

Competition Commission

Private Motor Insurance Market Investigation

Response by Accident Exchange to the Annotated Issues Statement and Working Papers in relation to the provision of Temporary Replacement Vehicles

6 September 2013

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Executive Summary

Our comments with regard to the Annotated Issues Statement and the Working Papers relating to the supply of Temporary Replacement Vehicles, which are set out in further detail below, may be broadly summarised as follows:

1. The Competition Commission (“CC”) has not defined the relevant market in which it considers any adverse effect on competition may arise. Furthermore, in relation to the provision of Temporary Replacement Vehicles to not-at fault drivers and the recovery of the costs of the same, we have set out below why there is no legal basis on which the CC can determine there has been an adverse effect on competition;
2. The CC has failed to acknowledge that the amounts which are recoverable in respect of the supply of Temporary Replacement Vehicles are set by general legal principles and must be reasonable: any “overcosting” or “overprovision” is not recoverable;
3. Throughout the Annotated Issues Statement and the various Working Papers, the CC has compared the costs of credit hire with the costs of direct hire: we have explained on many occasions that this is a false comparison;
4. The CC also assumes that the counterfactual to credit hire is direct hire. Again, this is a false premise. The counterfactual to credit hire is (as was the case prior to its existence) no provision of replacement vehicles to innocent motorists. Without the existence of credit hire, at-fault insurers would have no incentive to provide replacement vehicles to not-at-fault drivers;
5. The ‘frictional costs’ which the CC has identified arise as a result of the non-aligned interests of the consumers seeking redress for the damage caused by a negligent third party and at-fault insurers’ strong incentives to eschew their legal responsibility for meeting the costs of putting innocent motorists back in the position they would have been had the accident not occurred;
6. Referral fees represent a cost of business of CHCs, the principal beneficiaries of which are not-at fault insurers. The finding of “overcosting” is in part (or even wholly) a distributional matter in respect of which competition authorities do not generally have a preference.

The CC has not established the basis for any adverse effect on competition in a relevant market and moreover, appears to have reached inaccurate conclusions based on a false comparison between credit hire and direct hire which forms the basis of its analysis.

The CC should therefore reconsider its apparent position in relation to the issues it has identified and we would welcome the opportunity to assist the CC further in this regard.

We are also aware that The CHO has, in conjunction with its retained economic advisers, Compass Lexecon, developed an alternative analysis of credit hire and its effect on consumer welfare. We are also aware that The CHO has requested a meeting between its retained economist and the CC's team which we would encourage the CC to take up in order that other missing elements of the CC's approach can be discussed.

Accident Exchange

6 September 2013

Part A: General Comments on CC Investigation

1. Introduction

- 1.1 The starting point for a market investigation by the CC is that it must define the relevant market. Only once the CC has established an appropriate market definition can it then proceed to consider whether there has been an adverse effect on competition ("AEC") on that market.
- 1.2 In relation to the working paper on overcosting and overprovision of Temporary Replacement Vehicles ("TRVs"), the CC has not provided a definition of the relevant market. There may be two possible markets that are engaged by the provision of TRVs:
 - 1.2.1 market for the subrogation of claims; and
 - 1.2.2 market for private motor insurance.
- 1.3 However, for the reasons set out below, there is no legal basis on which the CC can determine that there has been an adverse effect on competition in either of these markets.

2. Market for subrogation of claims

- 2.1 Where a credit hire company ("CHC") provides services to a not-at-fault driver ("NAFD"), the NAFD assigns to the CHC the right to recover from the at-fault driver's ("AFD") insurer the reasonable costs of the services received. This might be referred to as the subrogation of claims market.
- 2.2 In general, NAFDs and CHCs contract on an individual basis. The CHC must determine:
 - 2.2.1 whether the potential customer is a genuine NAFD (i.e. they would have a right to have their reasonable costs of services procured reimbursed by the AFD's insurer); and
 - 2.2.2 what the reasonable costs of services being sought by the NAFD are.
- 2.3 Once the CHC has determined this, they then contract with the NAFD to provide the TRV. The price paid by the NAFD is the value of the subrogated claim. The CC appears to consider that the separation between the provision of the TRV and the cost being recovered is a cause for concern. However, the CC apparently continues to be under a misapprehension in this regard. As stated on many occasions previously, any overcosting or overprovision of TRV to the NAFD will not be recoverable by the CHC. Accordingly, any overcosting or overprovision merely results in under-recovery by the CHC and cannot result in any adverse effect on competition on the market for the subrogation of claims (or in the market for private motor insurance) and therefore there are no grounds for intervention by the CC.

- 2.4 In addition, if the CHC overprovides or supplies the TRV inefficiently, this will not be covered by the settlement of the claim (to the benefit of the consumer that might have had a better vehicle or for longer than entitled). To the extent that a CHC overprovides or overcosts, it has no means of raising prices to make good the under-recovery (other claims will be subject to similar scrutiny and any overcosting or overprovision in those claims will similarly go unrecovered). This demonstrates that CHCs are effectively disciplined and that they have every incentive not to overprovide or overcost and accordingly, there is no adverse effect on competition and there are no grounds for intervention by the CC.

3. Private Motor Insurance Market

- 3.1 It is true that CHCs provide services to NAFD. It is also true that the cost of these services forms part of the costs an AFD's insurer must settle. However, just because more NAFDs receive TRVs than might be the case if CHCs did not exist, this does not somehow indicate that CHCs are increasing motor insurers' costs except in so far as the insurers would otherwise escape their legal liability. It only indicates that more people are getting access to services, the costs of which they are legally entitled to recover from the AFD's insurer. CHCs merely pursue justified claims that might not otherwise be pursued.
- 3.2 The CC's concerns appears to be that CHCs may offer the NAFD TRV provision that reflects the value of the subrogated claim rather than some less valuable TRV provision that the NAFD might be prepared to accept. This is tantamount to suggesting that it be in the public interest for claims to be settled at an undervalue, and that NAFD's should not be encouraged to claim what they are entitled to. There is no basis, legal, economic or otherwise, for such a proposition.

4. No Market for the Settlement Of Claims

It is to be noted that there is no economic market for the provision of claims settlement services, that might be provided by CHCs, CMCs or solicitors, but the mere acceptance of a settlement by a claimant does not amount to an economic activity that takes place within any market. The value of the claim is not set by market forces but by the operation of the law.

5. Counterfactual: No CHCs

- 5.1 As we have consistently stated, the counterfactual to the provision of credit hire services is not, as the CC appears to have concluded, the provision of direct hire by at-fault insurers. At-fault insurers only provide direct hire services because of the threat of credit hire. This has been acknowledged by insurers themselves¹.

¹ See the comments from Admiral and esure on page 38 of the transcript of the Multi-Lateral hearing with insurers on 16 July 2013.

5.2 If the CC considers that the potential absence of CHCs would reduce motor insurers' costs, and that this might result in reduced insurance premiums for all drivers, we ask the CC to consider the following:

- 5.2.1 In the absence of CHCs, given the lack of incentive on at-fault insurers to provide TRVs, only those NAFDs with the financial means to fund the hire of a TRV themselves and the financial means and resolve to pursue the recovery of those costs from the AFD's insurer, will be able to exercise their legal rights to a TRV.
- 5.2.2 NAFDs without the financial means to fund a TRV themselves would be not only denied access to their own vehicle, but denied access to a TRV and accordingly their economic position would be further weakened.
- 5.2.3 It is unclear whether any potential (though wholly uncertain) reduction in motor insurance premiums would in any way offset the loss of access to a TRV faced by those NAFDs without the financial means to fund a TRV themselves.

Accordingly, the absence of CHCs would result in a significant imbalance of justice: those with weaker financial means would be further economically disadvantaged, whereas those with financial means may be less adversely affected. Disadvantaging certain consumers in order to benefit others is contrary to principle and would find no support in the Enterprise Act or the purposes for which the CC was established.

Part B: TOH 1: Overcosting and overprovision of TRVs

1. Missing elements in the CC's analysis

- 1.1 The working paper ('WP') is labelled 'theory of harm' but it does not articulate a theory of harm because while it tests for overcosting and overprovision it does not show that consumers would be worse off as a result of overcosting or overprovision.
- 1.2 It is not clear whether the CC is ultimately suggesting that any features of the market are consistent with harm (an 'adverse effect on competition'). There is reference in some sections (e.g. paragraphs 15 and 167) to an absence of consumer harm, but it is not clear from this whether in other sections where no such conclusion is reached that consumer harm should be inferred.
- 1.3 As stated in Part A, the CC has not defined the market(s) in which competition takes place or in which any alleged consumer harm takes place.
- 1.4 The CC has not explained how the relevant markets work. The working paper is essentially concerned with measuring some outcomes (in relation to costing and overprovision) but has no overall account of how the market functions.
- 1.5 The CC has not analysed the incentives (or lack of incentives) of fault insurers to provide TRVs.
- 1.6 The CC has not analysed competition among CHCs in the market(s) in which they compete,² the extent to which profits (before referral fees) are competed away or the extent to which referral fees are passed on to final consumers in the form of lower insurance premia or other benefits.
- 1.7 Other missing elements in the CC's analysis are identified in the section-by-section commentary below.

2. Key substantive points

The CC's underlying concern is a separation of cost liability and cost control (WP, paragraph 1). The CC's implicit position seems to be that (i) given an absence of underprovision when the TRV is provided by the AFD's insurer and (ii) given overcosting and overprovision when the TRV is provided by a CHC, welfare would be enhanced by giving at fault insurers control of providing TRVs to NAFDs. This is because it follows from (i) there would be no underprovision of TRVs and it follows from (ii) that there is overcosting and overprovision that would be eliminated.

If this is the CC's underlying concern, it has at least three main problems.

² The CC tends to refer to CHCs and CMCs collectively. Given that Accident Exchange is a CHC, our comments in this paper are from the perspective of CHCs.

- 2.1 First, it does not recognise that absent the threat of provision of a TRV by a CHC, fault insurers would have very limited incentives to intervene ('capture') NAFDs and underprovision would become prevalent (although this is partially and indirectly acknowledged in the WP, paragraph 143(b)). The CC appears to have adopted "*provision of TRVs by fault insurers*" as the appropriate counterfactual. However, this would not be an economic counterfactual in a world in which there was no provision by parties other than the fault insurer. In that world, the fault insurer would not have incentives to provide TRVs and accordingly, NAFDs' legal entitlement would go unfulfilled.

The CC does not appear to have addressed the evidence we have provided that insurers have consistently attempted to suppress the provision of TRVs including via the various technical legal challenges they have pursued in an attempt to escape their obligation to pay TRV charges entirely, the Autofocus fraud and bilateral agreements between insurers.³

- 2.2 Second, frictional costs are a consequence of the following in combination: (i) NAFDs' entitlement under law to a TRV, (ii) CHCs' actions (acting for consumer) to secure consumers' legal entitlement, and (iii) AFDs' insurers' incentives not to provide TRVs. In other words, frictional costs arise where there are non-aligned interests. Some frictional costs are inevitable if NAFDs are to enjoy their legal entitlement. Indeed, even in the absence of CHCs, there would be frictional costs if consumers sought to self-provide TRVs and arguably, frictional costs would be much higher as individual consumers lack scale and specialisation in obtaining TRVs.
- 2.3 Third, competition between CHCs will 'compete away' gross profits in the form of referral fees (the point is acknowledged in the WP, but not its implications). In the main, referral fees are captured by not at fault insurers. Therefore "overcosting" is compensated for by income to not at fault insurers. The finding of "overcosting" is then in part (or even wholly) a distributional matter. By criticising overcosting, the CC implies that it would prefer a distribution in favour of the insurers of fault drivers. However, competition authorities do not generally have preferences over distributional outcomes.

In addition, as we have previously indicated to the CC, we have concerns that the cost of claims (including claims relating to TRVs) that insurers present is distorted by the fact that offsetting referrals fees they receive in respect of TRVs is accounted for separately outside of the motor insurance book. We believe there is a risk that the true net cost of claims (including claims relating to TRVs) may be overstated accordingly.

3. Introduction

3.1 Separation of cost liability and cost control

Para 1 - "we are investigating whether the separation of cost liability and cost control in the supply of services [...] to non-fault parties involved in motor accidents increases the

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See for example Accident Exchange Response to the Statement of Issues, 11 January 2013, Section 3.

costs of the services supplied”. The CC should clarify whether the costs referred to are the costs incurred by the non-fault insurer or the totality of costs in the system. It is not disputed by that the cost faced by a fault insurer for credit hire may on some occasion exceed the cost it faces for direct hire. However: (i) a proportion of these extra costs are competed away as referral fees, (ii) frictional costs are inevitable given non-aligned interests, (iii) absent interventions, fault insurers would not have incentives to provide TRVs to NAFDs so are an inappropriate counterfactual, and (iv) the apparent increase in costs may be relative to underprovision by at fault insurers (all of these points are addressed in more detail below). Therefore a finding of increased costs is not sufficient in itself to constitute a finding of consumer harm.

3.2 **Overcosting**

Footnote 1 – “we do not use the term ‘overcosting’ pejoratively as any differences in costs may arise for legitimate reasons”. The CC does not say what ‘legitimate’ and ‘illegitimate’ reasons would be or on what legal standard legitimacy is assessed. It is not clear whether the CC considers consumer harm could arise from ‘legitimate’ overcosting (i.e. CHCs recovering the amounts allowed in law). Overall, the CC’s framework for assessing its theory of harm is extremely unclear.

3.3 **Overprovision**

Footnote 2 – “Some non-fault customers might choose to receive a service which is less than their legal entitlement”. The CC should clarify whether it thinks overprovision arises where a consumer is provided with a TRV in line with their legal rights (reflecting their ‘need’) but where the consumer would have been willing to waive their legal rights. If so, the CC should be clear that the feature of the market which gives rise to the theory of harm is in fact consumers’ rights under basic tort law, which would be a very far reaching finding, and one which we consider would be outside the scope of the CC’s remit.

Para 3 – it is confusing that “overcosting” refers to a difference which the CC considers might be justified while “overprovision” refers to a difference which the CC appears to consider cannot be justified.

3.4 **Counterfactual**

Footnote 1 – “[‘Overcosting’] refers to the costs of a TRV service provided by a non-fault insurer or CMC/CHC being ‘over and above’ the costs of a TRV service provided by a fault insurer.” The CC does not justify why the fault insurer establishes the benchmark (counterfactual), given that absent the threat of provision by a CHC (or another party), the fault insurer would have a more limited and potentially no incentive to intervene (‘capture’ the claim) (see **paragraph 2.1** above).

4. **Summary**

We have not commented on the summary separately. See comments on detailed sections below.

5. Outline of the paper

See above concerning missing elements in the CC's analysis.

6. Background

- 6.1 Para 20 – “When non-fault claimants make a claim under their own PMI policy, they typically receive a TRV in accordance with the terms of their policy.” The CC should recognise that such a consumer may be (unconsciously) forgoing their legal rights to a better quality TRV and incurring an excess payment which, under provision by a CHC, they could avoid.
- 6.2 Para 20 – “On occasion, if the non-fault insurer is satisfied that the customer is not at-fault, it might provide a vehicle of a higher class compared with the customer's contractual entitlement because it believes that the customer is entitled to it under tort law and, therefore, the cost of this vehicle can be legitimately recovered from the fault insurer”. The words “on occasion” indicate that as a corollary, the legal entitlement will often be contentious. Thus the frictional costs are, at least in part, necessary costs for resolving these contentious cases.
- 6.3 Paras 39-40 – there is no scrutiny of whether bilaterals work against the consumer interest. As we indicated in our response to the CC's Statement of Issues, these bilateral agreements result in consumers being treated differently depending on whether the AFD's insurer has an agreement with the NAFD's insurer or not. If there is an agreement between the AFD's and the NAFD's insurer, the customer will be dissuaded from seeking the like-for-like mobility to which they are entitled and instead will be persuaded to accept the mobility service offered by their own or the AFD's insurer, which may be in a lower specification vehicle/for a reduced hire period. Bilateral agreements between insurers may also have an anti-competitive effect if these agreements are only concluded between larger insurer companies, excluding their smaller competitors (e.g. because reaching an agreement is costly).⁴
- 6.4 Para 41 – the CC should examine whether consumers receive their full legal entitlement under this model, i.e. whether Enterprise is acting on behalf of the consumer or the insurers.

7. Cost of credit hire and direct hire

- 7.1 Table 5 is of limited interest in itself since, as the CC correctly notes (WP, paragraph 45) the figures in it depend on the combination of daily rates and hire durations and these can be analysed separately.

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Accident Exchange Response to Statement of Issues, 11 January 2013, paragraph 3.2.2.

7.2 Daily rate

- 7.2.1 Table 6 – the GTA rates are maxima and are generally discounted for early settlement so the comparison is not like for like. In addition, the CC's choice of vehicle categories do not include some of that major types (such as S3, S6, P2 and P3) while it does cover types that are barely used (such as S7, P1, P11 and SP11). This will distort the weighted averages.
- 7.2.2 Table 7 – the comparisons do not control for the mix of vehicles. We have previously submitted⁵ that replacement vehicles supplied to direct hire customers are more likely to be “downgraded” from the customer's own vehicle. This will bring down the average direct hire daily rate.
- 7.2.3 Para 48 – “The higher daily rate of credit hire compared with direct hire appears to be, at least in part, a result of the different incentives of and constraints on the different providers. For a direct hire provider, the daily rate is the result of competition against other direct hire providers and negotiation with an insurer in respect of a large volume of prospective direct hires. For a credit hire provider, the daily rate is usually set by the GTA and, in practice, the only limitation is that the rate represents the reasonable costs that can be recovered from the fault insurer under tort law”. This is broadly correct, however:
- 7.2.3.1 “usually set by the GTA” is incorrect if taken to mean the GTA maximum. Most GTA claims settle within 30 days which implies that the most representative indicator is the discounted GTA rate.
- 7.2.3.2 “only” is perjorative. It is not clear in what respect the CC thinks the constraint of tort law is inadequate. The locus of competition of CHCs is not the cost charged to the at fault insurer but the referral fees.
- 7.2.3.3 Some of the difference in costs is required in order for CHCs to assume the costs and risks of taking on contentious cases. It is not clear that these cases (and potentially very few cases at all) would be provided by AFDs' insurers absent CHCs operating in the market.
- 7.2.3.4 It is fundamentally incorrect to imply competition is only faced by direct hire providers. CHCs face intense competition (but with a different locus) and the difference between their costs and the

⁵ Accident Exchange Response to CC Questionnaire, 17 December 2012, Question 42 where we noted that in 68% of direct hire cases we handled in 2011 and 2012, the customer received a temporary vehicle in a lower GTA category than their own vehicle. See also Accident Exchange's response to the OFT dated 13 August 2012 which contained an analysis of the impact that the downgrading of vehicles in direct hires can have on average daily hire rates.

daily rates permissible under law are susceptible to being 'competed away' (as the CC recognises elsewhere in the WP).

7.3 Hire duration

Para 50 – the CC lists four factors why the average credit hire duration may be longer than the average direct hire duration.

7.3.1 The CC has presented no evidence on whether the results are caused by mix effects. As such it cannot reliably reach any conclusion on whether durations are excessive for malign reasons.

7.3.2 As we have already stated in its submission to the OFT, intervention cases are on the whole simpler from a factual point of view and (by definition) are cases in which the insurer of the AFD has accepted its responsibility to repair the NAFD's vehicle. Cases are therefore progressed more quickly, leading to shorter periods between the date of the accident and the date on which repairs are completed, and therefore shorter hire periods.⁶

7.3.3 Given the CC's definition of "overprovision", the higher durations could be consistent with credit hire providing consumers with their legal entitlement whereas fault insurers provide something less than this which consumers "might choose to receive" (see footnote 2).

7.4 Relative impact of daily rates and hire duration

Para 51-54 – this section reveals inconsistency in the CC's calculations. In Table 9, the "overall difference between credit hire bill and direct hire bill" (column D, £622) comes from the last row in Table 5 while the "average credit hire daily rate" (column A, £67.56) comes from Table 7. The relevant data from these two rows are copied in the table below. As shown, these figures imply that the average credit hire duration is actually shorter than the average direct hire duration. This is inconsistent with the CC's finding in Table 8 that the average credit hire duration is about 3.7 days longer than the average direct hire duration.

Table 1: Comparison of implied duration of credit hire and direct hire

	Credit hire	Direct hire	Difference
Average bill (Table 5)	£1,241	£618	£622
Average daily rate (Table 7)	£67.56	£32.40	£35.16
Implied average duration (days)	18.4	19.1	-0.7

⁶ Accident Exchange Response to the OFT's Market Study Report on Private Motor Insurance, 6 July 2012, paragraph 3.3.1.

8. Overcosting of credit hire

8.1 Referral fees

8.1.1 Para 62 – “Referral fees constitute a cost of acquiring business for a CMC/CHC [...] It appears to us that the result of this market structure [competition among CMCs/CHCs] is that referral fees represent a method by which non-fault insurers and brokers can extract the profits generated by CMCs/CHCs in the provision of credit hire (and other) services.”

8.1.1.1 The CC is correct that referral fees represent a ‘competing away’ of (what would otherwise be) CHCs’ gross profits.

8.1.1.2 The referral fees are mainly or only a cost of business in the sense that other CHCs may be offering them. In this sense they are no more a cost of business than discounts from headline prices are a cost of business for any firm.

8.1.1.3 The CC has not properly considered different business models (perhaps due to the lack of a description of how the market works or definition of the relevant markets). Accident Exchange principally has arrangements with franchised motor dealerships, manufacturer approved body repairers and leasing companies, rather than insurance companies.⁷

8.1.2 Para 62 – “We note that CMCs/CHCs are able to secure direct hire referrals from insurers without the payment of referral fees, competing instead on the price of the services they offer”. CHCs also compete but the locus of competition is different. The CC seems to imply a preference for competition for direct hire referrals but this is not explained or justified. See **paragraph 2.3** above.

8.1.3 Para 63 is also correct but has distributional implications.

8.2 Administrative costs

8.2.1 Para 65 – the CC distinguishes “(a) duplicated administrative costs, which arise from having two parties (rather than one) involved in the management of a non-fault claim; and (b) frictional costs, which arise from having two parties with different interests involved in a non-fault claim”.

8.2.1.1 The dichotomy between duplicated costs and frictional costs (at least as implemented by the CC) does not appear valid. To the extent there is some duplication of the costs listed by the CC in paragraph 65, this would be expected given the interests of

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Accident Exchange Response to CC Questionnaire, 17 December 2012, Question 4.

CHCs and NAFDs' insurers are not aligned (i.e. the same source as the frictional costs). Put another way, it is not clear how consumers' interests would be served if only the AFDs' insurers conducted all of the activities listed in paragraph 65.

8.2.1.2 Some of the costs incurred by CHCs are associated with consumer benefits other than provision of a TRV, e.g. recovering consumers' no claims bonuses.⁸

8.2.1.3 The CC has not in any case shown the existence or extent of any duplication within any of the activities listed. The fact that two parties are engaged in "similar activities" does not imply duplication.

8.2.2 It is therefore not clear that the presence of duplicated administrative costs (as identified by the CC) is welfare reducing. Given that the incentives of the claimant and the insurer are not aligned, if only one party conducted the assessment, it would likely to be biased (whereas duplication should help to counterbalance the two sides).

8.2.3 Duplicated costs are a feature of competitive markets⁹ and frictional costs are a feature of almost all markets since players' interests (principals and agents; contracting firms) are rarely aligned. Their presence is far from specific to the provision of TRVs and it is not clear why the CC would consider them to be a basis for a finding of harm in this market but not in others.

8.2.4 Frictional costs

8.2.4.1 Para 68 – The CC fails to recognise that if TRVs were not provided to non-captured NAFDs, fault insurers would not have incentives to intervene ('capture' them) (see **paragraph 2.1**). The frictional costs incurred in relation to drivers who are provided with TRVs by fault insurers therefore benefit the drivers who are provided with TRVs by fault insurers.

8.2.4.2 Para 68-69 – the CC has also not assessed the frictional costs of consumers self-providing a TRV. These frictional costs are likely to be very large indeed.

8.2.5 Frictional costs incurred by CMCs/CHCs

8.2.5.1 Para 73 – The largest elements of frictional costs incurred by CHCs are the costs of employing claims handlers and the costs

⁸ See Notes of a joint hearing with The Credit Hire Organisation *et al.*, 17 July 2013, page 20, lines 9-18.

⁹ See for example Mankiw, N. G. and M. D. Whinston, "Free Entry and Social Inefficiency", The RAND Journal of Economics, Vol. 17, No. 1 (Spring 1986).

of litigation. Given that CHCs gain experience and knowledge in handling claims and litigation, these frictional costs are likely to be substantially lower than the cost individual consumers self-providing a TRV would incur (consistent with the comment made in **paragraph 8.2.4.2** above).

8.2.5.2 Para 90 – bilaterals are presented as a mitigation strategy for frictional costs and therefore wholly benign (see also WP paragraph 94, which implies the only explanation of bilaterals is reducing frictional costs). This ignores the possibility that bilaterals are intended to suppress consumer entitlement i.e. underprovision. See **paragraph 2.1** above.

8.2.5.3 Para 95-99 – It is important to note that bilateral arrangements between insurers and CHCs of the type described in these paragraphs are wholly different from bilateral arrangements between insurers. The former simply define the manner in which the CHC and insurers have agreed to settle claims against that insurer; they do not impact the service the CHC provides to its customer. Bilateral agreement between insurers, on the other hand, seek to control costs by, amongst other things, attempting to influence the type of TRV a consumer is provided. This leads to underprovision against the consumer's legal entitlement.

8.2.6 Our assessment

8.2.6.1 Para 101 - "Overall, it appears to us that the separation of cost liability and cost control gives rise to significant frictional costs". The CC's conclusion about causality is incorrect. Cost liability and cost control could both reside in the fault insurer (rather than being separated) but substantial frictional costs would be required to ensure that consumers gained their legal entitlement (alternatively, in the absence of such frictional costs, consumers would likely forego their legal entitlement).

8.2.6.2 Frictional costs are a consequence of the following in combination: (i) NAFDs' entitlement under law to a TRV, (ii) CHCs' actions (acting for consumers) to secure consumers' legal entitlement, and (iii) AFDs' insurers' incentives not to provide TRVs. i.e. they arise from a claim situation provided under law. They are inevitable if NAFDs are to enjoy their legal entitlement and would arise even absent CHCs if consumers sought to self-provide TRVs (although would be much higher).

8.2.6.3 Para 101 – it is unclear where the percentage figures come from as they are not shown in any previous table or paragraph. We understand that these may be company-level estimates, If so,

we note that assuming that all firms have as low or as high frictional costs as the lowest or the highest company in the sample is unreasonable and results in a much wider range of values than what is realistic.

8.3 **Bad debt provision**

8.3.1 Para 102 – “Bad debts arise in relation to non-fault TRV service provision when: (a) there is a dispute over a credit hire bill; (b) subsequent evidence suggests that the non-fault customer was at fault; and/or (c) the customer submits a fraudulent claim”.

8.3.1.1 It would be inappropriate to attribute these costs to CHCs. If TRVs were only supplied by NAFDs’ insurers (despite their lack of incentive to do so), they would be subject to (b) and (c).

8.3.1.2 As regards (a), absent anyone acting in the consumers’ interest, at fault insurers would not have incentives to provide TRVs (see **paragraph 2.1**).

8.3.2 Para 110 – the CC finds that the vast majority of debt written off by CHCs is partial rather than full write-off, i.e. results from disputes over the class of vehicle, hire duration, etc. rather than from disputes over liability. This demonstrates that insurers are able to exercise control over the settlement amounts they pay to CHCs.

8.3.3 Paras 111-114 – the low proportion of credit hire claims terminated due to reassessment of liability suggests that CHCs have become efficient in judging liability and that CHCs have an incentive to get the initial judgment right. Absent credit hire, the liability assessment is likely to be done at higher cost (e.g. if the driver involved in the accident tries to establish himself whether he was at-fault or non-fault), possibly causing delays in how quickly mobility is provided to non-fault drivers.

8.3.4 The CC has not explained how bad debts harms consumers.

8.4 **Cost of credit**

8.4.1 Paras 115-116 – the CC states that CHCs incur “a working capital cost in providing credit hire services, as it does not receive payment for the services it provides until subsequently”. However, it does attempt to quantify this cost element and therefore has not established that it is significant.

8.4.2 The CC has not explained how cost of credit harms consumers.

8.5 Our assessment of the overcosting of credit hire

Para 117-120 – it is not clear what the CC ultimately concludes in terms of consumer harm. However, as noted above, the WP does not provide a basis on which to reach conclusions about consumer harm including because the counterfactual is incorrectly specified and there is no analysis of consumer welfare.

9. Overprovision of credit hire

Para 121 – the reference to “entitled and desire” does not reflect consumers’ entitlement as a matter of law and it is not clear why it is the CC’s standard.

Para 121 – the CC is correct to say that apparent overprovision by CMCs/CHCs could be the result of underprovision by fault insurers. However, the point is more general. If claims were not potentially handled by parties other than the fault insurer, the fault insurer would not have incentives to intervene (‘capture’) and there would be underprovision (see **paragraph 2.1**).

9.1 Credit hire duration

9.1.1 Para 126(a) – the CC compares respondents who received a TRV and those who did not, and does not seem to distinguish between TRVs under credit hire and TRVs under direct hire. If this interpretation is correct, the results are not informative regarding the length of repair under credit hire and direct hire. We also note that the survey results show that a higher proportion of claimants whose claim was handled by the AFD’s insurer said that the repair of their vehicle took longer than initially advised by the repairer than claimants whose claim was handled by the NAFD’s insurer.¹⁰

9.1.2 Para 126(b) – the CC is selective in reporting survey results. While the average length of repair is shorter for captured claims in the low and high damage categories, it is significantly longer in the medium damage category (22 days for captured claims compared to 12 days for NF claims).¹¹ In its working paper on the survey results, the CC concluded that “this comparison of the average length of time to complete the repair work between captured and NF claims does not suggest a distinct pattern”.¹²

9.1.3 Para 134 – the CC should assess empirically whether the repair under credit hire takes longer than under direct hire for a given problem. In our experience, direct hire is more common in simpler cases, and therefore one would need to

¹⁰ Survey report by IFF Research, 12 June 2013, Figure 3.57, page 70.

¹¹ See CC Working Paper “Theory of harm 1: Analysis of the results of the non-fault survey in relation to overprovision”, Table 4, page 6. NF claims are defined as claims where the “non-fault insurer manages the claim (and has no agreements in place with the fault insurer and is not itself the fault insurer)”, see paragraph 4.

¹² See CC Working Paper “Theory of harm 1: Analysis of the results of the non-fault survey in relation to overprovision”, paragraph 17.

compare the repair duration controlling for this difference. We disagree that CHCs are able to influence the repair process.

- 9.1.4 Para 134 – the CC’s conclusion is broadly that there is no overprovision due to credit hire durations: “hire duration is largely determined by repair duration and it is not clear from the evidence we have seen so far that non-fault repairer durations are longer when a non-fault claimant is provided with TRV services under credit hire than under direct hire”. We note this implies no consumer harm within the CC’s approach.

9.2 **Additional services**

- 9.2.1 Para 139 – rental fleets are typically populated with vehicles under six months old. For that reason alone it may be that a consumer felt over provided if their car was more than six months old. Operating an old fleet causes safety and reliability issues and that it is more efficient to operate rental fleets of newer vehicles.
- 9.2.2 Para 143 – The CC acknowledges that the fault insurers provide TRVs under the ‘threat’ of provision by others. This is consistent with AFDs’ insurers not having incentives to provide TRVs absent CHCs and that they therefore form an inappropriate counterfactual for this working paper (see paragraph 2.1).
- 9.2.3 Para 145(b) and 148 – the majority of our business is dealt with through the GTA and it is only in respect of prestige vehicles over six years of age that there is a duty to enquire in more detail about need.

9.3 **Our assessment of the overprovision of credit hire**

Para 166 – See comment on paragraphs 145(b) and 148 above.

Part C: TOH 2: Underprovision of TRVs

1. General comments

- 1.1 Please refer to our submission on the CC's Working Paper "TOH 1: Overcosting and overprovision of TRVs" in **Part B** above. A number of our comments in that submission also apply to this working paper ('WP') and we have not in general repeated them.
- 1.2 The CC's concern is the separation of the beneficiary of post-accident services and the procurer of these services, and in particular whether fault insurers "underprovide" TRVs to captured non-fault claimants. We agree that this is a valid concern, given the incentives of at fault insurers.
- 1.3 However, the CC has not referred to important submissions we have made concerning the incentives and behaviour of at fault insurers. In particular, the CC does not appear to have addressed the evidence we have provided that insurers have consistently attempted to suppress the provision of TRVs including via the various technical legal challenges they have pursued in an attempt to escape their obligation to pay TRV charges entirely, the Autofocus fraud and bilateral agreements between insurers.¹³
- 1.4 Our other key concern with this WP is that it does not consider that, to the extent there is no, or limited, underprovision or underprovision, this is only because of the participation of CHCs in the market (or more generally a 'threat' of consumers' legal rights being satisfied by another party). Absent CHCs (or other parties acting for consumers), AFDs' insurers would have limited incentives to provide TRVs at all. A finding of limited underprovision would therefore be attributable to the actions of CHCs (and other parties acting for consumers) rather than to the benign behaviour of at fault insurers.
- 1.5 In the remainder of this submission we comment on the WP section-by-section.

2. Introduction

- 2.1 Para 1 – "By 'underprovision', we refer to a level of TRV service which is below that to which non-fault claimants are entitled and desire". The CC's definition is confusing if entitlement and desire are different. See comments in **paragraph 3.3 of Part A** above.
- 2.2 Footnote 1 – "Some non-fault customers might choose to receive a service which is less than their legal entitlement." The CC has not explained the extent of or reasons for this.

3. Summary

- 3.1 Paras 5-7 – the CC finds that (i) there is potential for underprovision as a large proportion of non-fault drivers are not aware of their rights at the time of the accident and are not made aware of their rights following the accident, (ii) dissatisfaction is higher among

¹³ See for example Accident Exchange Response to the Statement of Issues, 11 January 2013, Section 3.

captured claimants in relation to the type of TRV provided and (iii) captured claimants are more likely to receive a lower quality TRV (a downgrade). Despite all of these results, the summary suggests that the CC is not concerned about underprovision. While we agree with the data limitations the CC refers to when interpreting the results, we encourage the CC to undertake further analysis and attempt to quantify consumer harm.

3.2 Para 7 – “identifying and meeting a customer’s needs may be conducted more effectively by fault insurers than by parties who have no incentives to keep costs down”. This sentence implies the CC has a very negative view of CHCs but is flawed:

3.2.1 First, the consumers here are not “customers” but claimants;

3.2.2 Second, CHCs have every incentive to minimise their own costs (for a given level of service provision) to maximise their profits;

3.2.3 Third, CHCs have an incentive to provide up to a NAFDs’ legal entitlement but not above that entitlement;

3.2.4 Fourth, the difference between what CHCs can charge on behalf of the claimants and their costs is susceptible to being competed away as referral fees.

Overall, the CC seems to imply that CHCs act without discipline whereas they are subject to a twin constraint of (i) what is recoverable as a matter of law and (ii) competition among CHCs, resulting in what would otherwise be gross profits being dissipated as referral fees.

4. Non-fault claimants’ awareness of their legal entitlements

4.1 Para 17 – In our view, the result that only 28% of the respondents whose claim was managed by the fault insurers were made aware of all or some of their legal rights for a TRV certainly suggests that there is potential for underprovision. Our analysis of our own direct hire activities in 2011 and 2012 showed that in direct hire cases, customers were provided with a ‘downgraded’ TRV at the instance of the AFD’s insurer in 68% of cases¹⁴.

4.2 Para 18 – “76 per cent of respondents to our survey said that, at the time of the accident, they thought that they were legally entitled to a TRV.” As noted by the CC in Footnote 10, this result is likely to be influenced by the knowledge respondents gained *following* the accident rather than the knowledge they had *at the time* of the accident. This is clearly stated in the survey report presenting the results.¹⁵ The survey results show that a significantly higher proportion of those drivers who received a TRV said they knew they were entitled for a TRV than those drivers who did not receive a TRV (80% and 63%,

¹⁴ *Ibid.* 5

¹⁵ Survey report by IFF Research, 12 June 2013, paragraph 3.38: “It is worth noting that it is likely that answers to this question – and the other questions that refer to “at the time of the accident” - will have been influenced by respondent’s experiences post-accident, i.e. respondents were not necessarily answering the question in terms of what they actually thought/ believed when the accident occurred.”

respectively).¹⁶ This again suggests that the 76% is not a reliable estimate and is likely to be biased upwards.

- 4.3 Para 20 – the findings above appear consistent with very substantial underprovision and the CC’s assessment appears unjustifiably weak.

5. Non-fault claimants’ views on the type of TRV and the hire duration

Paras 21-26 – The CC’s result that dissatisfaction in relation to the TRV provided is higher among captured claimants corresponds to our views on this issue, particularly with regard to the standard of the TRV offered by to captured claimants compared to that which they are entitled to hire¹⁷.

6. TRV downgrades

Paras 27-30 – The CC’s result that downgrades occur more often if the fault insurer handles the claim corresponds to our views on this issue¹⁸.

7. Review of insurer and CMC/CHC electronic call records

Paras 31-40 – The CC’s result that there is a greater likelihood of receiving a lower quality TRV if the claim is captured by the fault insurer corresponds to our expectations¹⁹. However, we note that the small size of the sample does not allow for drawing any robust conclusions.

¹⁶ Survey report by IFF Research, 12 June 2013, Figure 3.21, page 34.

¹⁷ *Ibid.* 5

¹⁸ *Ibid.*

¹⁹ *Ibid.*