

Annex 2 - Confidential Information Redacted

Compass Lexecon response to the Working Paper on AEC
detriment dated 8 July 2014

Private Motor Insurance Market Investigation
A submission for Accident Exchange Limited

Response to the Working Paper on AEC detriment

Neil Dryden, Zita Vasas and Keshav Parthasarathy
8 July 2014

Confidential

Table of contents

Section 1	Introduction and summary	1
	Introduction	1
	Summary of conclusions	2
	Structure of the report	3
	Data room	4
	Questions sent to other parties	4
	Note on frictional and management costs incurred by insurers	4
Section 2	Conceptual issues	6
	Introduction	6
	Benchmark	6
	Economic framework for quantitative analysis	8
	Conclusions	10
Section 3	Concerns in relation to the effects of separation	12
	Introduction	12
	Concerns	12
	Conclusions	15
Section 4	Concerns in relation to the effects of separation on insurers' and brokers' cost and revenue	16
	Introduction	16
	Concerns	16
	Conclusions	34
Section 5	Concerns in relation to quality and service differences associated with separation	36
	Introduction	36
	Concerns	36
	Conclusions	52
Section 6	Concerns in relation to implications for consumers of separation	54
	Introduction	54
	Concerns	54

	Conclusions	56
Section 7	Additional concerns from other CHC submissions	57
	Introduction	57
	Concerns	57
	Conclusions	58

Section 1

Introduction and summary

Introduction

- 1.1 The CMA published its Provisional Findings Report ("Provisional Findings") in December 2013. It concluded (as Theory of Harm 1 ("ToH1")) that a separation of cost liability and cost control gave rise to an adverse effect on competition ("AEC").¹ The CMA's analysis of the AEC addressed temporary replacement vehicles ("TRVs"), repairs and write-offs separately.² In relation to TRVs, the CMA provisionally concluded that the total cost increase resulting from the AEC was £193m against the total revenue increase (referral fees) of £98m.³
- 1.2 Compass Lexecon ("CL") submitted a report as part of Accident Exchange's ("AX's") response to the Provisional Findings on 7 February 2014 ("CL1"). We raised a number of concerns in that report in relation to the CMA's analysis and quantification of the AEC.
- 1.3 Following AX's query to the CMA on the treatment of VAT (see letter from Steve Evans to Sean Cornall, 24 January 2014), the CMA indicated that it erroneously excluded VAT from direct hire rates (see letter from Sean Cornall to Steve Evans, 31 January 2014). The CMA subsequently published an Erratum on 17 February 2014 wherein it provided a revised estimate of the detriment arising from the AEC after including VAT in the direct hire rates. In relation to TRVs, the CMA found that the total cost increase resulting from the AEC was £167m, as against its estimate in the Provisional Findings of £193m.⁴ The CMA did not mention any change in the total revenue increase (referral fees) due to separation and therefore, we assume this to be the same as in the Provisional Findings (=£98 m). Though the CMA did not state explicitly but this would have meant a net detriment from separation in relation to credit hire of £69m (=£167m - £98m).

¹ Provisional Findings, paragraph 6.93. See also paragraph 10.6.

² Provisional Findings, paragraphs 6.71 and 6.72.

³ Provisional Findings, Tables 6.3 and 6.4. We have used these figures, as the CMA's overall conclusions on the net cost of separation only cite figures for TRVs, repairs and write-offs combined.

⁴ Erratum, page 7 and page 8.

- 1.4 CL submitted another report (“CL2”) on behalf of AX on 5 March 2014 in relation to the material disclosed to advisers in the data room that the CMA opened in order to disclose certain data that was relied upon but excised in the Provisional Findings. CL2 listed the various concerns set out in CL1 and the additional concerns identified after review of the material in the data room as well as from the submission of evidence from other CHCs in response to the Provisional Findings.
- 1.5 CL also submitted a one page summary of adjustments (“CL one-pager”) on 5 March 2014. The CL one-pager quantified the impact of some of the concerns we had raised in CL1 and CL2.
- 1.6 Subsequently, the CMA published its Working Paper titled “Estimation of the detriment from the separation of cost liability and cost control (theory of harm 1)” (“Working Paper”) on 12 June 2014 wherein it revised its estimate of the net detriment arising from the AEC and responded to some of the concerns raised by CHCs. In relation to TRVs, the CMA found that the total cost increase resulting from the AEC was £186m against the total revenue increase (referral fees plus uninsured loss recovery) of £99m.

Summary of conclusions

- 1.7 In CL1 and CL2 we raised a number of concerns in relation to the CMA’s analysis and quantification of the AEC. The CMA has not addressed at all or has not addressed adequately (e.g. assessing a concern by relying on statements made by one party rather than collecting rigorous quantitative and qualitative evidence) most of these concerns.
- 1.8 In addition to the concerns set out in CL1 and CL2, we have a number of other concerns arising from the material disclosed in the data room that the CMA opened in June 2014. These concerns have been set out in a separate report, submitted on 8 July 2014.
- 1.9 In light of these concerns, we consider the CMA’s estimate (in relation to TRVs) of the net detriment arising from the AEC to be incomplete and subject to substantial uncertainty.

- 1.10 In relation to the quality differences that we identify in Section 5 (i.e. where direct hire provides lower quality of service compared to credit hire), we have indicated that the CMA should calculate the cost for the consumer under direct hire to remedy these quality differences. However, it appears to us that non-fault drivers would suffer from these quality differences under the CMA's preferred remedy package as the CMA appears to anticipate that the current credit hire model would be eliminated under the remedy.⁵ Therefore, the quality differences that we have identified need to be considered in the assessment of the remedies, in addition to being taken into account in the assessment of the AEC. In particular, in so far as consumers suffer a reduction in achieving a level of quality to which they are legally entitled, this would make any remedy inconsistent with the CMA's stated objective of not compromising consumers' legal entitlement.
- 1.11 The specific conclusions for each concern are summarised at the end of each section of this report.

Structure of the report

- 1.12 This report sets out (i) CL's analysis of concerns highlighted in CL1 and CL2; (ii) the CMA's response to these concerns; (iii) the status of these concerns (i.e. whether the concern still exists); and (iv) finally, the work required to address the concerns.
- 1.13 Section 2 of the report sets out certain conceptual issues.
- 1.14 Section 3 of the report sets out concerns in relation to the effects of separation and in particular the issue of whether bilateral agreements lead to consumers being provided their legal entitlement.
- 1.15 Section 4 of the report sets out the concerns in relation to the effects of separation on insurers' and brokers' costs and revenue.
- 1.16 Section 5 of the report sets out the concerns in relation to the quality and service differences associated with separation.
- 1.17 Section 6 of the report sets out the concerns in relation to the implications for consumers of separation.
- 1.18 Section 7 of the report sets out the concern raised by another CHC in its response to the CMA's Provisional Findings, namely the concern raised by Quindell that direct hire rates are subsidised through the fees charged to non-fault drivers.
- 1.19 There are a small number of concerns that we raised in CL1 and CL2 that the CMA has addressed in its Working Paper. For brevity we do not repeat those concerns in this report.

⁵ See CL paper on remedies, 8 July 2014.

Data room

- 1.20 The CMA granted access to a virtual data room in February 2014 wherein it provided some of the data that it used in its Provisional Findings. As mentioned in paragraph 1.4 above, CL submitted a report in relation to this data room (CL2). The CMA also granted access to a virtual data room in June 2014 wherein it provided some of the data that it used in its Working Paper. We submitted a separate report in relation to this data room on 8 July 2014. Since the CMA undertakings for the data room require any document incorporating or referring to the data in the data room to be submitted separately from any other AX's submission, we have not restated any issues mentioned in these reports. Instead, we cross-refer to them when required.

Questions sent to other parties

- 1.21 In CL1 and CL2 we identified a large number of matters the CMA would have to assess in order to carry out a proper analysis of any net detriment arising from the alleged AEC. Without carrying out such work the CMA was not able to conclude that there was a net detriment or what it amounted to. In our view in order to undertake a proper assessment of the AEC the CMA should gather extensive information from various parties. AX requested to see the questions sent to the other parties (see, for example, letter from DLA to CMA on 14 March 2014). However, we have not seen (with the exception of data requests EP6, EP11 and EP13 which related to credit hire turnover, uninsured loss recovery and vehicle costs respectively) the questions sent to other parties. It is therefore not clear if the CMA has gathered relevant information to address the concerns we identified and the Working Paper does not refer to the evidence gathering we considered the CMA should undertake. We, therefore, conclude that the CMA has still not undertaken extensive information gathering in order to properly assess the AEC and the consumer detriment arising from it.

Note on frictional and management costs incurred by insurers

- 1.22 As stated in paragraph 1.12 above, this report deals only with the approach taken by the CMA to address the concerns raised in CL1 and CL2. However, we note here one additional concern that arises as a result of a new element that has been added to the CMA's net detriment calculation which did not appear in the Provisional Findings. This new element is the frictional costs incurred and management costs saved by the at-fault insurer.
- 1.23 In the Provisional Findings, the CMA did not compare quantitatively the transactional/frictional costs incurred by the at-fault insurers in a world with separation with the management costs saved by the at-fault insurers absent separation in relation to TRVs.

- 1.24 In the Working Paper, the CMA has quantified both the frictional costs and management costs for at-fault insurers. In relation to replacement vehicles, the CMA estimated the frictional costs incurred by at-fault insurers to be about £78. The CMA estimated the management costs saved by at-fault insurers (in the base case) to be about £27. This resulted in an increase in net detriment of about £51 per claim or about £15.5 million (=£51 per claim multiplied by 301,000 credit hire episodes) in total.
- 1.25 In the base case the CMA allocated all common costs of managing a captured claim (costs common to both replacement vehicles and repairs/write-offs) to repairs/write-offs. In its sensitivity analysis, the CMA assumed an equal allocation of common management costs between replacement vehicles and repairs/write-offs. Under this assumption the CMA's estimate of net detriment reduced by £8.6 million (i.e. a reduction in net detriment from £87 million to £78.4 million in relation to TRVs).⁶
- 1.26 As mentioned above, in the base case the CMA estimated the management costs saved by insurers by allocating the common costs of managing a captured claim to repairs/write-offs only. The CMA has stated that the common costs include the costs of capturing a claim. However, (i) it has not provided any information on the other components of the common costs; and (ii) it has not provided any information on what the costs of capturing a claim would include. Therefore, we are not in a position to comment on and it appears that the CMA itself may not be in a position to assess what proportion of the common costs is attributable to replacement vehicles and what proportion of the common costs is attributable to repairs/write-offs.
- 1.27 Absent such information there is no reason to believe why the CMA's base case approach of not allocating any common costs to replacement vehicles is any better than its approach in the sensitivity analysis where there is an equal split of common costs between replacement vehicles and repairs/write-offs. Using the results from the sensitivity analysis, for example, would reduce the net detriment from credit hire by about £8.6 million. Furthermore, this concern needs to be taken with the additional concerns from the data room report.⁷

⁶ See Working Paper, Appendix G, Table 2.

⁷ Please see points 30 and 31 of CL's data room analysis, 8 July 2014.

Section 2

Conceptual issues

Introduction

- 2.1 This section sets out our comments regarding the benchmark used by the CMA for conducting the AEC analysis and our concern in relation to the economic framework for quantitative analysis. The first issue (i.e. benchmark) relates to Section 2 of CL1 while the second issue (i.e. economic framework) relates to Section 4 of CL1.

Benchmark

- 2.2 We raised the following concerns in CL1 in relation to the benchmark adopted by the CMA.
- The CMA's benchmark for conducting the AEC analysis is extreme. It is an idealised world of no frictional costs and is neither shown to be a market outcome in general nor is it the specific market outcome that would arise if the features allegedly leading to the AEC were not present (since in that case fault insurers would have at best limited incentives to provide direct hire). The CMA's adoption of this benchmark does not explain why at-fault insurers would provide direct hire absent separation or why consumers would not have to incur frictional costs themselves to receive their legal entitlement.
 - The CMA should have included in its estimates of net impact the frictional costs incurred by consumers to realise their legal entitlement in the absence of separation. Alternatively, the CMA should recognise that adopting such an extreme benchmark for the AEC assessment creates a bias towards finding an AEC and the imposition of remedies, which must be taken into account in any remedy assessment.
 - The CMA has not correctly applied its conceptual benchmark (one of legal rights being maintained) in practice as the CMA recognises that absent separation there will be a shortfall in quality and service provision but the CMA does not adjust its quantification to account for this. In particular, when assessing the effects on competition of separation against its benchmark the CMA has failed to consider the costs to consumers of making up the quality and service shortfall of direct hire compared to credit hire so that they do in fact realise their legal entitlement as postulated in the benchmark.

- Since the CMA's benchmark assumes that consumers' legal entitlements are maintained, the CMA's analysis of the AEC cannot form an adequate basis to assess any remedies that do change consumers' legal entitlements or the degree to which consumers would realise their legal entitlements.
- The AEC identified by the CMA has distributional implications for consumers, i.e. there would be winners and losers in the *status quo* compared to the CMA's benchmark, given quality and service differentials. In particular non-fault drivers may be worse off since they would suffer the quality and service differentials. The CMA has failed to address this because it has only considered consumers in aggregate (i.e. it has conceptually averaged benefits across all consumers rather than only those who receive them). It is highly unusual for a competition authority to reach an AEC finding that creates winners and losers among different groups of consumers based on changing their legal entitlements since such a finding includes implicit value judgements (more usually AEC findings are based on features of the market that make at least some consumers worse off and no consumers better off).

(See paragraph 2.2 of CL1.)

2.3 We note below the CMA's response to the above concerns.

- The CMA has stated that it considers an idealised (but not perfectly competitive) benchmark for its analysis and that such benchmarks are just used to inform the analysis and are not necessarily feasible market outcomes. Feasible market outcomes are considered in remedies analysis and not in the AEC analysis.
- The CMA has not explicitly commented on the frictional costs that consumers would need to incur to realise their legal entitlements in the absence of separation. However, we believe that since CMA assumes an idealised benchmark where consumers are provided their legal entitlements in the most efficient way, it effectively assumes that consumers do not incur these frictional costs. The CMA has acknowledged that its remedies analysis should take into account all relevant costs, including any indirect costs.
- The CMA has acknowledged that in the absence of separation non-fault claimants may not obtain their legal entitlement to a like-for-like replacement vehicle. However, it has stated that the existence of this problem does not imply there is no existing problem associated with rent-seeking by third parties and an inefficient supply chain. This is the reason why the CMA's benchmark assumes that claimants receive their legal entitlement. However, we note that the CMA has adopted a consumer surplus approach to analysing quality differences between credit hire and direct hire.⁸

⁸

See paragraph 2.9 and footnote 9 below where we note the CMA's approach to evaluating quality shortfall under direct hire absent separation.

- The CMA agrees that its Provisional Findings provide no basis for including in the net detriment any lower premiums resulting from the non-fault claimants receiving a level of replacement vehicle lower than their legal entitlement.
- The CMA agrees that the AEC involves distributional implications and that it stated this in its Provisional Findings. However, it has stated that this is not unusual as a merger could well involve price reductions for some consumers but price increases for others.

(See paragraph 16 of Working Paper.)

2.4 We have the following comments on the CMA's response to the benchmark concern.

- Since the CMA has compared the status quo with an idealised benchmark in its AEC analysis, it is not in a position in its remedies analysis to identify the part of the AEC detriment that results due to separation and the part of the AEC detriment that results due to frictional costs.
- The CMA's consumer surplus approach to evaluating quality shortfall under direct hire absent separation is incorrect for reasons mentioned in the sub-section below. As a result, the CMA has not evaluated appropriately the quality shortfall under direct hire absent separation, which is the benchmark assumed by the CMA.
- In relation to the distributional implications of the CMA's analysis, it is our understanding that the normal position in mergers is not to permit "netting-off" between consumers. However, in this case the CMA is "netting-off" benefits received by non-fault claimants under status quo (compared to its benchmark) against the costs borne by at-fault claimants under status quo (compared to benchmark).

Economic framework for quantitative analysis

Overview of the economic framework

2.5 In CL1 we set out an explicit economic framework that we considered was necessary in order to analyse the quality of service differences between credit hire and direct hire (see Section 4 of CL1). For brevity we do not restate this framework here.

- 2.6 Given the CMA's conceptual approach of taking consumers' legal entitlement as given, we stated that it would be necessary to measure the costs that a consumer would have to incur to remedy the quality shortfall under direct hire compared to credit hire (with the latter providing consumers' full legal entitlement and with direct hire not necessarily providing consumers' full legal entitlement). We also stated that it would be incorrect to assume that consumers would 'make do' with the quality provided under direct hire and for the CMA to then assess the consumer detriment by quantifying the loss of consumer surplus from a reduction in the level of quality. Taking such an approach for quantifying the detriment would not take as given consumers' legal entitlement and would therefore be contrary to the CMA's conceptual approach. Further, if the CMA did take this approach, in so far as it identified an AEC it would have to identify the level of entitlement itself as a feature of the market causing the AEC and then assess whether the cost of providing the legal entitlement exceeds the benefits to consumers as measured by the CMA.
- 2.7 We also noted that if the consumer was forced to pay extra to the at-fault insurer or the car hire company in order to obtain a TRV that met their needs (i.e. a payment to meet some of the quality shortfall under direct hire) then that payment is a cost to the consumer that needs to be recognised in the CMA's analysis of the alleged net detriment.

CMA's approach to quantifying the quality and service differences

- 2.8 The CMA has not referred to our economic framework nor has it itself provided an explicit economic framework in the Working Paper for assessing the consumer detriment.
- 2.9 In practice, the CMA's approach to assessing quality shortfall under direct hire appears to be one where it evaluates the loss of consumer surplus rather than calculating the cost incurred by the consumer to remedy the quality shortfall.⁹ For the reasons set out in paragraph 2.6 above, such an approach is incorrect.

⁹ See second bullet of paragraph 8, Appendix A of Working Paper where the CMA states that "In relation to this point [of at-fault insurers offering lower quality replacement car or not offering a replacement car at all in the absence of separation], we noted that it meant both that there were benefits to non-fault claimants (better quality of replacement vehicles) and costs to all drivers (higher costs of providing replacement vehicles which would be passed through to higher premiums); that neither was taken into account in our estimate of detriment (which was based on like-for-like replacement vehicles); and that there was no clear evidence on whether the benefits did exceed the costs." Also see example in paragraph 2.10. These indicate the approach followed by the CMA in assessing the benefits under credit hire compared to direct hire.

- 2.10 The clearest example of this incorrect approach in the Working Paper is where the CMA, based on evidence from its consumer survey, recognised that there was a quality shortfall under direct hire in about 6% of claims (even though the call records reveal a quality difference in a much higher proportion of claims) but instead of assessing the cost of remedying this quality shortfall it instead estimated consumers' value of the higher quality in order to assess the benefits from the quality difference. This effectively means that the CMA has approached the assessment on the basis that consumers' legal entitlements are not being met and has valued those entitlements to consumers. The correct analysis would have been to calculate the cost to the consumer of remedying the quality shortfall under direct hire.
- 2.11 The CMA has not provided any systematic analysis of the elements of credit hire service provision that are over and above consumers' legal entitlement. We understand from AX that the quality differences we have identified relate to elements of hire provision that are part of consumers' legal entitlement. Therefore, any diminution in quality would reflect consumers not achieving their legal entitlement.
- 2.12 As set out later in this report¹⁰, the CMA has also failed to consider the payments made by consumers to at-fault insurers to close the quality gap between credit hire and direct hire. It, therefore, has not assessed the relevant evidence in order to quantify the net detriment or the distributional consequences of direct hire relative to credit hire.

Conclusions

- 2.13 In conclusion, the CMA has failed in its analysis of the net detriment to apply an appropriate framework and take into account the relevant evidence:
- Since the CMA has compared the status quo with an idealised benchmark in its AEC analysis, it is not in a position in its remedies analysis to identify the part of the AEC detriment that results due to separation and the part of the AEC detriment that results due to frictional costs. Further, the CMA has not evaluated appropriately the quality shortfall under direct hire absent separation and has also failed to consider the distributional implications of its analysis.
 - We provided an explicit economic framework in CL1 to analyse quality of service differences between credit hire and direct hire and, therefore, to quantify the net detriment. The CMA has neither referred to this framework in the Working Paper nor has it provided an explicit economic framework of its own. Its quantification of the net detriment is, therefore, not grounded in making a proper economic comparison.

¹⁰ See paragraphs 5.8 to 5.22 below.

- The CMA's approach of using consumer surplus to analyse the quality shortfall under direct hire is incorrect and departs from its paradigm of taking consumers' legal entitlement as given. A consequence of this approach is that the remedy proposed on this basis does not take consumers' legal entitlement as sacrosanct but rather is based on an erosion of consumers' legal entitlement.

Section 3

Concerns in relation to the effects of separation

Introduction

- 3.1 In Provisional Findings, the CMA had a sub-section on the effects of separation in which it discussed the effects of bilateral agreements between insurers (see Provisional Findings, paragraphs 6.8 to 6.11). We commented on the effects of bilateral agreements in CL1 and CL2 (see Section 3 of CL1 and point 1 of CL2).

Concerns

Issue of whether bilateral agreements lead to consumers being provided their legal entitlement

CL analysis

- 3.2 In previous reports we raised the concern that bilateral agreements are used by insurers to agree mutually not to provide consumers their legal entitlement (see paragraphs 3.15 of CL1 and point 1 of CL2). We considered it necessary for the CMA to review these bilateral agreements in order to assess this issue.

- 3.3 [REDACTED]. This showed that insurers were seeking to use bilateral agreements to agree mutually to not provide consumers their full legal entitlement.

- 3.4 The CMA stated that it intended to investigate the issue of bilateral agreements further by collecting data on service quality (see email from CMA to AX, 10 March 2014). We suggested that the CMA should look at the clauses of the bilateral agreements themselves to establish whether they indicate that insurers agree implicitly or explicitly to provide a service level that is in any respect less than consumers' legal entitlement, in addition to the work the CMA intended to do (see CL paper attached to the DLA letter sent to the CMA on 14 March 2014). We also requested the CMA to provide access to the bilateral agreements for inspection by CHCs who are in a better position to assess whether or not any specific provisions in the bilateral agreements indicate any attempt by insurers to not provide consumers' their full legal entitlement (see, for example, letter from DLA to CMA, dated 18 February 2014).

CMA's treatment of the concern

- 3.5 The CMA has not referred to the evidence provided by AX in the Working Paper.
- 3.6 However, the CMA has stated that it reviewed bilateral agreements and collected quantitative evidence on the proportion of split liability cases and the proportion of non-fault claimants receiving a TRV (excluding courtesy cars) for three categories of claims: same insurer, no bilateral and bilateral.
- 3.7 On reviewing bilateral agreements which exist between some insurers, the CMA found that these agreements do not require the adoption of practices with the aim of denying non-fault claimants the services to which they are entitled. The CMA noted, however, that it is still possible that insurers' replacement vehicle provision is worse under a bilateral agreement.¹¹ It appears from this statement that the CMA acknowledges the possibility of insurers' agreeing to not provide consumers' their legal entitlement in cases where there is no explicit agreement in the bilateral contracts. However, it has not taken this into account when assessing the AEC and the consumer detriment.
- 3.8 The CMA has identified three different ways in which the quality of service could be reduced under bilateral agreements: (i) insurers settling a larger fraction of claims with split liability; (ii) insurers providing replacement vehicles to a smaller proportion of non-fault claimants; and (iii) insurers providing replacement vehicles of a lower category or with an inferior service.
- 3.9 Issues (i) and (ii) above do not address AX's concern as it relates only to whether or not a TRV is provided under bilateral agreements compared to no bilateral cases. AX's concern was that bilateral agreements are used by insurers to not provide consumers their full legal rights. Only issue (iii) relates to AX's concern. Therefore, in what follows we only consider issue (iii).

¹¹ See Working Paper, paragraph 101.

- 3.10 In relation to issue (iii), the CMA has stated in the Working Paper that individually, insurers do not have an incentive to under-provide services to their own customers when they are subrogating the cost to the fault insurer. However, the CMA has noted that “if both parties to a bilateral agree to reduce provision, they can both gain through lower costs” and that “such implicit agreements may be easier to negotiate between insurers of similar size” than insurers that greatly differ in their size.

(See paragraphs 99 to 107 and footnote 30 of the Working Paper.)

Status of the concern

- 3.11 The CMA has failed to address adequately our concern in relation to bilateral agreements.
- 3.12 The CMA has performed no quantitative analysis to address issue (iii) above. In particular, not only has the CMA not conducted any quantitative analysis to compare the quality levels between credit hire and direct hire¹², it has also not conducted any analysis of quality levels in the presence and absence of bilateral agreements.
- 3.13 It is only the qualitative evidence stated by the CMA on their review of bilateral agreements that attempts to address this concern. However, the CMA has not stated the number of bilateral agreements it has reviewed in assessing this concern. Further, the CMA has not provided access to the bilateral agreements for inspection by CHCs who are in a better position to assess whether or not any specific provisions in the bilateral agreements indicate any attempt by insurers to not provide consumers’ their full legal entitlement. This is despite AX’s request for access to the copies of all bilateral agreements between insurers that have been provided to the CMA (see, for example, letter from DLA to CMA, dated 18 February 2014).¹³

¹² We note that the CMA conducted a consumer survey, the results of which, according to the CMA, show that a small proportion of non-fault claimants thought that their replacement vehicle fell short of their needs for captured claims relative to claims managed by non-fault insurers or claims management companies (CMCs). However, for reasons mentioned in paragraph 4.41 below, using this result for analysing quality differences is incorrect. The correct approach would have been to calculate the cost to the consumer of obtaining the quality shortfall under direct hire.

¹³ Please also see point 1 of CL’s data room analysis, 8 July 2014.

Work required to address this concern

- 3.14 Given that the CMA acknowledges a potential for insurers mutually to agree to reduce provision and thus gain by lowering costs, the CMA should have conducted quantitative (see paragraph 3.12 above) and qualitative analysis to address this issue. The CMA should provide information on the number of bilateral agreements it has reviewed in assessing this concern. The CMA also ought to put the bilateral agreements it has reviewed for inspection by CHCs who are in a far better position to assess whether or not a bilateral agreement indicates any attempt by insurers to not provide consumers their full legal entitlement. Without access to these agreements between insurers we are not in a position to comment on the CMA's review of these agreements.

Conclusions

- 3.15 The key point in this section is:
- The CMA has failed to address our concern that bilateral agreements are used by insurers to agree mutually not to provide consumers their legal entitlement. This is because (a) the CMA has conducted no quantitative analysis to address the difference in quality levels in the presence and absence of bilateral agreements; (b) it is not clear whether the CMA reviewed a sufficient number of bilateral agreements in assessing this concern; and (c) the CMA has not provided access to the bilateral agreements for inspection by the CHCs who are in a better position to assess whether or not any specific provisions of the bilateral agreements indicate any attempt by insurers to not provide consumers their full legal entitlement.

Section 4

Concerns in relation to the effects of separation on insurers' and brokers' cost and revenue

Introduction

- 4.1 In its Provisional Findings, the CMA addressed the effects of separation on insurers' and brokers' cost and revenue (see Provisional Findings, paragraph 6.12 to 6.28). We raised concerns in relation to the CMA's analysis in CL1 and CL2 (see Section 4 of CL1 and points 2–15 of CL2).

Concerns

Failure to account for VAT effects

CL analysis

- 4.2 We raised two sources of concern in relation to VAT. First, the CMA had made a material error by comparing direct hire rates that excluded VAT with credit hire rates that included VAT, which led to overestimating the multiple of credit hire rate over direct hire rate. Second, if the beneficiary of a TRV was VAT registered, the insurer does not pay for VAT under credit hire but pays VAT under direct hire. Therefore, the CMA's approach of grossing up direct hire rates by VAT would not lead to a like for like comparison with credit hire on the population of claims identified. (See paragraphs 5.25 to 5.27 of CL1 and point 2 of CL2.)
- 4.3 CL estimated the impact of the first source of concern to be £181 per claim by excluding VAT from credit hire rates (see paragraphs 5.27 of CL1 and point 2 of CL2).
- 4.4 We suggested that the CMA should investigate this concern rigorously by collecting and analysing relevant quantitative information, augmented with qualitative information where relevant (see CL paper attached to the DLA letter sent to the CMA on 14 March 2014).

CMA's treatment of the concern

- 4.5 The CMA had corrected for the exclusion of VAT in the direct hire rates provided by three insurers by adding 20% VAT to these rates (see Notice of Erratum, 17 February 2014).
- 4.6 However, the CMA has dismissed the significance of the second source of concern i.e. that for beneficiaries of the TRV that are VAT registered, the insurer does not pay for VAT under credit hire but pays VAT under direct hire. The CMA has noted that at least some insurers pay VAT for direct hires even if the claimant is VAT registered. However, they state that the "proportion of PMI replacement vehicles in which VAT is not paid by the insurer is small". (See paragraphs 81 to 84 of Working Paper.)
- 4.7 In the sensitivity analysis, the CMA has referred to evidence from one insurer that the proportion of claims where the client was a private motorist and was VAT registered was less than 5% of the total claims handled by the insurer. Based on this evidence, the CMA has excluded VAT from credit hire in 5% of the claims which results in reducing the net detriment in relation to TRVs by £3.3 million to £83.7 million (see paragraph 9, Appendix G of Working Paper).

Status of the concern

- 4.8 The CMA has addressed our first source of concern provided that the direct hire revenue used by the CMA to calculate the direct hire rates include VAT.
- 4.9 The CMA has failed to address adequately our second source of concern, i.e. that for beneficiaries of the TRV that are VAT registered, the insurer does not pay for VAT under credit hire but pays VAT under direct hire. This is because the CMA has relied on data from only one insurer on the number of claims where the claimant was a private motorist and VAT registered and such data may not be representative.
- 4.10 Since the CMA has acknowledged this concern it should have properly investigated it by reference to an adequate sample of providers and included the impact of this concern in its base estimate of net detriment.¹⁴

Work required to address this concern

- 4.11 The CMA should obtain quantitative evidence from a large set of CHCs/insurers on the proportion of claims where the claimant was both a private motorist and VAT registered. Without undertaking this work the CMA cannot know that "proportion of PMI replacement vehicles in which VAT is not paid by the insurer is small".

¹⁴ Please also see point 2 of CL's data room analysis, 8 July 2014.

- 4.12 Once the CMA has obtained the quantitative evidence, it should then use this evidence in quantifying the impact of this concern. Further, it should adjust its base estimate of the net detriment for the impact of this concern instead of adjusting for the impact in the sensitivity analysis.

Overestimate of credit hire costs

CL analysis

- 4.13 In previous reports we raised a concern that the CMA had not made clear the sample of CHCs it used to estimate the credit hire costs and in particular whether Enterprise (which is considered to be a low cost provider) is included in the sample. We noted that the possibility of excluding Enterprise could have led the CMA to overestimate credit hire costs. (See paragraphs 5.28 to 5.29 of CL1 and point 3 of CL2.)
- 4.14 The CMA stated that the issue of credit hire rates being overstated due to the exclusion of Enterprise did not arise and that it did not intend to disclose further information in relation to this issue (see email from CMA to AX, 10 March 2014). We suggested that the CMA should clarify its statement of why this concern did not arise (see CL paper attached to the DLA letter sent to the CMA on 14 March 2014).

CMA's treatment of the concern

- 4.15 The CMA has not stated explicitly in its Working Paper whether Enterprise has been included in the sample of CHCs used for calculating the credit hire daily rate. Therefore, it is not clear whether the CMA has or has not overestimated credit hire costs in this regard.

Status of the concern

- 4.16 The CMA has not addressed this concern.¹⁵

Work required to address this concern

- 4.17 The CMA should clarify whether Enterprise has been included or excluded from its sample of CHCs whose data was used for calculating credit hire daily rates and average credit hire bill.

¹⁵ Please also see point 3 of CL's data room analysis, 8 July 2014.

Understated direct hire costs (2) – failure to reflect full costs of direct hire¹⁶

CL analysis

- 4.18 In previous reports we raised a concern that the CMA may not have taken into account the full costs of direct hire by excluding add-on items such as uplifts for non-standard drivers or automatic cars, all of which was included in the credit hire bills. We stated that to the extent at-fault insurers pay for these add-ons, such costs should be reflected in the cost of direct hire (see paragraphs 5.35 to 5.38 of CL1 and point 5 of CL2).
- 4.19 As part of its response to the CMA's Provisional Findings, AX provided evidence on what additional services a CHC is allowed to charge for under the GTA (see Exhibit 3 in Annex 2 to AX's Response to Provisional Findings). In addition, AX provided a breakdown of its revenue billed into hire revenue and revenue from extras (see Exhibit 1 in Annex 2 to AX's Response to Provisional Findings).
- 4.20 Using the evidence provided by AX, we found that charges for automatics, estate cars, SatNav, tow bar and non-standard drivers accounted for [redacted]% of AX's bills in 2012 (including VAT, or [redacted] excluding VAT). This amounted to £[redacted] on average per credit hire bill (= £1,085 [redacted]). (See paragraph 5.37 of CL1 and point 5 of CL2.) Using the CMA's estimate of 301,000 credit hire claims, the total impact of this factor would have amounted to £[redacted] ([redacted]*301,000) compared to the £69 million identified by the CMA in the Erratum as net detriment from separation in relation to credit hire.
- 4.21 The CMA stated that it did not have data on the full cost of direct hire and that it intended to investigate this issue further (see CMA's Reply to DLA, 25 February 2014). We suggested that the CMA should investigate this concern rigorously by collecting and analysing relevant information, augmented with qualitative information where relevant (see CL paper attached to the DLA letter sent to the CMA on 14 March 2014).

CMA's treatment of the concern

- 4.22 The CMA has not referred to the evidence provided by AX in the Working Paper and there is accordingly no evidence that it has taken into account relevant evidence.
- 4.23 The CMA has stated that since it is now deriving direct hire rates from direct hire providers' revenue, adjusting for the additional extras is no longer necessary. However, it has not indicated explicitly whether the direct hire revenue includes revenues from all extras sold by direct hire providers (see Paragraphs 58 to 62 of Working Paper).

¹⁶ In CL1 we raised a concern on "Understated direct hire costs (1) – bias from only including three large insurers' direct hire rates". The CMA appears to have addressed this concern in the Working Paper.

Status of the concern

- 4.24 The CMA does appear to have now considered the full cost of direct hire, provided that the direct hire revenue used by the CMA includes payments made by at-fault insurers for elements of service provision that are part of consumers' legal entitlement.

Work required to address this concern

- 4.25 The CMA should confirm whether the direct hire revenue figures include payments made by at-fault insurers to direct hire providers for all elements of service provision that are part of consumers' legal entitlement.

Understated direct hire costs (3) – bias if the CC has used “bracketed” direct hire rates

CL analysis

- 4.26 In previous reports we raised a concern that the CMA may have understated direct hire costs as a result of using “bracketed” direct hire rates (see paragraph. 5.39 to 5.42 of CL1 and point 6 of CL2).
- 4.27 As part of its response to the Provisional Findings, AX submitted evidence that direct hire companies use bracketed rates (see for example Exhibit 4 and Exhibit 7 in Annex 2 to AX's Response to Provisional Findings).
- 4.28 We provided an example that showed that the impact of this factor could be £81 per direct hire claim (see paragraph 5.42 of CL1). Using the CMA's estimate of 301,000 credit hire claims, the total impact of this factor would have amounted to £24.3 million (=£81*301,000) compared to the £69 million identified by the CMA in the Erratum as net detriment from separation in relation to credit hire. For an alternative estimate of the potential impact of bracketing, please refer to point 6 of CL2.
- 4.29 We suggested that the CMA should investigate this concern rigorously by collecting and analysing relevant quantitative information, augmented with qualitative information where relevant (see CL paper attached to the DLA letter sent to the CMA on 14 March 2014).

CMA's treatment of the concern

- 4.30 The CMA has not directly referred to the evidence provided by AX in the Working Paper. However, it has noted that Enterprise, the largest direct hire provider, does not categorise cars according to the classes used for credit hire under the GTA (which was one of the evidence provided by AX).

- 4.31 The CMA has stated that Enterprise, the largest direct hire provider, uses standard hire classes which are not as granular as the classes used by the GTA. Since Enterprise accounts for a big share of the direct hire market, the CMA has tried to estimate the impact of its practice when comparing credit hire and direct hire rates (it has noted that other direct hire providers may use more granular classification).
- 4.32 The CMA has noted two implications of broad classification adopted by Enterprise:
- A broad classification could help Enterprise source cars more cheaply since it is easier to source a car within a larger group.
 - Quality of service provided in direct hire and credit hire may differ as claimants may get comparable cars in credit hire but not in direct hire.
- 4.33 The first implication is covered in the CMA's estimation of the consumer detriment as the direct hire rates would reflect the lower costs of direct hire providers.
- 4.34 For the second implication, the CMA has adopted an approach to analysing this whereby (i) it has assumed that Enterprise provides the cheapest car within each broad category; (ii) computed the fraction of total hire days for different GTA classes which do not correspond to the cheapest model within one of Enterprise's classes.
- 4.35 The CMA found that there may be a quality difference in at most 20% of cases, most of which pertain to sports and premium car categories. However, the CMA has stated that the Enterprise and GTA classes match quite closely on size of vehicles, power and number of doors and where they may not match is the prestige of the car. The CMA has stated that there is a room for doubt about how important more precise matching is for the relatively short period of a typical replacement car hire.
- 4.36 Further, the CMA has quoted evidence from their consumer survey which shows that a very small proportion of non-fault claimants thought that their replacement vehicle fell short of their needs for captured claims relative to claims managed by non-fault insurers or claims management companies (CMCs), with the differences being due to replacement cars falling 'slightly' short of their needs for captured claimants than replacement cars falling 'well' short of the needs.
- 4.37 The CMA concluded that quality differences resulting from bracketing is likely to be small (affecting no more than 6% of the non-fault claimants). (See paragraphs 48 to 54 of Working Paper.)

4.38 In its sensitivity analysis, the CMA estimated the effect of bracketing to be £6 per hire (assuming that less good quality of service is worth £100 to consumers and using the survey data that only 6% more respondents felt that the TRV did not meet their need when their claim was managed by the at-fault insurer than under claims which were managed by non-fault insurer). This amounted to £1.8 million adjustment, resulting in net detriment from credit hire of £85.2 million (down from CMA's base estimate of £87 million). (See paragraph 10, Appendix G of Working Paper.)

Status of the concern

4.39 The CMA's analysis in the Working Paper does not address our concern adequately.

4.40 There are three problems with the CMA's approach in addressing the issue of bracketing. First, the CMA is assessing the consumer surplus to the non-fault driver of getting his legal entitlement and is concluding that this surplus is small. This is an incorrect approach for reasons mentioned in paragraph 2.6 above as it indicates the CMA's willingness to allow consumers' legal entitlement being compromised. Second, the approach taken to estimate the effect of bracketing seems to be a departure from the CMA's more general approach of comparing credit hire and direct hire costs on a like-for-like basis where the grade of car provided is the same under credit hire and direct hire. Finally, even if "bracketing" reduces the cost of provision under direct hire, that cannot be 'traded-off' against consumers' legal entitlement.

4.41 Further, using the survey results to conclude that the number of claimants who felt the TRV fell short of their needs under direct hire was only 6% more than under claims managed by non-fault insurer is erroneous as (i) 'needs' are subjective and vary from consumer to consumer; and (ii) consumers 'needs' might be less than their legal entitlement and the CMA takes the latter as given and so it has not properly assessed this issue by reference to the appropriate benchmark. Therefore, the CMA is not in a position to use the survey results to dismiss the impact of bracketing and it has not collected the relevant evidence to consider the impact of bracketing. The CMA has also ignored the results from the call records, which showed that 70% of claimants whose claims were managed by fault insurers received a replacement car similar to their own while 92% of the claimants whose claims were managed by non-fault insurers received a replacement car similar to their own. A potential reason for this difference (22 percentage points) could be bracketing and the CMA should investigate this. (See paragraph 6.30, footnote 25 of Provisional Findings.)

4.42 It is incorrect for the CMA to adjust for the effect of bracketing in its sensitivity analysis. This adjustment should be made to the CMA's base case estimate given that the CMA acknowledges the problem.¹⁷

¹⁷ Please also see point 6 of CL's data room analysis, 8 July 2014.

Work required to address this concern

- 4.43 Given that the CMA acknowledges the problem in direct hire rates, it should investigate this concern rigorously by collecting and analysing relevant quantitative information, augmented with qualitative information where relevant. In order to calculate the net detriment after adjusting for bracketing, the CMA could, for example, calculate the multiple using the credit hire rate and direct hire rate for only the cheapest car within each car category. Further, the CMA should adjust its base case estimate for the impact of this concern. Without doing this the CMA is not in a position to know the appropriate figure to include in the AEC calculation.

Omitted direct hire costs (1) – discounted direct hire rates

CL analysis

- 4.44 In previous reports we raised a concern that the CMA had not analysed the market dynamics around the provision of direct hire and not accounted for the commercial incentive of CHCs to offer lower direct hire rates in the light of their interests to obtain credit hire referrals (see paragraphs 5.43 to 5.46 of CL1 and point 7 of CL2).
- 4.45 In CL2 we noted the evidence provided by other CHCs in relation to this point. For example - Kindertons had stated that they offer direct hire solution as part of a wider credit hire commercial arrangement. (See point 7 of CL2.)
- 4.46 We suggested that the CMA should investigate the concern rigorously by collecting and analysing relevant quantitative information, augmented with qualitative information where relevant (see the CL paper attached to the DLA letter sent to the CMA on 14 March 2014).

CMA's treatment of the concern

- 4.47 The CMA has not referred to the evidence provided by other CHCs including the evidence provided by Kindertons which has stated that it itself offers direct hire solution as part of a wider commercial arrangement.

- 4.48 The CMA focussed its analysis of the concern on Enterprise. It was unclear to the CMA why Enterprise, which has a large share of direct hire market and a small share of credit hire market, would price direct hire low and credit hire high. Further, Enterprise told the CMA that it does not cross-subsidise between credit hire and direct hire and that it offered the same direct hire rates irrespective of whether an insurer tendered for direct hire only or jointly for direct hire and credit hire. The CMA collected quantitative evidence from Enterprise on the profitability of its hire services using which it estimated Enterprise's net daily rate under third party direct hire and credit hire. It appears that the CMA first obtained average credit hire and direct hire daily rates, then subtracted non-essential functions, referral fees and uncollectable debts from average credit hire daily rate to obtain the net credit hire daily rate. This was then compared to the net direct hire daily rate which was the same as average direct hire daily rate (see Table 5 of Working Paper). Further, the CMA stated that there is at least one direct hire provider that does not provide credit hire services – Europcar.
- 4.49 The CMA also stated that it is implausible that Enterprise is pricing below its cost to get monopoly position because (a) there are few obstacles to other large hire companies competing for this business; and (b) when Enterprise finally increases its rates, competitors would be able to increase their share of direct hire.
- 4.50 Thus, the CMA found no qualitative or quantitative evidence that supported this concern. (See paragraphs 73-80 of Working Paper.)

Status of the concern

- 4.51 The CMA's response does not address our concern adequately.
- 4.52 The quantitative evidence collected by the CMA in relation to net daily rates charged by Enterprise for credit hire and direct hire is redacted and the CMA has not disclosed this information in the data room despite our request for the data (see CL paper attached to DLA's email to CMA on 17 June 2014). Without access to the data, we are unable comment fully on the analysis done by the CMA or understand its conclusions. For example (i) we do not know what data was used to arrive at the average credit hire and direct hire daily rates; (ii) we do not understand what non-essential functions include and why they are subtracted from the average credit hire daily rates.

4.53 Further, the CMA has not collected any qualitative or quantitative evidence from other direct hire providers and has relied solely on the data and statements provided by Enterprise. This is plainly insufficient. We note that the CMA received data from Helphire in relation to their direct hire business and credit hire business (see Appendix D of Working Paper). These data could help assess the concern. However, again these data are redacted and the CMA has not disclosed this information, despite our request for the data (see CL paper attached to DLA's email to CMA on 17 June 2014). Unless we are able to analyse this data, we will not be in a position to comment fully on the analysis done by the CMA or understand its conclusions.¹⁸

Work required to address this concern

4.54 The CMA should investigate the concern rigorously by collecting and analysing relevant quantitative information, augmented with qualitative information where relevant. The CMA should investigate the extent to which credit hire companies provide direct hire services on terms where it is not viable for the entire business.

Omitted direct hire costs (2) – claims management services provided

CL analysis

4.55 In previous reports we raised a concern that the CMA had not considered or taken account of the extent to which insurers benefit from the provision of claims management services for direct hire because of CHCs incentives to obtain credit hire business (see paragraphs 5.50 to 5.53 of CL1 and point 9 of CL2).

4.56 We suggested that the CMA should investigate this concern rigorously by collecting and analysing relevant quantitative information, augmented with qualitative information where relevant (see CL paper attached to the DLA letter sent to the CMA on 14 March 2014).

CMA's treatment of the concern

4.57 The CMA has dismissed this concern in the Working Paper. It has stated that this issue was raised by AX in reference to the business of other CHCs but no other CHC mentioned this issue (see paragraph 38 of Working Paper).

Status of the concern

4.58 The CMA's response does not address our concern adequately as other CHCs may not have realised the relevance of this practice to the CMA's analysis and hence might not have provided evidence in relation to this concern.¹⁹

¹⁸ Please also see point 7 of CL's data room analysis, 8 July 2014.

¹⁹ Please also see point 8 of CL's data room analysis, 8 July 2014.

Work required to address this concern

- 4.59 The CMA should ask each CHC if it provided such services to insurers which the insurers benefit from. The CMA should investigate this concern rigorously by collecting and analysing relevant quantitative information, augmented with qualitative information where relevant.

Omitted direct hire costs (3) – payment timing

CL analysis

- 4.60 In previous reports we raised a concern that the CMA had not taken account of the implications of payment timing i.e. that insurers settle credit hire invoices on average considerably later than direct hire invoices (see paragraphs 5.50 to 5.53 of CL1 and point 9 of CL2).
- 4.61 As part of its response to the Provisional Findings, AX submitted data on its average debtor days for the period 1 November 2011 to 1 November 2012 and this was equal to 192 days (see Exhibit 8 in Annex 2 to AX's Response to Provisional Findings).
- 4.62 In CL1, we provided an example that showed that the impact of this factor could be £42 for which we assumed an illustrative discount rate of 10% and the average difference in payment delays between credit hire and direct hire of five months (or about 150 days) (see paragraph 5.52 of CL1). This estimate of £42 would have been equal to 3.90% of the average credit hire bill of £1,085. Using the CMA's estimate of 301,000 credit hire claims, the total impact of this factor would have amounted to £12.6 million (=£42*301,000) compared to the £69 million identified by the CMA in the Erratum as net detriment from separation in relation to credit hire.
- 4.63 To quantify this factor we used the weighted average cost of capital (WACC) as the appropriate discount rate. We indicated that WACC was the appropriate rate to use as the payments in question were the insurance companies' accounts payable which in turn are part of their working capital and a company's cost of financing its working capital is given by its WACC.
- 4.64 We suggested that the CMA should investigate this concern rigorously by collecting and analysing relevant quantitative information, augmented with qualitative information where relevant (see CL paper attached to the DLA letter sent to the CMA on 14 March 2014).

CMA's treatment of the concern

- 4.65 The CMA has not directly referred to the evidence provided by AX in the Working Paper and so there is no indication that it has taken account of this relevant evidence.

4.66 CMA has acknowledged that there is timing benefit associated with credit hire. To estimate the benefit it has obtained the weighted average difference in delays between credit hire bill payments and direct hire bill payments, where weights are the percentage of payments received within different periods (0-30 days, 31-60 days etc). The average delay in credit hire payment within each time period has been calculated using the data provided by one CHC (since only one CHC could provide daily data on payments received). We note that the average difference in payment delays between credit hire and direct hire in the CMA's calculation is about 161 days.²⁰ It has used a cost of debt of 5%.²¹ Combining the weighted average difference in delays of payments between credit hire and direct hire along with cost of debt, it obtained the timing benefit to be equal to 2.20% of the overall bill. The CMA has subsequently discounted the average credit hire rate by 2.20%. (See paragraphs 85 to 91 of Working Paper.)

Status of the concern

- 4.67 The CMA's response does not address our concern adequately as it has failed to provide a correct estimate of the benefit.
- 4.68 The CMA has simply assumed that accounts payable, which is part of the working capital of a firm, is funded by debt and has not provided any reason for why the working capital cannot be funded by a mix of debt and equity. The CMA has not provided any justification for preferring the cost of debt to WACC in estimating the impact of this concern.
- 4.69 As mentioned in paragraph 4.63 above, we believe the correct discount rate to use would be WACC because the payments in question are the insurance companies' accounts payable which in turn are part of their working capital and a company's cost of financing its working capital is given by its WACC.²²

Work required to address the concern

- 4.70 The CMA should obtain data on WACC for insurers and apply this information to estimate the benefit. In the alternative if the CMA were to continue using the cost of debt, the CMA should explain how insurers fund their working capital rather than simply assuming that the cost of debt is the correct discount rate. It should also explain why a company's cost of financing its working capital is not given by its WACC.

²⁰ We calculate this based on data provided in Table 7 of the Working Paper (i.e. using data on fraction of credit hire payments falling into different categories to weight the average difference in payment delays between credit hire and direct hire in each category).

²¹ See footnote 28 of Working Paper: the CMA has stated that this is the approximate average suggested by the analysis of insurers' reports and accounts.

²² Please also see point 9 of CL's data room analysis, 8 July 2014.

Omitted direct hire costs (4) – insurance risk

CL analysis

- 4.71 In previous reports we raised a concern that the CMA had not taken into account any situations where the fault insurer bears the additional risks in respect of direct hire. In cases where the fault insurer bears the additional risk in respect of direct hire, the costs under direct hire would be higher once it is adjusted for the risk level to make it comparable to credit hire (see paragraphs 5.54 to 5.55 of CL1 and point 10 of CL2).
- 4.72 We suggested that the CMA should investigate this concern rigorously by collecting and analysing relevant quantitative information, augmented with qualitative information where relevant (see CL paper attached to the DLA letter sent to the CMA on 14 March 2014).

CMA's treatment of the concern

- 4.73 The CMA did not address this concern in the Working Paper.

Status of the concern

- 4.74 The CMA has not addressed this concern in the Working Paper.²³

Work required to address this concern

- 4.75 The CMA should investigate this concern rigorously by collecting and analysing relevant quantitative information, augmented with qualitative information where relevant.

Omitted relevant adjustments to the base year (1) – GTA efficiency improvements

CL analysis

- 4.76 In previous reports we raised a concern that the CMA had conducted a static analysis that has not considered improvements in the efficiency of the GTA (see paragraphs 5.56 to 5.58 of CL1 and point 11 of CL2) despite its recognition that the GTA provides an efficient framework for negotiation and settlements of claims.²⁴
- 4.77 AX provided details of the minimum expected cost savings arising out of the current project to increase the efficiency of the GTA in its Response to the Provisional Findings (see Exhibit 9 in Annex 2 to AX's Response to Provisional Findings). In CL2, we noted evidence provided by other CHCs in relation to this issue. In Helphire's experience frictional costs have reduced significantly since 2012 due to significant efficiency improvements in the management of claims under the GTA (see point 11 of CL2).

²³ Please also see point 10 of CL's data room analysis, 8 July 2014.

²⁴ See paragraph 66 in Appendix 6.1 of Provisional Findings.

- 4.78 We understood from AX that one of the sources of cost savings from GTA efficiency improvements was savings on phone calls and postage which would result in CHC's per claim saving of £[redacted]. Using the CMA's estimate of 301,000 credit hire claims, the total impact of this factor would have amounted to £[redacted] (=£[redacted]*301,000) compared to the £69 million identified by the CMA in the Erratum as net detriment from separation in relation to credit hire.
- 4.79 We also understood from AX that the online portal project that has been underway to improve the efficiency of the GTA is likely to have been slowed down by the CMA's market investigation. (See paragraph 5.57 of CL1.)
- 4.80 We suggested that the CMA should investigate this concern rigorously by collecting and analysing relevant quantitative information, augmented with qualitative information where relevant (see CL paper attached to the DLA letter sent to the CMA on 14 March 2014).

CMA's treatment of the concern

- 4.81 The CMA has not referred to the evidence provided by AX or Helphire in the Working Paper and has, therefore, not taken account of the relevant evidence.
- 4.82 However, despite not analysing the evidence provided to it on this issue the CMA has dismissed this concern in the Working Paper. It has stated that using 2013 data would not be practical as many of the claims for 2013 would still be open and there would be greater uncertainty around the revenue of CHCs. Further, the CMA has stated that many changes occurring during 2013 could have been influenced by their inquiry which started in September 2012. (See paragraph 41 of Working Paper.)
- 4.83 It must be noted that the CMA acknowledges the possibility of an increase in the efficiency of GTA arrangements (see paragraph 87 of Working Paper).

Status of the concern

- 4.84 The CMA has not addressed this concern adequately.
- 4.85 In order to address this concern, the CMA does not require data for 2013 from the CHCs. It could use the 2012 data and adjust the credit hire costs for the increase in efficiency of the GTA. In any event the CMA's justification for not using 2013 data is incorrect. While it is true that many of the claims for 2013 would still be open and, therefore, there would be greater uncertainty around the CHCs revenue, the CMA could compare, for example, the CHCs estimate of 2012 revenue as of May 2013 and the CHCs estimate of 2013 revenue as of May 2014. It could then use this comparison to adjust the latest figure for 2012 revenues.
- 4.86 We understand from AX that the online portal project was the result of an audit programme which concluded in Spring 2012, much before the start of the CMA inquiry into the private motor insurance market and so the inquiry cannot be said to have initiated this project.

- 4.87 Further, even if changes occurring during 2013 could have been influenced by the CMA's inquiry which started in September 2012, these changes need to be accounted for in the CMA's estimate of net detriment in so far as these changes are irreversible or there is no incentive for the CHCs to reverse these changes even if they are reversible. Since the increase in efficiency of GTA reduces cost to CHCs of handling the credit hire claims, it is certainly not in the CHCs interests to reverse these changes, especially when the costs incurred to increase efficiency are sunk. The CMA's analysis of the AEC compares the cost the consumer would have to pay in its benchmark with the costs it pays or would have to pay in the status quo. Given the cost to consumers would decrease in the status quo (prospectively), the CMA should compare those costs with the costs in its benchmark case.
- 4.88 Further, the CMA has taken a one-sided approach in its analysis of GTA efficiency improvements as it has not considered AX's concern of the possibility of its inquiry delaying the project that aims to increase GTA efficiency (see paragraph 4.78 above).²⁵

Work required to address the concern

- 4.89 Given that the CMA acknowledges the possibility of increase in GTA efficiency, it should investigate this concern rigorously by collecting and analysing relevant quantitative information, augmented with qualitative information where relevant.

Omitted relevant adjustments to the base year (2) – higher rate of GTA settlements

CL analysis

- 4.90 In previous reports we raised a concern that the CMA had conducted a static analysis that had not considered the rate of claims settlement within the GTA (see paragraphs 5.59 to 5.60 of CL1 and point 12 of CL2).
- 4.91 As part of its response to the Provisional Findings, AX provided historical evidence (starting from 2005) on the faster rate of GTA settlements (see Figure 2 of CL1). This evidence indicated a historical trend of increasing rate of GTA settlements. In CL2, we also noted the evidence provided by other CHCs. Kindertons pointed out that in comparison to the original data which they had provided to the CMA in 2012, the proportion of claims settled within 30 and 90 days had improved. (See point 12 of CL2.)
- 4.92 We suggested that the CMA should investigate this concern rigorously by collecting and analysing relevant quantitative information, augmented with qualitative information where relevant (see CL paper attached to the DLA letter sent to the CMA on 14 March 2014).

²⁵ Please also see point 11 of CL's data room analysis, 8 July 2014.

CMA's treatment of the concern

- 4.93 The CMA has not referred to the evidence provided by AX or Kindertons in the Working Paper and does not appear to have taken account of this relevant evidence.
- 4.94 Moreover, the CMA has not addressed this concern at all despite it being important in terms of its detriment analysis. However, it has noted elsewhere in its Working Paper that there has been an increase in the percentage of payments received within 30 days by CHCs in the first six months of 2013 compared to 2012 (see paragraph 87 and Figure 1 of Working Paper).

Status of the concern

- 4.95 The CMA has not addressed this concern. If the CMA were to use the same arguments as in paragraph 4.82 above, then it would be ignoring the historical trend of increasing GTA settlements that AX provided as evidence in relation to the Provisional Findings.²⁶

Work required to address the concern

- 4.96 The CMA should investigate this concern rigorously by collecting and analysing relevant quantitative information, augmented with qualitative information where relevant.

Omitted relevant adjustments to the base year (3) – corrections to provisions

CL analysis

- 4.97 In previous reports we raised a concern that the credit hire costs for AX in 2012 were overstated and that AX's realised revenue for 2012 was actually materially lower than its forecast when it submitted data to the CMA in 2013. We said that this issue may apply to other CHCs as well (see paragraphs 5.61 to 5.62 of CL1 and point 13 of CL2).
- 4.98 However, on reviewing AX's response to EP10, we found that the figure originally submitted by AX was largely correct. We still considered that the CMA needed to verify and/or update the figures for revenue recognised in 2012 for all CHCs since the original figure had a large forecast element. (See email from Compass Lexecon to CMA, 28 May 2014.)
- 4.99 We suggested that the CMA should investigate this concern rigorously by collecting and analysing relevant quantitative information, augmented with qualitative information where relevant (see CL paper attached to the DLA letter sent to the CMA on 14 March 2014).

CMA's treatment of the concern

- 4.100 The CMA has stated that it has obtained updated 2012 data from AX and we believe the CMA has used this data in its calculations (see paragraph 41 of the Working Paper).

²⁶ Please also see point 12 of CL's data room analysis, 8 July 2014.

Status of the concern

- 4.101 The CMA's analysis does not address our concern adequately. We considered that the CMA should update the revenue recognised figures for all CHCs (and not just for AX) and to base its calculations on figures with a lower forecast element. However, the CMA does not seem to have collected updated information from all CHCs and therefore there is bound to be uncertainty around the estimates of credit hire daily rates and the average credit hire bill as the revenue data that was used to estimate these variables would have a large forecast element.²⁷

Work required to address the concern

- 4.102 The CMA should collect updated revenue recognised figures for 2012 from all CHCs in its sample to calculate the average credit hire daily rate and the average credit hire bill. This would ensure that the calculations are based on data that have a lower forecast element to it.

Decomposition of the residual

CL analysis

- 4.103 In our previous reports we raised a concern that the CMA should decompose the residual between that arising from the difference between credit hire costs and GTA costs and that arising from the difference between GTA costs and direct hire costs. We said that this is relevant for both the AEC and the remedies assessment as in so far as a proportion of residual between credit hire costs and direct hire costs arise from the difference between the GTA costs and direct hire costs, the CMA should consider that the GTA is an efficient way to resolve claims between parties with non-aligned interests.

(Paragraph 5.66 of CL1 and point 14 of CL2)

- 4.104 Previously the CMA had not commented on the concern. We suggested that the CMA should consider whether each of the cost and benefit differentials between direct hire and credit hire are attributable to the difference between direct hire and GTA or to the difference between GTA and credit hire and then consider the implications of this assessment on its conclusions of net detriment (see CL paper attached to the DLA letter sent to the CMA on 14 March 2014).
- 4.105 We note that the CMA raised queries on the "decomposition" exercise at the bilateral hearing between Accident Exchange and the CMA on 4 March 2014. We provided a response to these queries in our submission to the CMA on 10 April 2014 (See CL's paper on Response to the CMA's queries, submitted on 10 April 2014).

²⁷

Please also see point 13 of CL's data room analysis, 8 July 2014.

CMA's treatment of the concern

4.106 The CMA has not addressed the decomposition concern in its Working Paper.

Status of the concern

4.107 The CMA has not addressed this concern.²⁸

Work required to address the concern

4.108 The CMA should carry out the decomposition exercise for a proper analysis of the AEC and the remedies.

Analysis of the CMA's direct estimate of frictional costs of CHCs

CL analysis

4.109 In previous reports we raised a concern that the CMA's residual approach of estimating transactional and frictional costs appeared to be inconsistent with its direct estimation of frictional costs which were substantially lower. The CMA had provided very little explanation of these figures, and in particular the CMA failed to set out what proportion of these costs relate to disputes around resolution of liability and/or recovery of uninsured losses (see paragraphs 5.71 to 5.72 of CL1 and point 15 of CL2).

4.110 Previously, the CMA had not commented on this concern specifically but had stated that the parties who provided data on frictional costs had difficulties in quantifying these frictional costs (see email from CMA to AX, 10 March 2014). This suggested that the CMA did not intend to rely on its direct estimates of frictional costs. We suggested that the CMA should study insurer behaviour to assess the extent to which their behaviour of resisting claims outside the GTA would explain the frictional costs (see paragraphs 5.72 of CL1).

CMA's treatment of the concern

4.111 The CMA has not analysed the frictional costs incurred by CHCs in its Working Paper.

4.112 The CMA has stated in its Working Paper that whatever the reason for the excessive frictional costs arising from the interaction between insurers and CHCs, these represent part of the detriment from separation as such frictional costs would not be present without the features of the market causing the AEC (see paragraph 27 of the Working Paper). However, the CMA has stated that understanding the sources of friction could be useful for the evaluation of proposed remedies; yet it has not undertaken any adequate work to understand these sources of friction.

²⁸ Please also see point 14 of CL's data room analysis, 8 July 2014.

4.113 In order to analyse the extent to which the delays in payments by insurers result from the inefficiency of the insurer and the extent to which they reflect the rational behaviour of cost-minimising insurers, the CMA has obtained quantitative data on the recovery rate of credit hire claims in 2012 as a function of timing of payments, for six large CHCs. The CMA noted from this data that the recovery rate declines with payment delay, except for when payment is delayed between 31 and 60 days for which recovery rate is higher compared to no delay. The CMA concluded that the general decline in recovery rate is consistent with more justified challenges to credit hire bills taking longer to resolve. However, the CMA has also acknowledged that the decrease in recovery rate for delays between 31 and 60 days could be suggestive of a certain degree of inefficiency on the side of insurers in making payments and that this was consistent with the evidence provided by Helphire, according to which more than half the delayed payments under the GTA were not due to any form of challenge. (See Appendix B of the Working Paper.)

Status of the concern

4.114 The CMA has not analysed the frictional costs of CHCs in the Working Paper.²⁹

Work required to address the concern

4.115 The CMA should analyse and provide a direct estimate of the frictional costs incurred by CHCs if it believes that the residual between credit hire costs and direct hire costs after accounting for frictional costs incurred by insurers is due to the frictional costs incurred by CHCs.

Conclusions

4.116 The key conclusions on the CMA's continued failure to properly assess the consumer detriment arising out of the alleged AEC are as follows:

- The CMA has failed to appropriately account for the effects of VAT as it collected data from only one insurer on the proportion of claims where a claimant was both a private motorist and VAT registered and such data may not be representative.
- In relation to overestimate of credit hire costs the CMA has not conveyed whether the credit hire data includes data from Enterprise (which is a low cost provider); and if it does not then the CMA has not analysed whether this overstates the cost of credit hire.
- In relation to understated direct hire costs arising from "bracketed" direct hire rates, the CMA has acknowledged but not quantified appropriately the magnitude of this issue.

²⁹

Please also see point 15 of CL's data room analysis, 8 July 2014.

- In relation to omitted direct hire costs due to discounted direct hire rates, the CMA has just relied on statements made by Enterprise and has not collected quantitative and qualitative evidence from hire providers to assess the impact of these omitted costs.
- In relation to omitted direct hire costs due to claims management services provided by CHCs, the CMA has not collected evidence from CHCs to assess the impact of these omitted costs.
- In relation to omitted direct hire costs due to payment timing, the CMA has quantified the magnitude of this concern but it has used incorrect discount rates for quantifying this concern.
- In relation to omitted direct hire costs due to insurance risk, the CMA has not addressed this concern.
- In relation to omitted relevant adjustments to base year due to GTA efficiency improvements, the CMA has not addressed this concern appropriately as (i) it has not considered the cost to the consumer under status quo (prospectively); (ii) it did not take into account the fact that the project to increase GTA efficiency was a result of an audit programme that concluded much before the CMA's inquiry process began; and (iii) it has taken a one-sided approach to its analysis wherein it has not considered AX's evidence that the CMA enquiry has delayed the project that aims to enhance GTA efficiency.
- In relation to omitted relevant adjustments to base year due to higher rate of GTA settlements, the CMA has not addressed this concern.
- In relation to omitted relevant adjustments to base year due to corrections to provisions, the CMA has not obtained updated 2012 data on revenues from credit hire for all CHCs and therefore, its estimates of credit hire rate and average credit hire bill would still come from data that involves a large forecast element. .
- In relation to decomposition of residual, the CMA has not addressed this concern.
- In relation to frictional costs incurred by CHCs, the CMA has not addressed this concern.

Section 5

Concerns in relation to quality and service differences associated with separation

Introduction

- 5.1 In Provisional Findings, the CMA addressed the quality and service differences associated with separation (see Provisional Findings, paragraphs 6.29 to 6.41). We raised concerns in relation to the CMA's analysis in CL1 and CL2 (Section 5 of CL1 and points 16–23 of CL2).

Concerns

Omitted consumer frictional costs

CL analysis

- 5.2 In previous reports we raised a concern that the CMA had omitted consumers' private frictional costs which they would need to incur to obtain their legal entitlement in the absence of credit hire. These costs were likely to be very substantial and could materially affect the AEC analysis and the possible remedies (see paragraphs 6.21 to 6.24 of CL1 and point 16 of CL2).
- 5.3 We estimated the impact of this factor to be £36.66 per additional hour the non-fault driver needs to spend with the at-fault insurer rather than with the CHC/CMC (see paragraph 6.24 of CL1 and point 16 of CL2). Illustratively, if the consumer were to spend one more hour with the at-fault insurer rather than with the CHC/CMC, then the impact of this factor would be £36.66 per claim. Using the CMA's estimate of 301,000 credit hire claims, the total impact of this factor would have amounted to £11 million ($=£36.66 \times 301,000$) compared to the £69 million identified by the CMA in the Erratum as net detriment from separation in relation to credit hire.
- 5.4 We suggested that the CMA should investigate this concern rigorously by collecting and analysing the relevant quantitative information, augmented with qualitative information where necessary (see CL paper attached to the DLA letter sent to the CMA on 14 March 2014).

CMA's treatment of the concern

- 5.5 The CMA has not explicitly commented on the frictional costs that consumers would need to incur to realise their legal entitlements in the absence of separation. However, we believe that since CMA assumes an idealised benchmark where consumers are provided their legal entitlements in the most efficient way, it effectively assumes that consumers do not incur these frictional costs. The CMA has acknowledged that its remedies analysis should take into account all relevant costs, including any indirect costs.

(See Appendix A of Working Paper)

Status of the concern

- 5.6 The CMA has never evaluated private frictional costs at any point during its investigation process. Therefore, in assessing remedies the CMA is not in a position to take into account any effects that the remedies might have on consumer frictional costs i.e. any remedy that makes consumers' spend more time and effort in obtaining their legal entitlement.³⁰

Work required to address the concern

- 5.7 In an inquiry that has concentrated largely around frictional costs, the CMA ought to have an estimate on private frictional costs incurred by the non-fault driver at least as a relevant factor for assessing remedies.

Understated benefits / failure to quantify (1) – quality of car

CL analysis

- 5.8 In previous reports we raised a concern that the CMA had failed to identify adequately or quantify at all the extent to which the quality of car under direct hire may be less than consumers' legal entitlement (aside from the grade of car and duration for which it is provided, both of which the CMA assumes to be same under credit hire and direct hire in its analysis of the net detriment in relation to TRVs) or that consumers may actually in some direct hire cases be paying to receive the quality levels to which they are entitled (see paragraphs 6.25 to 6.32 of CL1 and point 17 of CL2).
- 5.9 As part of its response to Provisional Findings, AX provided evidence on what additional services a CHC is allowed to charge for under the GTA which influences the quality of TRV service provided (see Exhibit 3 in Annex 2 to AX's Response to Provisional Findings). This included charges for automatics, estate vehicles, tow bars, baby seats, dual control vehicles etc.

³⁰ Please also see point 16 of CL's data room analysis, 8 July 2014.

- 5.10 In CL2, we also noted evidence provided by other CHCs. Direct Accident Management and Exchange Insurance Services indicated, referring, to the Financial Conduct Authority's Thematic Review on Motor Legal Expenses Insurance of June 2013, that insurers sell customers add-ons at a cost of £50-£60 when in fact the true value of the add-on is 50p at the most (see point 17 of CL2). We noted that to the extent non-fault drivers pay directly to the direct hire provider/insurer for these add-ons and the add-ons are part of consumers' legal entitlement, this point is relevant to this concern.
- 5.11 We suggested that the CMA should investigate this concern rigorously by collecting and analysing the relevant quantitative information, augmented with qualitative information where relevant (see CL paper attached to the DLA letter sent to the CMA on 14 March 2014).

CMA's treatment of the concern

- 5.12 The CMA has not referred to the evidence provided by AX and other CHCs in the Working Paper and there is no evidence it has considered this material.
- 5.13 The CMA has not explicitly treated this concern. However, it has stated that since it is deriving direct hire rates from direct hire providers' revenue, adjusting for the additional extras is no longer necessary (see paragraph 58 of the Working Paper). We believe this is because the charges for any extras paid by the non-fault driver to the direct hire provider would be part of the revenue data provided by the direct hire company.

Status of the concern

- 5.14 The CMA's analysis does not address our concern adequately.
- 5.15 Our concern was three-fold – (i) to the extent that the TRV provided under credit hire includes a range of factors that affect the quality of TRV provided and these factors are not part of direct hire, the CMA should estimate the benefit received by the consumer under credit hire (in other words the cost the consumer would need to incur to obtain the same level of service under direct hire); and (ii) to the extent that the consumer is already paying the at-fault insurer for some elements of the service provision under direct hire (for eg. paying for automatic), the CMA should add such costs to the cost of direct hire; and (iii) to the extent that the consumer is already paying the direct hire provider for some elements of the service provision under direct hire (for eg. paying for automatic), the CMA should add such costs to the cost of direct hire.

- 5.16 The CMA's approach addresses issue (iii) above provided that the direct hire revenue used by the CMA to calculate the direct hire rates include payments made by the non-fault driver to the direct hire provider for elements of service provision that are part of consumers' legal entitlement. The CMA has not made clear whether the direct revenue include payments made by non-fault drivers to the direct hire providers and it has not made clear the level of any such payments, which is important for assessing distributional implications as the non-fault claimants are paying for elements of direct hire that they would receive for free under credit hire.
- 5.17 However, the direct hire rates would not include any payment made by the consumer to the at-fault insurer and hence the CMA has not addressed issue (ii).
- 5.18 The CMA has not addressed issue (i) above as in many instances the direct hire company may not offer the add-on to the consumer or even if the add-on is offered the consumer may choose to not take the add-on. In such cases the data on direct hire rates would not reflect the difference in the quality of service between credit hire and direct hire.
- 5.19 It is also surprising that the CMA has ignored the results from the call records, which showed that 70% of claimants whose claims were managed by fault insurers received a replacement car similar to their own while 92% of the claimants whose claims were managed by non-fault insurers received a replacement car similar to their own.³¹ This shows that there is a significant difference in quality of TRV provision between credit hire and direct hire.³²

Work required to address the concern

- 5.20 In relation to issue (iii) above, the CMA should confirm whether the direct hire revenue figures include payments made by non-fault drivers to direct hire providers. It should also indicate the level of any such payments and should consider its implications on distributional analysis.
- 5.21 In relation to issue (ii), the CMA should recognise in its analysis the payments made by non-fault drivers to at-fault insurers for elements of hire provision that are part of consumers' legal entitlement.
- 5.22 In relation to issue (iii), the CMA should investigate this issue rigorously by collecting and analysing the relevant quantitative information, augmented with qualitative information where relevant. It should (a) quantify the proportion of cases where the claimant is provided the different extras under credit hire and direct hire; (b) calculate the cost to consumer of obtaining these extras under direct hire; and then (c) estimate the benefit to consumers by using (a) and (b).

³¹ Provisional Findings, paragraph 6.30, footnote 25.

³² Please also see point 17 of CL's data room analysis, 8 July 2014.

Understated benefits / failure to quantify (2) – collision damage waiver

CL analysis

- 5.23 In previous reports we raised a concern that the CMA had failed to quantify the benefits that consumers obtain from not having to pay the collision damage waiver (CDW) under credit hire (see paragraphs 6.33 to 6.35 of CL1 and point 18 of CL2).
- 5.24 As part of its response to Provisional Findings, AX submitted evidence which showed that the non-fault driver may be required to pay CDW under direct hire. For example, AX provided evidence that showed that CCL charges £2 per day to reduce excess to zero (see Exhibit 4 in Annex 2 to AX's Response to Provisional Findings) and also provided evidence where it was stated that if the driver wished to reduce the excess to zero, he/she "may be able to take out additional insurance with the hire company" at his/her own cost (see Exhibit 11 in Annex 2 to AX's Response to Provisional Findings).
- 5.25 In CL2, we noted evidence provided by other CHCs in relation to this concern. Quindell had stated that under direct hire CDW "is a cost born by the not at fault first party motorist and is generally not recovered" and that this cost can be over £15 (see point 18 of CL2). Using the CMA's estimate of 301,000 credit hire claims, the total impact of this factor would have amounted to £4.5 million (=£15*301,000) compared to the £69 million identified by the CMA in the Erratum as net detriment from separation in relation to credit hire.
- 5.26 The CMA stated that it did not have data on the benefits of additional services provided by CHCs (see email from CMA to AX, 10 March 2014) but it had not indicated whether it intended to investigate this issue further. We suggested that the CMA should investigate this concern rigorously by collecting and analysing relevant quantitative information, augmented with qualitative information where relevant (see CL paper attached to the DLA letter sent to the CMA on 14 March 2014).

CMA's treatment of the concern

- 5.27 The CMA has not referred to the evidence provided by AX in the Working Paper except for recognising that AX offers CDW to all its credit hire customers free of charge (see paragraph 63 of the Working Paper).
- 5.28 The CMA has stated that CDW is offered as an additional protection to both credit hire and direct hire customers under similar terms and that it is usually a customer who pays for the CDW, even under credit hire. The CMA has also stated that CDW cannot be recovered from at-fault insurer under the GTA, though, outside the GTA CDW is sometimes charged to the at-fault insurer. It has noted two exceptions – (i) AX offers CDW to all its credit hire customers free of charge; and (ii) Enterprise offers CDW as part of its basic rates agreed with some insurers. The CMA has then assumed that these two effects tend to offset each other and that any remaining difference would be small and uncertain. (See paragraphs 63 to 64 of the Working Paper).

Status of the concern

- 5.29 The CMA has not addressed our concern adequately.
- 5.30 The CMA has not addressed the legal position in relation to CDW. We understand from AX that CDW is recoverable under the law and the rationale for this being that according to tort law the consumer should be put back into a position that he would have been but for the accident.³³ If it were not for the accident, the non-fault driver would not have to pay the excess (or even if he did pay it would be recoverable under law) for cases where he is a non-fault party to an accident.
- 5.31 The CMA has simply stated that CDW is an additional protection that is provided under credit hire and direct hire under similar terms. It is unclear whether the CMA asked all CHCs on whether or not the CHCs provided CDW free of charge. It has only stated that CDW is charged to the customers under credit hire with AX being a notable exception as it provides this benefit free of charge.
- 5.32 Further, it is unclear from the CMA's statement that "CDW is included in the basic rates Enterprise has agreed with some insurers" as to whether CDW is included in the basic rates Enterprise charges its direct hire customers and/or the basic rates it charges its credit hire customers.
- 5.33 The more fundamental problem with the CMA's statement is that if CDW is part of consumers' legal entitlement, then it is incorrect to treat Enterprise's inclusion of CDW (even if one were to assume that Enterprise provides CDW free of charge only to its direct hire customers) in its direct hire rates as offsetting the CDW benefit provided by AX as the CMA takes consumers' legal entitlement as given. Instead, under the CMA's approach where the benchmark would consist of all credit hire cases converted to direct hire cases and where all consumers' are provided their legal entitlement, one would expect that the claimants who received a TRV from AX under credit hire (and therefore who received CDW free of charge) would now have to pay for the CDW under direct hire. This would be true for at least those consumers of AX who will not be provided a TRV by Enterprise in the counterfactual. At the very minimum, the CMA should have estimated the cost to these consumers of obtaining CDW under direct hire.
- 5.34 Moreover, if Enterprise provides CDW free of charge to its credit hire customers as well, then the CMA would have to calculate the cost of obtaining CDW under direct hire for those consumers that do not receive TRVs from Enterprise in the counterfactual.³⁴

³³ We understand from AX that the relevant precedent in relation to this issue is *Bee v/s Jensen*.

³⁴ Please also see point 18 of CL's data room analysis, 8 July 2014.

Work required to address the concern

- 5.35 The CMA should analyse the legal position in relation to CDWs.
- 5.36 The CMA should collect evidence from all CHCs to assess how many CHCs provide CDW free of charge. Once it obtains this data it should estimate the benefit of CDW provision by multiplying the number of credit hire claims where CDW is provided free of charge with the cost of purchasing CDW in a world where such service was not provided free of charge (at least for those consumers that do not receive replacement cars from Enterprise in the counterfactual).

Understated benefits / failure to quantify (3) – uninsured loss recovery

CL analysis

- 5.37 In previous reports we raised a concern that the CMA had failed to quantify the benefits of uninsured loss recovery services that consumers obtain under credit hire but not under direct hire (see paragraphs 6.36 to 6.41 of CL1 and point 19 of CL2).
- 5.38 As part of its response to Provisional Findings, AX submitted evidence on the cost to consumers of obtaining uninsured loss recovery through solicitors in the absence of CHCs/CMCs doing this on their behalf (see Exhibit 12 in Annex 2 to AX's Response to Provisional Findings). AX also provided evidence on the cost to consumers of obtaining uninsured loss recovery through legal expenses insurance in the absence of CHCs doing this on their behalf (see Exhibit 13 in Annex 2 to AX's Response to Provisional Findings). The evidence suggests that the cost of uninsured loss recovery could be £100-£150 per hour if consumers use the services of a solicitor and £25-£30 per annum if consumers buy legal expenses cover (see paragraphs 6.40 and 6.41 of CL1 and point 19 of CL2).
- 5.39 AX provided further evidence on ULR in relation to CMA request EP11 which included the activities performed when providing the uninsured loss recovery services, the proportion of claimants to whom the ULR services were provided, data on number of claims where ULR was provided, cost incurred to provide the services and the type and value of losses that AX helped claimants recover in 2012. (See AX's response to EP11 request, sent to CMA on 6 May 2014.)
- 5.40 In CL2 we also noted evidence provided by other CHCs. For example Quindell calculated the cost of engaging a law firm to recover special damages to be between £200 and £250 and noted that this cost would not be recoverable for certain smaller claims (see point 19 of CL2).

- 5.41 We used the evidence provided by AX on the rates charged by solicitors and the rates charged for motor legal expenses cover to quantify the impact of this factor on a per claim basis. On the assumption that (i) consumer pays an annual premium of £25 for legal expenses cover; (ii) a consumer is involved in an accident every 7 years; and (iii) the probability of the customer being not at fault is 50%, we estimated the total cost of insurance per non-fault claim as £350 (=£25*14 i.e. a premium of £25 per annum for 14 years). If this cover could be used for other cases, then some part of the cost needs to be attributed to such cases. Using the CMA's estimate of 301,000 credit hire claims, the total impact of this factor would have amounted to £105.35 million (=£350*301,000) compared to the £69 million identified by the CMA in the Erratum as net detriment from separation in relation to credit hire. Alternatively, the consumer would have to pay the solicitor a charge of £100-£150 per hour (see row 50 of CL one-pager).
- 5.42 The CMA stated that it did not have data on the benefits of additional services provided by CHCs (see email from CC to AX, 10 March 2014) but had not indicated that it would intend to investigate this issue further. We suggested that the CMA should investigate this concern rigorously by collecting and analysing relevant quantitative information, augmented with qualitative information where relevant (see CL paper attached to the DLA letter sent to the CMA on 14 March 2014).

CMA's treatment of the concern

- 5.43 The CMA has not referred to the evidence provided by AX or Quindell in relation to the cost to the consumer of obtaining uninsured loss recovery services in the absence of credit hire. The CMA has referred to the information provided by AX in response to CMA request EP11.
- 5.44 In all cases the CMA is assuming that there is a population of non-fault drivers for which the CHC assists in ULR service provision (other than the TRV which itself is an uninsured loss). To analyse this concern, the CMA has split consumers into three groups:

Customer has MLEI

- 5.45 For those customers that have motor legal expenses insurance (MLEI)³⁵, the CMA appears to be saying that given the presence of CHCs, consumers would not use their MLEI policy and absent CHCs consumers would use their MLEI policy.
- 5.46 In the status quo a CHC provides ULR services to a population of non-fault drivers. If the CHC no longer provides this service then the cost to the CHC would go down (as it is no longer providing this service), the referral fee paid by the CHC to the non-fault insurer would go up by the same amount resulting in an equivalent reduction of private motor insurance premiums (assuming a 100% pass-through as the CMA does).³⁶

³⁵ According to the CMA, 76% of consumers have MLEI (see footnote 22 of the Working Paper).

³⁶ See paragraph 67 of the Working Paper where the CMA makes the relevant statement.

5.47 The CMA appears to value the benefit to this group of customers as the maximum cost incurred across CHCs in providing this service (=£45) multiplied by the number of CHC clients who both receive ULR services and have MLEI.

Customer does not have MLEI but the customer pursues ULR

5.48 For those consumers that do not have MLEI but who intend to pursue the uninsured losses themselves, the CMA recognises that the consumer would have to incur some costs and appears to be saying that the costs consumers would have to bear would unlikely exceed £45 per claim which is the maximum cost incurred for providing ULR services by the CHCs in the CMA's sample.

Customer does not have MLEI and the customer does not intend to pursue ULR

5.49 The CMA envisages a group of customers who do not have an MLEI and would only recover their ULR in the presence of CHCs. For this group the CMA concludes no impact on consumer welfare because the CMA states that in such cases the consumer benefit is the value of ULR recovered but by pursuing ULR the cost to insurers would also increase. Assuming a 100% pass through, this means that the premium for the consumer increases by the amount of ULR he recovers from the insurer. Thus, there is no net benefit in this case and no impact on detriment calculation.

Numerical estimation of ULR benefit

5.50 As indicated above, the CMA appears to be attributing a benefit (an amount going into the AEC calculation) for customers in the first and second group but not for the third group. For both the first and second group of customers, the CMA calculated a total benefit of £0.5 million in total. This was calculated on the basis that (i) the cost to the consumer is equal to £45 if the CHC does not provide ULR services; and (ii) the number of claims in which the CHCs provided ULR services is equal to 12,000. The CMA calculated this benefit to be £1.60 per credit hire claim (by dividing £0.5 million by total number of credit hire claims).

(See paragraphs 65-72 and Appendix C of the Working Paper.)

Status of the concern

5.51 We comment on the CMA's approach with respect to each of the three groups.

Customer has MLEI

5.52 We are unable to understand the CMA's analysis for this group of customers.

- 5.53 If the CHCs do not provide the ULR service, then the CHCs will save the cost of providing the ULR service which would result in CHCs paying higher referral fees to the non-fault insurer. Assuming a 100% pass-through, the private motor insurance premiums would reduce by the same amount as the cost saved by CHCs by not providing the ULR service. However, the MLEI provider would now incur a cost of providing the ULR service and assuming that the MLEI provider and the CHC incur the same costs of providing this service, the cost incurred by the MLEI provider would increase by the same amount as the cost saved by the CHC. Assuming a 100% pass-through, the MLEI premiums would increase by the same amount as the increase in costs incurred by the MLEI provider. Therefore, the net effect on the consumer is neutral in terms of premiums paid – the private motor insurance premium reduces and the MLEI premium increases by the same amount (equal to the costs saved by CHCs for not providing the service).
- 5.54 However, the CMA has failed to consider that a non-fault driver would have to spend more time to obtain ULR from an insurer compared to the time they would need to spend with the assistance of the CHC. The CMA has not investigated whether and if so how much more time the consumer would need to spend with the MLEI provider in the absence of any assistance from CHCs. As we set out in our previous report, we estimate consumers' time value to be about £36.66 per hour.³⁷ Therefore, illustratively if the consumer had to spend three more hours with an MLEI provider in the absence of CHCs compared to a situation where the CHC provided assistance, then the impact on the consumer would be more than double of the CMA's estimate of £45.

Customer does not have MLEI but the customer pursues ULR

- 5.55 For the second group of consumers the CMA is correct to identify the cost to consumers of trying to recover the uninsured losses themselves in the case where they do not have MLEI.
- 5.56 However, we consider the estimate of £45 used by the CMA to be unrealistic and grossly underestimated. If it cost the consumer only £45 to recover the uninsured losses themselves, then consumers would not buy MLEI policies that cost £25-£30 per annum unless they are extremely risk averse. As indicated in CL1, the cost to the consumer in such cases is correctly measured by either the cost of MLEI to the consumer per time it is invoked or the cost paid to the lawyer/solicitor for recovering the ULR.³⁸ On this basis we conclude that the CMA has grossly underestimated the benefits of ULR service provision by CHCs.

³⁷ See paragraph 6.24 of CL1.

³⁸ See paragraphs 5.40 and 5.41 above for estimates of these costs.

Customer does not have MLEI and the customer does not intend to pursue ULR

5.57 With respect to this group of customers, the CMA's approach of analysing benefits of ULR service provision by CHCs to consumers is flawed. The CMA's approach does not take consumers' legal entitlement as given and instead it assesses the consumer surplus from the provision of ULR service by CHCs. Such an approach is incorrect for reasons mentioned in paragraph 2.6 above. Such an approach denies the utility provided by insurance products to consumers since it assumes that if consumers do not have insurance, then the reduced payments by insurance firms would be reflected in lower premiums and these two factors net out in the CMA's analysis. The CMA has also failed to recognise the distributional consequences of non-fault drivers not obtaining their uninsured losses.

Numerical estimation of ULR benefit

5.58 With respect to the first and second group of customers, the CMA is incorrect in using £45 as the cost to the consumer for obtaining uninsured losses themselves. We have set out the reasons for this in paragraphs 5.54 and 5.56 above.

5.59 With respect to the third group of customers, it is incorrect for the CMA to argue that there is no detriment to this group of consumers if the CHCs do not assist in providing ULR services. The reasons for this have been set out in paragraph 5.57 above.

5.60 Finally, the CMA has misconstrued the evidence provided on ULR by AX (and possibly by other CHCs as well). For example the CMA has calculated the total number of ULR claims handled by four CHCs (Accident Exchange, ClaimsFast, Helphire and Kindertons) was in the range of 6,286 and 9,944.³⁹ This cannot be possible given [redacted].⁴⁰ AX has stated on a number of occasions that the numbers it provided in relation to ULR were lower bound⁴¹ and the CMA appears to not have considered these caveats while estimating the total number of ULR claims handled by AX. We note that this concern may also hold with respect to the data provided by other CHCs.⁴²

³⁹ See Table 1 of Appendix C to the Working Paper

⁴⁰ See AX's response to CMA request EP11, page 4.

⁴¹ See, for example, AX's response to CMA request EP11, page 4 and AX's comments on CMA's put-back request PB14.

⁴² Please also see point 19 of CL's data room analysis, 8 July 2014.

Work required to address the concern

- 5.61 The CMA should investigate this concern rigorously by collecting and analysing relevant quantitative information, augmented with qualitative information where relevant. The CMA should use a correct measure for the cost to the consumer of obtaining ULR services in the absence of CHCs and should quantify this benefit even for group of consumers who do not have MLEI and who do not intend to pursue recovery of uninsured losses as the CMA takes consumers' legal entitlements as given. It should also use a correct estimate for the total number of claims in which consumers receive the ULR service from CHCs.

Understated benefits / failure to quantify (4) – provision of replacement car when liability was uncertain

CL analysis

- 5.62 In previous reports we raised a concern that the CMA has failed to quantify the benefit to consumers of the provision of TRVs before the liability is resolved – which occurs under credit hire but not under direct hire (see paragraphs 6.42 to 6.45 of CL1 and point 20 of CL2).
- 5.63 As part of its response to Provisional Findings, AX submitted evidence on claims that suggested that liability is agreed less often by insurers than what the CMA's non-fault survey suggests (which showed that 80% of respondents said that the other driver admitted that the accident was their fault at the scene of the accident). (See Exhibit 15 in Annex 2 to AX's Response to Provisional Findings.)
- 5.64 In CL2 we noted evidence provided by other CHCs in relation to this concern. In particular we noted the evidence provided by Direct Accident Management and Exchange Insurance Services who state that in their collective experience of 35 years of operating in the sector, the vast majority of claims (90%) are such that there is little clarity in terms of which party is liable in the first instance and that at-fault insurers are reluctant to concede liability in such instances. We also noted the evidence provided by Helphire that in as many as 40% of non-fault accidents liability is not admitted. Finally, Kindertons Accident Management believes that the percentage of claims that are disputed regarding fault are much higher than the 25% quoted by the CC. Kindertons submitted evidence in relation to this point which was redacted from the publicly available version of Kindertons' response (see page 31 of Kindertons Accident Management's response to Remedies Notice). Kindertons also states elsewhere in the response that its statistics show that in over 70% of the claims liability is not conceded within 48 hours. (See point 20 of CL2.)
- 5.65 Using the IFF survey report, we had estimated that liability is not admitted in 25% of the cases where the claim was managed by the non-fault insurer, or around 75,000 cases (based on the CMA's estimate of 301,000 credit hire claims). (See paragraph 6.44 of CL1.)

- 5.66 The CMA stated that it did not have data on the benefits of additional services provided by CHCs (see email from CC to AX, 10 March 2014) but had not indicated that it intended to investigate this issue further. We suggested that the CMA should investigate this concern rigorously by collecting and analysing relevant quantitative information, augmented with qualitative information where relevant (see CL paper attached to the DLA letter sent to the CMA on 14 March 2014).

CMA's treatment of the concern

- 5.67 The CMA has not referred to the evidence provided by AX or other CHCs and has not addressed this concern in the Working Paper.

Status of the concern

- 5.68 The CMA has failed to analyse the relevant evidence provided by the CHCs and to address this concern and thus to quantify the benefit of this factor.⁴³

Work required to address the concern

- 5.69 The CMA should investigate this concern rigorously by collecting and analysing relevant quantitative information, augmented with qualitative information where relevant. It should obtain data from CHCs on the (a) number of cases where the CHCs have provided TRVs prior to the resolution of liability and where the CHC was correct in their assessment of liability; and (b) the average time taken in such cases to resolve the liability. It should then use (a) and (b) to quantify the benefit from credit hire. In addition it should also take into account the transactional and frictional costs that the consumer would have to incur if he had to rent the car himself in the world without credit hire.

Understated benefits / failure to quantify (5) – resolution of liability

CL analysis

- 5.70 In previous CL reports we raised a concern that the CMA had failed to consider the benefits that result from liability being resolved more often in the presence of credit hire (see paragraphs 6.46 to 6.48 of CL1 and point 21 of CL2).
- 5.71 The CMA stated that it did not have data on the benefits of additional services provided by CHCs (see email from CMA to AX, 10 March 2014) but had not indicated that it intended to investigate this issue further. We suggested that the CMA should investigate this concern rigorously by collecting and analysing relevant quantitative information, augmented with qualitative information where relevant (see CL paper attached to the DLA letter sent to the CMA on 14 March 2014).

⁴³ Please also see point 20 of CL's data room analysis, 8 July 2014.

CMA's response to the concern

- 5.72 The CMA has tried to assess two issues in relation to this concern: (i) frequency of the resolution of liability; and (ii) the speed of resolution of liability.
- 5.73 In relation to issue (i), the CMA has attempted to check the hypothesis that credit hire leads to liability being resolved more often by comparing the proportion of total claims that resulted in a split liability across three categories of cases: (a) where the fault and non-fault insurer were same; (b) where the claim involved another insurer but there was no bilateral agreement between the fault and non-fault insurer; and (c) where the claim involved another insurer but there was a bilateral agreement between the fault and non-fault insurer.
- 5.74 The CMA found that the percentage of split liability cases were similar under categories (b) and (c) and in fact slightly lower under category (c). On the basis of this evidence, the CMA concluded that "the presence of CHCs does not seem to have any impact on the frequency of resolution of liability".
- 5.75 In relation to issue (ii), the CMA stated that only one insurer was able to provide data on the timing of liability determination and that this insurer's average length of liability determination was lower under bilateral agreements. While the CMA has not interpreted this evidence, it has stated that it has seen no evidence to suggest a higher speed of liability resolution under separation. (See paragraphs 92 to 98 of the Working Paper.)

Status of the concern

- 5.76 The CMA's analysis does not address our concern adequately.
- 5.77 The CMA has not stated the number of insurers from whom the data on resolution of liability was obtained and on the proportion of bilateral cases handled by these insurers. As a result, we are unable to comment fully on the analysis done by the CMA.
- 5.78 We note that the data on split liability used by the CMA would reflect the final assessment of claims. It would not reflect the initial assessment of claims and how this initial assessment changed over time. It is possible that based on the initial assessment of claims, split liability was much higher under no bilateral cases and that the lower proportion of split liability observed in the final assessment of claims under no bilateral cases reflects the CHCs impact on liability resolution.
- 5.79 For the issue of speed of resolution of liability, the CMA has only gathered evidence from one insurer. This is insufficient and may be unrepresentative of the market.⁴⁴

⁴⁴

Please also see point 21 of CL's data room analysis, 8 July 2014.

Work required to address this concern

- 5.80 The CMA needs to collect more qualitative and quantitative evidence to assess this concern. It should gather evidence on the number of claims where the liability was uncertain at the beginning under both credit hire and direct hire and then analyse how many of these liabilities were resolved under credit hire and direct hire. To the extent that more liabilities were resolved in such cases under credit hire, it should quantify the benefit from credit hire.

Omitted benefits – collection and delivery

CL analysis

- 5.81 In previous CL reports we raised a concern that the CMA had not considered that the collection and delivery service under direct hire may sometimes be inferior to that under credit hire (see paragraphs 6.49 to 6.53 of CL1 and point 22 of CL2).
- 5.82 According to AX, Enterprise typically collects the non-fault drivers from the bodyshop and takes them to their depot and provides the TRV there. Typically, this is in a minibus which will often wait to collect several not at fault drivers for one “run”. The same would then apply in reverse at the end of the direct hire period. The consumer therefore incurs additional waiting time and journey time to obtain the TRV and possibly additional driving time if the depot is in an inconvenient location (and the same in reverse). (See paragraph 6.51 of CL1.)
- 5.83 We understand from AX that [redacted] charges AX a wholesale rate of £[redacted] for collection and the same for delivery. These charges are applicable for deliveries within 20 miles of a [redacted] Depot, beyond which an additional charge of £[redacted] per mile becomes applicable. (Note that each of collection and delivery entails the car hire company carrying out an outward and a return leg.) AX has provided further evidence on retail rates charged for collection and delivery by a number of hire companies and these rates vary by geographic location (see Exhibit 14 in Annex 2 to AX’s Response to Provisional Findings).
- 5.84 We used the evidence provided by AX on the wholesale rates charged by [redacted] to estimate the impact of this factor to be £[redacted] (for deliveries within 20 miles). Using the CMA’s estimate of 301,000 credit hire claims, the total impact of this factor would have amounted to £[redacted] (=£[redacted]*301,000) compared to the £69 million identified by the CMA in the Erratum as net detriment from separation in relation to credit hire.
- 5.85 We suggested that the CMA should investigate this concern rigorously by collecting and analysing relevant quantitative information, augmented with qualitative information where relevant (see CL paper attached to the DLA letter sent to the CMA on 14 March 2014).

CMA’s response to the concern

- 5.86 The CMA has not referred to the evidence provided by AX in the Working Paper and there is no evidence that it has taken it into account.

5.87 The CMA has noted Enterprise's statement that it always offered delivery and collection to non-fault direct hire customers. Enterprise also told the CMA that many of its customers chose to pick up the TRV at the site of the rental company instead of having it delivered to their own premises in order to obtain the car more quickly. Further, on the basis of evidence provided by Enterprise and other CHCs, the CMA concluded that the time taken to deliver the vehicle to the customer is similar under credit hire and direct hire and hence both credit hire and direct hire appear to provide a similar level of service. (See paragraphs 55 to 57 of the Working Paper.)

Status of the concern

5.88 The CMA's analysis does not address our concern adequately. The CMA has simply collected statements made by Enterprise. It has failed to gather quantitative and qualitative evidence on this issue from a sample of credit hire and direct hire providers and has therefore failed to assess this concern properly.⁴⁵

Work required to address the concern

5.89 The CMA should investigate this concern rigorously by collecting and analysing relevant quantitative information, augmented with qualitative information where relevant instead of just relying on the statements made by Enterprise.

Distributional considerations

CL analysis

5.90 In previous reports we raised a concern that the CMA should not dismiss all the concerns pointed out in CL1 and CL2 as small but rather quantify their significance both in aggregate and also to separate classes of consumers (see paragraphs 6.54 of CL1 and point 23 of CL2).

5.91 We suggested that the CMA should investigate this concern rigorously by collecting and analysing relevant quantitative information (augmented with qualitative information where relevant), and, in particular by assessing how the provision of credit hire affects the expected utility of drivers with different risk profiles relevant (see CL paper attached to the DLA letter sent to the CMA on 14 March 2014).

⁴⁵ Please also see point 22 of CL's data room analysis, 8 July 2014.

CMA's response to the concern

- 5.92 The CMA has stated that its revised estimation allows for a separate assessment of distributional effects due to credit hire, credit repairs, write-offs, insurer-managed repairs and write-offs. It has concluded that there are clear distributional effects in relation to credit hire, since there is both a cost to at-fault insurers and a profit to non-fault insurers (receipt of referral fees). (See paragraphs 132 to 133 of the Working Paper.)

Status of the concern

- 5.93 The CMA's response does not address our concern adequately. The CMA's point is about the risk reflectivity and not about quantifying the significance of concerns highlighted in CL1 and CL2 to separate classes of consumers.⁴⁶

Work required to address the concern

- 5.94 The CMA should investigate this concern rigorously by collecting and analysing relevant quantitative information (augmented with qualitative information where relevant), and, in particular by assessing how the provision of credit hire affects the expected utility of drivers with different risk profiles relevant.

Conclusions

- 5.95 The key conclusions in relation to the CMA's failure to consider relevant benefits are as follows:
- The CMA has never evaluated private frictional costs at any point during its investigation process. Therefore, in assessing remedies the CMA is not in a position to take into account any effects that the remedies might have on consumer frictional costs i.e. any remedy that makes consumers' spend more time and effort in obtaining their legal entitlement.
 - In relation to understated benefits from quality of car, the CMA has failed to quantify the benefit arising from differences in quality of car between credit hire and direct hire as (i) it has not taken into account payments made by non-fault drivers to at-fault insurers under direct hire; and (ii) it has not quantified the costs to the consumer to meet the quality shortfall under direct hire.
 - In relation to understated benefits from collision damage waiver (CDW), the CMA has failed to appropriately take into account this benefit under credit hire.

⁴⁶

Please also see point 23 of CL's data room analysis, 8 July 2014.

- In relation to understated benefits from uninsured loss recovery, the CMA has failed to appropriately take into account this benefit under credit hire.
- In relation to understated benefits from provision of replacement car when liability was uncertain, the CMA has not addressed this concern.
- In relation to understated benefits from resolution of liability, the CMA has failed to gather sufficient quantitative and qualitative evidence to test this concern.
- In relation to omitted benefits from collection and delivery, the CMA has just relied on statements made by Enterprise and has failed to collect quantitative and qualitative evidence from credit hire and direct hire providers.
- In relation to distributional considerations, the CMA has not addressed this concern.

Section 6

Concerns in relation to implications for consumers of separation

Introduction

- 6.1 In Provisional Findings, the CMA addressed the implications for consumers of separation (see Provisional Findings, paragraphs 6.42 to 6.85). We raised concerns in relation to the CMA's analysis in CL1 and CL2 (Section 7 of CL1 and points 24–25 of CL2).

Concerns

- 6.2 In Provisional Findings, the CMA used a figure of £663 million for credit hire turnover in 2012 as a cross-check of its estimate of consumer detriment. We notice that the CMA has not used its updated estimate of credit hire turnover as a cross-check in its Working Paper.⁴⁷

Effect on consumers – scope of the investigation

CL analysis

- 6.3 In previous reports we raised a concern that the CMA had not investigated what proportion of claims is made against commercial motor insurance policies and whether there is any asymmetry in revenues received and costs borne by commercial motor insurers. Given that commercial motor insurance is out of the scope of the CMA's Terms of Reference, the CMA would need to quantitatively adjust for any asymmetry in its estimation of impact on consumers. (See paragraphs 7.23 to 7.26 of CL1 and point 24 of CL2.)

⁴⁷

Please also see point 25 of CL's data room analysis, 8 July 2014.

- 6.4 In CL2 we noted the evidence provided by other CHCs. Quindell pointed out that while only a small proportion of drivers with a commercial insurance policy use credit hire, they do bear the costs. Quindell argued that the estimate of net cost of credit hire thus should be averaged over all insurance policies in the UK. Quindell further added that the average cost of credit hire claims against fleet and commercial insurance policies is materially higher than against private policies (see page 9 of Quindell's response to Remedies Notice). Excluding these claims from the CMA's analysis would therefore have the impact of decreasing the average credit hire bill. Also, Helphire pointed out that major insurers like Aviva, RSA, Zurich, Ageas etc. have very large commercial businesses. Helphire estimated that at least 13.7% of non-fault claimants could be attributed to commercially insured vehicles. (See point 24 of CL2.)
- 6.5 We suggested that the CMA should investigate this concern rigorously by collecting and analysing relevant quantitative information, augmented with qualitative information where relevant (see CL paper attached to the DLA letter sent to the CMA on 14 March 2014).

CMA's treatment of the concern

- 6.6 The CMA has noted that in case of claims against commercial insurance, the detriment from separation affects a commercial insurer and not a private one. However, the CMA considers that detriment from such claims arises in the PMI market since it is generated by the practices and conduct of the parties managing the non-fault claim and therefore such detriment must be included in the estimation. (See paragraph 36 of Working Paper.)

Status of the concern

- 6.7 The CMA's analysis does not address our concern adequately.
- 6.8 The motivation for this investigation is the high premiums in the private motor insurance market. To the extent that the costs of separation are borne by commercial motor insurers, this would not affect the premiums paid by private motorists. Therefore, the CMA should quantify the costs of separation borne by commercial insurers and exclude it from its estimate of net detriment.⁴⁸

Work required to address the concern

- 6.9 The CMA should investigate this concern rigorously by collecting and analysing relevant quantitative information, augmented with qualitative information where relevant.

⁴⁸ Please also see point 24 of CL's data room analysis, 8 July 2014.

Conclusions

- 6.10 The key conclusion is that in relation to the effect on consumers and the scope of this investigation, the CMA's explanation for including claims where fault claimant is a commercial motorist is absurd and incorrect.

Section 7

Additional concerns from other CHC submissions

Introduction

- 7.1 This section sets out the concern raised by another CHC in its response to the CMA's Provisional Findings (point 29 of CL2).

Concerns

Concern

- 7.2 In CL2, we had highlighted the concern raised by Quindell that direct hire rates are subsidised through fees charged to non-fault drivers (see point 29 of CL2).
- 7.3 Quindell submitted that under direct hire CDW "is a cost born by the not at fault first party motorist and is generally not recovered" and that this cost can be over £15. Further, Quindell argued that the margin rental companies make on selling insurance and CDW allows them to reduce their direct hire rates to uneconomically low levels (see point 29 of CL2). To the extent that the "headline" direct hire rates are cross-subsidised by the margin on add-ons, this magnifies our concern that the CMA has not acknowledged the costs of these add-ons.
- 7.4 We suggested that the CMA should investigate this concern rigorously by collecting and analysing relevant quantitative information, augmented with qualitative information where relevant (see CL paper attached to the DLA letter sent to the CMA on 14 March 2014).

CMA's response to the concern

- 7.5 The CMA has not directly addressed this concern. However, it has now used data on direct hire revenue to calculate direct hire rates.

Status of the concern

- 7.6 The CMA's analysis addresses our concern provided that the direct hire revenue used by the CMA includes payments made by the non-fault driver to the direct hire provider for elements of the service provision that are part of their legal entitlement.⁴⁹

Work required to address this concern

- 7.7 The CMA should confirm whether the direct hire revenue figures include payments made by non-fault drivers to direct hire providers for elements of the service provision that are part of their legal entitlement.

Conclusions

- 7.8 The key point in this section is:
- The CMA's analysis addresses the concern. However, the CMA should confirm whether the direct hire revenue figures include payments made by the non-fault driver to the direct hire provider for elements of the service provision that are part of their legal entitlement.

⁴⁹

Please also see point 29 of CL's data room analysis, 8 July 2014.