However, if a claim for diminution in value is brought, then the Court could only consider the reasonableness or otherwise of the overall sum claimed. On that basis, it would be proper for a claim to be brought for repair costs and services that were not even provided as long as they are commercially reasonable.
39. On this basis it is apparent to Allianz, that unless the Court of Appeal overturns this decision, RSAI and presumably others going forward, will charge the insurers of "at fault" drivers a sum over and above that at which they are able to obtain repairs in their own right, on the basis that the costs that they are claiming are commercially reasonable. Unless the Court or the Competition Commission prevent this practice commercial pressure, the need to compete on a level playing field, will force other insurers to adopt the RSAI Type Repair Model.
40. The fact that insurers are able to hide these arrangements, behind the individual insured whose name is effectively used to bring the subrogated claim on behalf of the insurer, makes challenging these arrangements significantly more difficult.
41. The Commercial Court decision may also be seen as validating dual pricing models and accordingly it could exacerbate a known market issue to the detriment of PMI customers unless the CC address the point or the Court of Appeal overturns the judgment.

Yours faithfully,

S J Hutchings
Chief Legal Officer and Company Secretary