

Submission to the Competition Commission.

Private Motor Insurance Market Investigation

Response to statement of issues.

Authors: Nigel & Brian Hecks.

Date: 9th January 2013.

- 1** This document has been drafted in response to the Statement of Issues published by the Competition Commission on 12th December 2012.
- 2** Paragraph 5(b) of the statement asks for parties to identify issues that they believe the Competition Commission should investigate which are over and above the current level of intent.
- 3** The purpose of this document is to set out as to why I believe the Competition Commission should investigate the supply of automotive paint to bodyshops that repair vehicles in the PMI market.
- 4** In my opinion the development of supply arrangements over recent years has had an adverse effect on competition. The market has become increasingly “immune” to competitive market pressures. The “immunity” has reached such a level that in 2012 the insurance companies paid in the region of £230m more for paint than they would have done if normal market forces had been allowed to influence the market.
- 5** The harm is inflicted on the market due to “horizontal effects” (**ToH 3**) and “vertical relationships” (**ToH 5**).
- 6** In my opinion the Competition Commission could establish the validity of my claims by using statutory powers to request information from Paint Marketing Associations, Paint Manufacturers, Insurance Companies, Claims Management Companies, Motor Manufacturers and Bodyshops.
- Inflationary Pressure on Prices Due to Commercial Approvals**
- 7** In recent years the term “Influencer” has become defined in the automotive paint market. An “influencer” is an entity that is recognised as being able to “incentivise” a bodyshop to choose a particular brand of automotive paint.

- 8 There are recognised groups of “influencers” in the market:-
- a) **Insurance companies.** Very influential with bodyshops due to the fact they are either existing customers or potential customers.
 - b) **Accident Management Companies.** Very influential with bodyshops due to the fact they are either existing customers or potential customers.
 - c) **Motor Manufacturers.** Obviously powerful in the automotive market. Some main dealers do not have bodyshops thus providing an opportunity for an independent bodyshop to achieve the status of an approved motor manufacturer repairer. Or, in cases where a main dealer does have a bodyshop, the motor manufacturer has influence over the whole business (ie the bodyshop as well as car sales, workshop, parts etc).
- 9 In its most basic form the influence is exerted using a “carrot and stick” method.
- (i) If a bodyshop does not have the benefit of repair work from an influencer then the carrot is used
“if you consider using paint brand “xyz” and buying it from source “abc” then it will greatly increase the probability of us referring repair work to your business”
 - (ii) If a bodyshop does have the benefit of repair work from an influencer then the stick is used
“if you don’t buy enough of paint brand “xyz” from source “abc” then the repair work will have to be referred to another bodyshop that is willing to be more co-operative”
- 10 Dialogue between paint manufacturers and influencers has increased consistently over recent times. Paint manufacturers have offered rewards to influencers in return for exerting “pressure” on bodyshops to use a particular brand.
- 11 The more aggressive the pressure then the larger the reward.
- 12 In some cases the reward is calculated as a percentage of the total bodyshop spend. In others it is a value per job referred to the bodyshop.

- 13** Paragraph 100 of the issues statement acknowledges that bodyshops work for a number of work providers. This means that a reward based on the total spend of the bodyshop results in goods purchased for the repair referred by one influencer are also contributing to the reward received by another influencer and vice-versa.
- 14** A flat fee per job referred to the bodyshop is also problematic. Not all jobs require the same value of paint to be purchased. In extreme cases the value of the reward fee paid is greater than the cost of paint required for the repair.
- 15** The prevalence and value of these incentive schemes has grown year-on-year. As at the end of 2012 the majority of influencers (by volume and market share) have a commercial arrangement in place with a paint manufacturer and/or paint marketing association.
- 16** In recent years the phenomenon of “double-dipping” has become common place. This is the scenario where a number of influencers are claiming rewards for sales into a particular bodyshop. The most common occurrence is cross-over between motor manufacturer influence and insurer influence.

Example: AXA refer the repair of a Vauxhall to a bodyshop that is approved by VW/Audi, Mercedes and Ford. If the bodyshop purchases Spies Hecker from a distributor that is affiliated to the NIBS (paint marketing association) via the Ford Central Billing programme then the following “rewards” become payable:-

- (i) AXA, referral fee
- (ii) VW/Audi, approval fee
- (iii) Mercedes, approval fee
- (iv) Vauxhall, approval fee
- (v) Ford, approval fee + central billing rebate

Rewards (ii), (iii) and (v) are calculated on the total Spies Hecker paint spend of the bodyshop not just the spend that relates to VW/Audi, Mercedes or Ford vehicles.

- 17** In an accident repair market in which it is accepted that repair volumes are static (or even falling) the paint companies have had to earn extra revenue to finance the increasing costs of incentives offered to influencers.
- 18** In the main paint companies have achieved this by a combination of cutting infra-structure costs and aggressive price increases for brands that are approved by influencers.

- 19 The price increases are fed into the market via the Audatex system. The Audatex system is accepted by the majority of insurers as an acceptable method for estimating the price of paint. Audatex base their estimates for paint on the trade prices submitted by the major paint and consumable manufacturers. The paint manufacturers only submit prices to Audatex for brands that are approved by influencers.
- 20 Obviously, for the increased trade price of paint to generate the maximum amount of revenue the competitive market forces need to be neutralised as much as possible.
- 21 Arrangements between the “influencers” and the paint manufacturers have applied vertical restrictions on the market (**ToH 5**). The characteristics of the agreements are that they:-
- (i) specify “approved brands” and/or the “source of the approved brands”
 - (ii) apply a “consequence” to the bodyshop in the event of non-conformance
- 22 Arrangements between paint manufacturers and **Paint Marketing Associations** (defined later in submission) have applied horizontal restrictions on the market (**ToH 3**). The characteristics of the agreements are:-
- (i) limited “distributor membership” of the Paint Marketing Association with minimal geographical overlap between approved distributors
 - (ii) “consequences” for distributor in the event of non-compliance with association rules
 - (iii) collection / payment of “influencer” rewards from paint distributors
 - (iv) collection of end user spend data from distributors
- 23 Paint company activities (in particular with regard to auditing spend data, differentiating availability of technical data and verbal claims about product warranty) seek to partition the UK market from other European markets. This applies horizontal restrictions (**ToH 3**) to the market and that reduces the impact of cross-border trade within the European Union.
- 24 More details about **Paint Marketing Associations** are given in one of the sections later in the document.
- 25 More details regarding the vertical and horizontal restrictions are given in sections later in the document.

Quantum of anti-competitive activity on the consumer.

- 26 In order to evaluate the cost of the cumulative effect of the price increases due to influencer fees it is necessary to compare products that are approved by influencers against products that are not approved.
- 27 The four largest paint manufacturers have 95% of the available market. Each of these manufacturers sells multiple brands.
- 28 In recent years the “profile” of paint brands has been categorised as “Premium” or “Budget”.
- 29 “Premium” brands have the characteristics that they are approved by “industry influencers”, have a high selling price and are included in the Audatex assessment for the costs of paint and materials.
- 30 “Budget” brands have the characteristics that they are not approved by “industry influencers”, have an economical selling price and are not included in the Audatex assessment for costs of paint and materials.

The table below summarises the situation:-

| Manufacturer | Brand | Market Share | Profile |
|---------------------|------------------|---------------------|----------------|
| PPG | Nexa Autocolor | 19% | Premium |
| PPG | PPG | 8% | Premium |
| PPG | Max Meyer | 6% | Budget |
| DuPont | Spies Hecker | 8% | Premium |
| DuPont | Standox | 9% | Premium |
| DuPont | Dupont | 6% | Premium |
| Akzo Nobel | Sikkens | 19% | Premium |
| Akzo Nobel | Lesonal | 4% | Budget |
| BASF | Glasurit | 12% | Premium |
| BASF | R-M | 5% | Premium |
| Valspar | Octoral | 1% | Budget |
| Valspar | DeBeer | 1% | Budget |
| Lechler | Lechler | 2% | Budget |
| Sherwin Williams | Sherwin Williams | 1% | Budget |

86% of the paint supplied in the market is “Premium”.

14% of the paint supplied in the market is “Budget”.

- 31 The three most common components of a paint system used in the repair of a vehicle are primer, colour basecoat and clearcoat. The table below compares the prices of the “Premium” and “Budget” paint for each of these components. The prices are based on the cost to the insurers (the cost that would be included by insurance companies to calculate the cost of future insurance premiums).

| | Premium (£/litre) | Budget (£/litre) |
|-----------------|-----------------------------|----------------------------|
| Primer | £90 | £58 |
| Colour Basecoat | £145 | £105 |
| Clearcoat | £95 | £72 |

- 32 For the average repair 0.5 litres of primer is required, 0.4 litres of colour basecoat and 0.4 litres of clearcoat. Applying this ratio of usage to the prices above:-

The average price of “Premium” paint for a repair is £141
The average price of “Budget” paint for a repair is £95

This calculation shows a difference of £46 per repair.

- 33 5,000,000 vehicles are repaired each year. At £46 per repair the financial cost of using “Premium” paints is £230 million and it is valid to assume that this increased cost will be to the detriment of the consumer via higher insurance premiums.

- 34 If the market was open to normal market influences bodyshops would look to reduce costs by taking advantage of the “Budget” product offer. To obtain a competitive advantage the bodyshops would offer savings to insurers in an effort to attract work. However the requirement to use paints approved by “influencers” prevents the possibility of bodyshops taking advantage of the “Budget” product offer.

Performance of Premium paints against Budget paints.

- 35 As “Premium” paints are more expensive than “Budget” paints consideration must be given as to whether the Premium paints offer a better level of service to the consumer than the Budget paints.

- 36 For the consumer the purpose of the paint finish on the repair area is to make the repair “invisible” (ie replicate the colour and finish of the undamaged part of the vehicle). The “invisibility” needs to be maintained for the warranty period that is offered by the bodyshop.
- 37 In general bodyshops offer a five year warranty on repairs (sometimes even a lifetime). If Premium paints offer a better product warranty to bodyshops than that of Budget paints then this could be considered to contribute towards a better level of service to consumers.
- 38 In order to assess the product warranty offered by the “Premium” paint brands I refer to the standard terms and conditions of sale for each of the paint manufacturers.
- 39 **DuPont.**
All of the brands offered by DuPont are Premium. Relevant extracts from their terms and conditions are as follows:-
- “14. Seller warrants that goods sold hereunder shall be equal to the Sellers specifications and Buyer assumes all risks and liability for the results obtained by the use of the goods covered by this order whether used singly or in combination with other products.”*
- “15. Subject as expressly provided in these conditions, and except where the goods are sold to a person dealing as a consumer (within the meaning of the Unfair Contract Terms Act 1977) all warranties, conditions or other terms implied by statute or common law are excluded to the fullest extent permitted by law.”*
- 40 The terms and conditions of sale do not offer a bodyshop any support in providing a product warranty.
- 41 The Marketing and Strategic Planning Manager of DuPont confirmed this during October 2011 in response to an enquiry from a repairer – I quote:-
- “I am in receipt of your enquiry regarding warranty cover on DPC materials purchased by you.
.... DuPont in the UK does not provide any kind of manufacturer warranty on its Refinish products to end-users.”*

42 BASF

All of the brands offered by BASF are Premium. Relevant extracts from their terms and conditions are as follows:-

“3.1 Unless otherwise agreed the quality of the goods is exclusively determined by BASF’s product specifications.”

“3.3 Quality and shelf life data as well as other data constitute a guarantee only if they have been agreed and designated as such”

“10.3 Buyers claims for defective goods are subject to a period of limitation of one year from the receipt of the goods.”

43 As long as BASF and the bodyshop have completed the relevant paperwork for each repair there may be support to provide a 12 month product warranty.

44 PPG.

PPG offer both “Premium” and “Budget” paints. The terms and conditions of sale for all brands are identical. As a result the Premium paint warranty support cannot be greater than that of the Budget paint.

45 Relevant extracts from the terms and conditions are as follows:-

“4.1 It is for the Buyer to satisfy himself of the suitability of the goods for his own particular purpose. Accordingly the Seller gives no warranty as to the fitness of the goods for any particular purpose and any implied warranty of condition (statutory or otherwise) is excluded except in so far as such exclusion is prevented by law.”

46 The terms and conditions of sale do not offer a bodyshop any support in providing a product warranty.

47 Akzo.

Akzo offer “Premium” and “Budget” paints. The terms and conditions of sale for both brands are identical. As a result the Premium paint warranty support cannot be greater than the Budget paint.

48 Relevant extracts from the terms and conditions are as follows:-

“The goods will be reasonably fit for their general purposes, but we give no warranty that they will be fit for any particular purpose or process unless this has been specifically agreed in writing.”

49 The Premium paint brands offer the minimum amount of support for bodyshops in providing a product warranty. This level of support is equalled by the “Budget” paint offers.

Request to Investigate.

50 It is shown that limiting the bodyshops choice of purchases and requiring the use of Premium paints does not contribute towards any improvement for the consumer, but the consumer is having to pay higher motor insurance premiums as a result of this requirement.

51 The quantum of this detrimental effect has been calculated at £230 million for 2012.

52 This figure is projected to increase to over £250 million for 2013 (next price increases for Premium paints are expected in quarter 1 of 2013). Over the past 7-8 years the consumers have been disadvantaged by a cumulative figure approaching £1 billion.

53 On this basis, I believe it is vital that the Competition Commission investigates the effect of the vertical relationships (**ToH 5**) as well as the horizontal restrictions (**ToH 3**) for the supply of automotive car paint to car body repair shops (bodyshops).

Paint Marketing Associations.

54 There are three major Paint Marketing Associations (**PMA**) in the UK – IRIS Coatings, NIBS and ACIS.

55 PMAs are companies that have paint distributors as members. The aim of a PMA is not only to have a network of distributors that give national coverage for the UK market, but also to restrict the membership so that the number of distributors offering services to a particular geographical area is kept to a minimum.

56 The methods by which the **PMA** controls members competing with each other ranges from non-competition clauses being written into the joint venture agreement to managing “border conflicts” on a Gentleman’s club basis.

- 57 The purpose of a PMA is to formulate and present a sales proposition on behalf of the member distributor. The success criteria for a PMA is to get bodyshops to adopt the sales proposition and to enter into a trading relationship with one of the member distributors.
- 58 It is important to note that the PMAs are not distributors and they do not have bodyshops as customers. This is often misrepresented within the industry. PMAs will often refer to themselves as distributors of paint or talk about ownership of customers.
- 59 PMAs also recognise the potential powers of industry influencers and they will offer rewards to influencers in return for endorsing their sales proposition. In order to raise funds to pay for these rewards PMAs will invoice member distributors. Usually these charges are calculated as a percentage of a particular bodyshop purchases. In order to maintain the revenue for payment of the rewards the PMA has to enforce a discipline on the member distributors (that makes payment of PMA charges not optional) but also to protect member distributors from other competitive influences.

The Compounding Effect of Vertical Relationships and Horizontal Restrictions

- 60 The market has developed in such a way that in return for a strong approval influencers can obtain financial rewards from paint manufacturers and PMAs.
- 61 The paint manufacturers and PMAs have a common interest in that they rely on horizontal restrictions to raise funds to pay the influencers.

Nature of Vertical Relationships

- 62 Agreements exist between influencers and paint manufacturers that prevent bodyshops from using budget paints.
- 63 Agreements exist between influencers and PMAs that seek to define the distributor that bodyshops will trade with.
- 64 Agreements exist between influencers and PMAs that seek to control the re-sale price of paint.

Nature of Horizontal Restrictions

- 65 PMA activity will seek to reduce competition between member distributors and will seek to reduce the activity of non-member distributors.
- 66 Paint Manufacturer activity seeks to protect “Premium” paint price points by horizontal restrictions that seek to monitor and reduce the effect of cross-border trade.