COMPETITION AND MARKETS AUTHORITY
MARKET INVESTIGATION

PRIVATE MOTOR INSURANCE

ACCIDENT EXCHANGE'S RESPONSE TO THE COMPETITION AND MARKETS AUTHORITY'S NOTICE OF FURTHER CONSULTATION ON REMEDY 1C (PUBLISHED ON 28 JULY 2014)

4 AUGUST 2014

CONTENTS

1. EXECUTIVE SUMMARY

1.1 The CMA's Notice of further consultation on Remedy 1C (the "**Notice of Further Consultation**" or **"Notice"**) sets out the CMA's decision not to pursue Remedy 1C as originally proposed (**"Original Remedy 1C"**) in its Provisional Decision on Remedies ("**PDR**"). The Notice invites views on a variant of Remedy 1C (the "**Remedy 1C Variant**").

1.2 AX welcomes and fully agrees with the CMA's decision not to pursue Original Remedy 1C on the basis that this would be outside the scope of its powers under Schedule 8 of the Enterprise Act 2002 (the "**2002 Act**").

1.3 However, AX submits that the Remedy 1C Variant also falls outside the scope of the CMA's Schedule 8 powers. Furthermore, the Remedy 1C Variant shares many of the other fundamental problems of the Original Remedy 1C, and introduces new problems. It would not address the AEC and would undermine consumers' ability to achieve their full legal entitlement, thereby being inconsistent with the premise of the investigation of keeping non-fault drivers' achievement of their legal entitlement as given.

1.4 The CMA has referred to Remedy 1C Variant as an "alternative *implementation* proposal"[1] (emphasis added). It has not set out in the Notice any comment on changing the level of the price cap, save that the Notice explains the CMA is continuing to consider the appropriateness of direct hire rates as the low rate benchmark. AX maintains the concerns it has previously expressed about the proposed level of the price cap[2], and for the purpose of this submission proceeds on the basis that the CMA is consulting on a regulated price level "slightly" above the cost of providing TRVs, as was the case for Original Remedy 1C.[3] The CMA also refers to a higher price level although only in the specific context of its question at paragraph 21(e) of it's the Notice. AX therefore addresses the possibility of the price cap being set at a different price level in the context of responding to that question.

1.5 In summary, the fundamental issues with Remedy 1C Variant are as follows:

Problems associated with Original Remedy 1C which would persist

1 Paragraph 14 of the Notice.

2 See paragraphs 6.51 to 6.65 of AX's response to the PDR.

3 PDR, para. 2.66.

1.5.1 The CMA does not have the statutory power to impose a price control remedy in relation to Provisional Findings that have not analysed the price to be remedied and which do not find that the price that is to be capped is too high (see paragraphs 3.2 to 3.9 below).

1.5.2 As in the case of Original Remedy 1C, the Remedy 1C Variant will not address the AEC and, therefore, cannot lawfully be imposed (see paragraphs 3.10 to 3.18).

1.5.3 As in the case of Original Remedy 1C, the Remedy 1C Variant will lead to non-fault drivers not receiving their full legal entitlement and, therefore, cannot lawfully be imposed (see paragraphs 3.19 to 3.20).

1.5.4 The imposition of a price cap will create an entirely closed system whereby only insurers will operate. This will give rise to a serious risk of collusion (see paragraphs 3.21 to 3.23).

New problems introduced by Remedy 1C Variant

1.5.5 The price cap will lead to a distortion of competition between CHCs and insurers and is discriminatory and cannot be lawfully imposed. Moreover, these distortions will reinforce the conditions for collusion amongst insurers (see paragraphs 3.24 to 3.26 below).

1.5.6 If the CMA sets the price cap lower than the basic hire rate ("**BHR**") this will not influence the Courts to change many years of tort law which allow consumers to recover the BHR (see paragraphs 3.27 to 3.37 below).

1.5.7 In any case, it was open to the CMA to recommend changes of law to Government; having not done so it is unlawful for it to disingenuously to seek to circumvent its failure to pursue this option and to intend its findings to "seep into" case-law (see paragraphs 3.27 to 3.37 below).

1.5.8 It is entirely unclear when the price cap would apply and how the CMA would be able to regulate compliance with the price cap (see paragraphs 3.38 to 3.41 below).

1.5.9 The Remedy 1C Variant would be ineffective in any event because subrogated claims will not be restricted to the rate cap, and so will be charged at a higher rate (or a rate equivalent to the BHR). This will lead to strategies being adopted by

TRV providers and others to pursue claims on a subrogated basis and circumvent the rate cap. CHCs (including AX) already operate models that include mobility insurance policies being issued pre-accident (and often provide these policies to customers free of charge), with hire claims then being pursued on a truly subrogated basis. This would increase in a world post-Remedy 1C Variant, and therefore, lead to a situation in which the remedy would be wholly ineffective (see paragraph 4.1.2 below).

1.6 AX also has serious concerns with the CMA's ideas for "encouraging" industry practice as set out in paragraph 23 of the Notice. Despite not having published any consultation on the scope of the bilaterals, the CMA suggests (as an alternative to the Remedy 1C Variant) encouraging bilateral agreements amongst insurers. Moreover, this is despite itself recognising the aligned incentives of insurers to minimise TRV provision in denial of victims' legal entitlement.

1.7 It would be an utterly perverse outcome for a competition authority to advocate an instrument that actually or at least readily can be used to undermine victims' rights. AX has urged the CMA to properly investigate bilateral agreements on the basis that, based on tender documents which AX had declined to tender against, there was a conflict between competing insurers seeking to reduce their own costs by limiting the legal entitlement of a not at fault driver where it suited their commercial interests but opting to increase the charge where they could earn a rent from a non-participating insurer[4]. AX is seriously concerned that this behaviour is akin to cartel behaviour and that evidence of this behaviour (clearly aimed at curtailing consumer's legal entitlement) has not been investigated by the CMA nor taken account of in the CMA's Notice. Rather, the CMA (without any justification or explanation) treats insurers' incentives in this regard as completely legitimate and benign. The CMA has not acknowledged these concerns (and it does not appear the CMA has investigated them either). It now seems reckless for the CMA to seek to consider encouraging insurers to engage with each other on a bilateral basis, which will clearly increase the risk of collusion.

1.8 Moreover, the CMA's other suggestion of encouraging not at fault insurers to transfer the insurance cover from a not-fault victims own car to the CHC's hire car, as a means of reducing cost only serves to highlight the CMA's lack of understanding of the key issues. If a not at fault driver suffers an accident, and mitigates his loss by hiring a car, then he is entitled to a fully insured hire car without any excess applicable. This is his legal entitlement.

4 See paragraph 3.2.2 of AX's response to the Statement of Issues, dated 11 January, paragraph 6.9 to 6.10 of AX's response to the PFs and section 3 of Compass Lexecon's response to the PF's (attached at Annex 1), both dated 7 February 2014.

Essentially, the CMA would be encouraging not at fault insurers to mislead not at fault drivers to transfer their own insurance at their cost (or miss-sell to them on this basis), when this is a cost which they are entitled to recover by law.

1.9 Finally, AX also has a fundamental concern with the provisional AEC finding. Given that the CMA is effectively conceding in the Notice that it cannot impose any remedies (other than Remedy A and 1F), it must also be concluding that the market is operating as efficiently as it can and that there is, therefore, no AEC (noting that Remedy A bears no actual relationship to the AEC and both Remedies A and 1F were only advanced as part of a package of remedies that no longer exists). The AEC finding was predicated on comparison to a utopian frictionless world. The CMA made such a comparison contrary to its Guidelines and solely for the purposes of seeking remedies. If the CMA cannot identify remedies superior to the existing 'Remedy' of the GTA it must conclude that there was no AEC in the first place. To maintain the existing AEC finding would be inconsistent with the way the CMA justified the extreme benchmark and would be unlawful. It would also (of relevance to AX and the credit hire industry) be reputationally damaging and unfair to those that are tarred with the brush of causing an AEC that in fact does not exist as a result of their practices.

2. AEC FINDING

2.1 As Compass Lexecon set out in Annex 1 to AX's Response to Provisional Findings[5], the CMA's benchmark for conducting the AEC analysis is extreme as it is an idealised world of no frictional costs. This benchmark has neither been shown to be a market outcome in general nor 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).[6]

2.2 As Compass Lexecon also noted, the CMA's approach to the benchmark for assessing the AEC is not consistent with its own Guidelines for market investigation as the Guidelines state that the relevant benchmark for assessing an AEC should not be an idealised one.[7]

2.3 In response to the above concern the CMA stated that it considers an idealised (but not perfectly competitive) benchmark for its analysis and that such benchmarks are just used to

5 Submitted to the CMA on 7 February 2014.

6 See paragraph 2.2 of Compass Lexecon's response to the PF's, dated 7 February 2014.

7 See paragraph 2.20 of Compass Lexecon's response to the PF's, dated 7 February 2014.

inform the analysis and are not necessarily feasible market outcomes. It further stated that the feasible market outcomes are considered in remedies analysis and not in the AEC analysis.[8]

2.4 The CMA also argued that this approach was consistent with its Guidelines, finding that the Guidelines provide that the CMA will not to take an idealised perfectively competitive benchmark but that the CMA can take a benchmark that is idealised in other respects[9]. This is a strained interpretation to say the least.

2.5 If, as AX considers the CMA should now conclude, there is no realistic remedy that can solve/mitigate the alleged AEC, then it must imply that the current market outcome is an efficient one (if one were to take the consumers' legal entitlement as given). In particular, this means that the GTA is indeed an efficient mechanism which helps in achieving the efficient outcome.[10] Further, in so far as the CMA suggests an online portal for delivering quicker and cheaper administration of claims[11], it should be noted that the online portal project started long before the CMA's investigation began and that the project will be implemented irrespective of the CMA's final remedies decision.

2.6 The CMA may ask what difference it makes to AX or the credit hire industry as to whether or not there is an AEC finding if there are no remedies imposed. The answer is that it does matter a great deal as it has serious reputational implications for the credit hire firms and for the industry as a whole. If following a two year inquiry, there is no reasonable and practicable remedy within the CMA's powers that would improve on the current market outcome that is delivered through the GTA, then the implication of that finding is that the market is as efficient as it can reasonably be (noting that the GTA is dynamic and all parties have an interest in increasing efficiency over time) and this should be communicated through a no AEC finding and not through an AEC finding with no remedies imposed.

2.7 In summary, the AEC finding was predicated on comparison to a utopian frictionless world. The CMA made such an extreme comparison contrary to its Guidelines and solely for the purposes of seeking remedies. If the CMA cannot identify remedies superior to the existing 'Remedy' of the GTA it must conclude there was no AEC in the first place (or even if there are inefficient separation costs (which AX denies), given the structure of tort law, the CMA

8 See paragraph 16 of the Working Paper titled "Estimation of the detriment from the separation of cost liability and cost control (theory of harm 1)", published on 12 June 2014 ("**WP 23**").

9 Paragraph 13, Appendix A of WP 23..

10 The CMA has acknowledged that the GTA is an efficient mechanism. For example see paragraph 66 in Appendix 6.1 of Provisional Findings.

11 See paragraph 23 (a) of the Notice.

has not been able to find a reasonable and practicable way to eliminate them). To maintain the existing AEC finding would be inconsistent with the way the CMA justified the benchmark and unlawful, and (of relevance to AX and the credit hire industry) reputationally damaging and unfair.

2.8 Finally, the CMA need not consider that the logic above sets an adverse precedent. On the contrary, such a conclusion would be entirely sensible. “Frictional costs” arising from non-aligned interests are pervasive throughout the economy. It would make no sense for the CMA to establish that AECs wherever such costs exist relative to utopian worlds in which costs are simply assumed not to exist. Any sensible AEC analysis has to consider whether costs beyond those necessarily incurred exist in order to find an AEC and in the absence of any remedies (proportionate or otherwise) that simply cannot be the case.

3. FUNDAMENTAL PROBLEMS ASSOCIATED WITH REMEDY 1C VARIANT

3.1 There are a multitude of fundamental problems associated with the Remedy 1C Variant. The majority of the problems that AX identified in relation to Original Remedy 1C also equally apply to the Remedy 1C Variant. Moreover, there are a number of additional material complications, which the CMA has not considered. The Remedy 1C Variant will, therefore, be more problematic and will bring about the same unintended consequences as the original proposed price cap fundamentally depriving consumers of the benefit of credit hire services.

The CMA does not have the statutory power to impose a price control remedy

3.2 Firstly, and most importantly, the CMA does not have the power under Schedule 8 of the 2002 Act to impose a price cap in circumstances in which the CMA has not identified in its PFs the price that requires remedial action.

3.3 Paragraph 8(1) Schedule 8 of the 2002 Act provides that the CMA can make an Order that regulates the price that can be charged for any goods or services. However, Paragraph 8(2) Schedule 8 makes it clear that *"No order shall be made by virtue of sub-paragraph (1) unless the relevant report in relation to the matter concerned identifies the prices charged for the goods or services as requiring remedial action"*.

3.4 There is nothing in the CMA's PFs (the precursor to its Final Report which is the "Relevant Report" for the purposes of Schedule 8) which either (i) defines the relevant price that is charged to not at fault accident victims; or (ii) which finds that any such price that is charged is too high and requires remedial action.

3.5 In fact, the provisional AEC as found by the CMA is one that is a combination of (i) separation (which is a function of the law of tort); and (ii) various practices and conduct, leading to excessive frictional and transactional costs. One aspect of the alleged friction is that CHCs are, allegedly, charging more than the costs incurred. This was analysed by the CMA by reference to direct hire rates.

3.6 However, as the CMA now recognises in the Notice it is still considering and investigating the differences between direct hire rates and credit hire. As AX set out in its response to the PDR[12] the CMA did not appear to fully understand the nature of direct hire and what consumers were obtaining under direct hire and at what cost. Therefore, the CMA does not know whether the credit hire rate (to the extent it can define a credit hire rate) is too high.

3.7 Therefore, it is clear that the CMA has not undertaken sufficient analysis in order to define a price that requires remedial action.

3.8 AX is utterly disheartened that the CMA appears to have taken seriously the prospect of the Remedy 1C Variant which was described as the "*relatively easy solution*"[13] by an insurer, but which suggestion was premised on the CMA "*tackling the **inflated costs from credit hire***"[14]. As set out above, the CMA has not undertaken any necessary or sufficient analysis of the costs of credit hire and whether these are inflated by reference to an appropriate benchmark. It has, therefore, not found that the price of credit hire is too high such that it is able to impose a price cap remedy.

3.9 In any event, the CMA ought to realise that this proposal was put forward only with the insurer's own interests in mind, namely (i) lowering their costs and, (ii) in an attempt to reduce the effectiveness of CHCs/CMCs, who are insurers' only direct competition in the provision of TRVs (and their existence is the only reason insurers provide direct hire services at all).

The Remedy 1C Variant will not address the AEC

3.10 As previously submitted by AX[15], the CMA can only know if its proposed remedies will address the AEC if it understands (a) what proportion of the net detriment identified is made up of (i) frictional costs unavoidable due to separation; versus (ii) *"excessive"* frictional costs

12 Paragraphs 5.10 to 5.15, AX's response to the PDR dated 8 July 2014.

13 Paragraph 1.2(b), Direct Line Insurance Group Plc, response to the PDR.

14 Paragraph 1.2(b) Direct Line Insurance Group Plc's response to the PDR.

15 Paragraphs 4.2 to 4.9, AX's response to the PDR dated 7 July 2014.

and (b) what drives any excessive frictional costs. However the CMA's AEC analysis is flawed in that it fails at both stages:

3.10.1 It has not identified what proportion of the net detriment is due to unavoidable frictional costs caused by separation versus excessive frictional costs; and

3.10.2 It has not identified what drives the "excessive" frictional costs i.e. it does not know what drives the disputes that these allegedly excessive frictional costs relate to.

3.11 Therefore, the CMA is not in a position to put in place a remedy designed to address the alleged "excessive" frictional costs. It simply does not know what these amount to and so cannot assess how to remedy them or whether its proposed remedy is proportionate.

3.12 The Remedy 1C Variant (like the original version) remains an unusual price control as the CMA is capping credit hire rates, in an attempt to drive down frictional costs (which are a function of separation). However, this can only make sense if by regulating the price that CHCs charge their customers at a particular level that frictional costs will fall. As Compass Lexecon explained in its comments on the PDR[16], the CMA has not undertaken any analysis of the relationship between rates and frictional costs and does not know what the elasticity of frictional costs is with respect to the price level.

3.13 The CMA itself finds that only a substantial price reduction would affect (and lower) frictional costs[17]. However, for the reasons set out below, Remedy 1C Variant should not be set lower than BHR or at a rate lower than that which allows CHCs to fully recover all their costs. Any lower price would impact on consumers' ability to receive their full legal entitlement.

3.14 Moreover, as the CMA does not know what drives frictional costs, it does not know whether the remedy will be effective in dealing with the AEC it alleged exists in excessive frictional costs. Accordingly, the CMA's proportionality assessment is flawed. For example, if only a few disputes relate to the price level (and there is no evidence that there would be fewer disputes at a lower price level), the price cap remedy is unlikely to be effective and or proportionate. See further paragraph 4.7 of AX's response to the PDR.

16 Paragraphs 17 to 30 of Compass Lexecon's comments on the PDR, dated 8 July 2014.

17 See paragraph 2.65 of the PDR.

3.15 Insofar as the Remedy 1C Variant is also aimed at tackling (and reducing) frictional costs in relation to duration, need or liability either directly or indirectly, there is no suggestion from the CMA that it will have this effect[18].

3.16 As set out in *inter alia* paragraphs 4.1.3 and 6.25 of AX's response to the PDR (which AX repeats in this submission), even with a rate cap in place, at fault insurers will still have an incentive to dispute liability, need and hire duration. This incentive remains irrespective of whether the cap is on what CHCs can charge their customers or on what can be claimed from at fault insurers.

3.17 Not at fault insurers have as their primary motive the interests of stakeholders (and are unjustifiably being favoured under the Remedy 1C Variant, as the rate cap will not apply to them). It is in the not at fault insurers' interests to limit the total amount payable to a not at fault claimant and so there is no reason to believe that pre-litigation disputes (such as withholding payment in order to negotiate a settlement) and litigation over need and hire duration will be fewer or disappear). The CMA recognises at paragraph 2.105(b) of the PDR that hire duration is a significant source of dispute and nothing in the Remedy 1C Variant will address hire duration.

3.18 Moreover, the proposed Remedy 1C Variant does not include any measure to address disputes over liability which arise irrespective of the price charged by CHCs to their customers. Therefore, there is no reason to believe liability disputes will lessen. AX repeats the submissions made in Section 4 and paragraph 6.25 of its response to the PDR and paragraphs 17 to 30 of Compass Lexecon's comments on the PDR. Even if the rate cap was intended to apply in a dual way (which is not clear from the Notice and it is not clear how this could work in any event) AX would repeat the submissions it made in its response to the PDR on why a dual rate cap will not reduce disputes over liability and would be impractical to operate in a way that allowed it to comply with its consumer protection and TCF obligations[19].

The imposition of the price cap will lead to consumers not receiving their full legal entitlement

3.19 As set out further below at paragraphs 4.1.9 to 4.1.14 if CHCs are capped in relation to the price they can charge their customers, and the level of the cap is too low, then they will either (i) reduce the service they offer; or (ii) exit the market.

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18 See further paragraph 4.9 of AX's response to the PDR which is repeated dated 7 July 2014.

19 Paragraphs 1.95, 6.46.5 and 6.51 to 6.85, AX's response to the PDR dated 7 July 2014.

3.20 For the reasons set out in AX's response to the PDRs, this was a concern in relation to Original Remedy 1C and remains a serious concern in relation to Remedy 1C Variant.

The imposition of a price cap will create an entirely closed system which will give rise to a risk of explicit or tacit collusion

3.21 As set out in AX's Response to the PDR the elimination of credit hire would transform the provision of TRV to a "*closed system*" in which only insurers provide TRVs to non-fault drivers. See further paragraph 6.50 of AX's response to the PDR.

3.22 This outcome would give rise to strong incentives to explicitly or tacitly agree not to provide consumers' legal entitlement (given that this would allow them to avoid collectively the cost of TRV provision). See further paragraphs 5.1 to 5.9 of AX's response to the PDR.

3.23 The Remedy 1C Variant does nothing to alter the consequence that credit hire will be eliminated and makes this position even more likely in that insurers would not be subject to any control on the value of the claims they can make against at fault insurers. This would give rise to an even greater concern about collusion as it is an entirely closed system in which it is plainly in the interests of the insurers to reach agreements between themselves over provision and the level of charges.

Remedy 1C Variant will distort competition between CHCs and insurers

3.24 Furthermore, as recognised by the CMA in the Notice the Remedy 1C Variant would distort competition between insurers and CHCs (to the extent that they remain active in the market which is unclear).

3.25 CHC's would be artificially prevented from competing with insurers who can recover from at fault insurers at a higher rate. The Remedy 1C Variant would put CHC's at a competitive disadvantage as their recovery may be lower than insurers unless the price they can charge customers was capped at a level that allowed them to recover their costs in full with an appropriate profit margin. In practice, insurers will have no incentive to offer a better direct hire service, as CHC's (if they are even active on the market) will be restricted in what they can charge, and what level of service they can provide.

3.26 Such a distortion of competition cannot be a proportionate outcome of a remedy. The CMA must consider these consequences fully and in line with its own guidance which states that the CMA will consider the potential negative effects of its proposed remedies, including:

"*unintended distortions to market outcomes*. *This is more likely to be the case where behavioural remedies are used which intervene directly in market outcomes, especially over a long period. Such distortions may reduce economic efficiency (including dynamic incentives to invest and innovate) and adversely affect the economic interests of customers over the longer term*" (emphasis added).[20]

The price cap cannot be set lower than BHR / must allow CHCs to recover their costs as otherwise consumers will not be able to realise their full legal entitlement

3.27 The effect of the CMA's approach would be to create a two tier system: (i) CHCs limited to the rate cap, and (ii) insurers who are able to recover the BHR. This evidently creates a distortion of competition. The CMA has raised a question about whether Courts are likely to follow the new rate cap (and depart from previous decisional practice to apply the BHR). There is no reason to suppose the Courts would or should depart from previous case-law[21]: the Courts are seeking to ensure that drivers recover the full measure of tortious damages that they are legally entitled to. The CMA has already (rightly) concluded that it should not change the fundamental entitlement of accident victims in tort.[22]

3.28 Moreover, the CMA cannot rely on a purely speculative hope that the Courts will reduce the level of recovery of accident victims so as to eliminate the distortion of competition which the CMA is proposing to introduce.

3.29 The Courts would continue to apply the BHR (as they currently do) and make their assessment on the basis of what rate the consumer could have hired an equivalent car for, on comparable terms in his local area. Moreover, non-fault drivers who are "*impecunious*" (i.e. those who are more vulnerable as they do not have the financial means to hire a vehicle at BHR) would continue to be entitled to recover the *full* credit hire charges, even if they exceed the BHR. Again, see paragraphs 2.8 to 2.9 of AX's response to the PDR.

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20 Paragraph 352 of the"Guidelines for market investigations: their role, procedures, assessment and remedies" (April 2013) and adopted by the CMA.

21 The Courts have already held that the GTA has no basis in determining issues before the Court see *Burdis v Livsey* [2001] 1 W.L.R. 1751

22 Even if the Courts did depart from previous decisional practice (which AX submits would not happen) the adoption by the Courts of the CMA's rate cap would lead to (i) increased friction as insurers would seek to avoid settling claims in light of the fact the Courts would impose the CMA's rate cap, (ii) increased litigation resulting in appeals seeking to confirm the current state of the law as to the recovery of damages, and (iii) uncertainty in an environment which has established, through the collaborative operation of the GTA, certainty in respect of the management of the majority of tort claims processed through the GTA. The CMA has not assessed or quantified any of these new sources of friction or consumer detriment.

3.30 In order to avoid any such distortion of competition, and in order to allow CHCs to operate profitably[23] any cap on what CHCs can charge their customers would have to be set at a level that allowed CHCs to recover all the costs they incur in providing consumers with their full legal entitlement. Otherwise, CHCs will either (i) exit the market; or (ii) be forced to reduce what they offer consumers. In either case consumers will suffer and will not be able to achieve their full legal entitlement from CHCs. Consequently, they will be left with little options and a world in which insurers will still have little or no incentive to provide TRVs.

3.31 For the purpose of this submission, AX sets out below a recap of the submissions which it has already made in its response to the PDR in relation to the setting of the rate:

3.31.1 The CMA has undertaken no analysis of what costs CHCs should be entitled to recover under any rate capping what they can charge their customers. As set out in paragraph 5.1 of AX 's Response to the PDR credit hire provides claimants with a wide range of services that they are legally entitled to (subject to mitigation). The costs of provision of these services would need to be allowed for in any price control.

3.31.2 Moreover, CHCs would need to be able to recover their costs of assessing liability, and any rate cap would need to take account of the risks that arise in the claimant's pursuit of their losses and the consequential (and material) risk that CHCs will not be paid by their customer. AX refers the CMA back to paragraph 6.46 of its response to the PDR which details these risks and the issues arising from a cap on the charges they can levy on their customer.

3.31.3 As set out above, the CMA concluded in the PDR that a large reduction in prices was necessary for the remedy to have any effect on the AEC[24]. However, as AX explained in its response to the PDR, this is likely to lead to unintended consequences causing non-fault drivers not to realise their legal entitlement. In particular, any large reduction in the price that CHC's could charge will eliminate credit hire. The CMA has not considered this at all in its Notice. See further paragraph 5.1 to 5.9 of AX's Response to the PDR.

3.31.4 It is very likely (unless the cap is set at current credit hire rates or BHR) that a cap on CHCs charges would eliminate credit hire. A cap that did not allow a

[23] See further paragraphs 6.51 to 6.65 of AX's Response to the PDRs on what costs CHCs must be entitled to recover and Annex A of Compass Lexecon's comments on the PDR, dated 7 July 2014.

CHC to recover its costs would also have the consequence that CHCs will no longer be able to pay significant referral fees to insurers and therefore insurers may decide not to refer non-fault claimants to CHCs.

3.31.5 Before deciding whether to limit the amount a CHC can charge for the provision of a TRV, the CMA must investigate the incentives for a CHC to provide at different price levels. A price that is too low will alter the incentives of a CHC to provide a TRV to a non-fault claimant; either at all or one that gives them their full legal entitlement to a like for like replacement vehicle. Any impact on consumers receiving their full legal entitlement will render the remedy unlawful. See further paragraphs 6.132 to 6.135 of AX's response to the PDR

3.32 The consequence of the elimination of credit hire would be extreme. Consumers will be left without recourse to a service of real benefit to them and which has proved effective in bridging the "practical gap" which the courts have identified. See paragraph 2.25 of AX's response to the PDR.

3.33 Furthermore, the CMA has not analysed the incentives of insurers to provide consumers' legal entitlement if credit hire were to disappear. The CMA has not considered whether consumers would be able to obtain all the other services to which they are legally entitled and which are currently provided under credit hire. As set out in paragraph 2.12 of AX's Response to the PDR not at fault insurers and at fault insurers do not have an (or any sufficient) incentive to provide a TRV to not at fault accident victims and/or provide them with their full legal entitlement.

3.34 In a post-remedy world without CHC's and no cap on what insurers can recover under subrogated claims, insurers would have weak unilateral incentives to provide consumers' legal entitlement.[25]

3.35 The Remedy 1C Variant is biased towards at-fault insurers with all obligations and restrictions being placed on CHCs and the innocent victims of road accidents. In a world in which CHCs do remain (which is far from certain unless the price was set at a level that allowed CHCs to recover their costs), at-fault insurers retain the ability to perpetuate friction in relation to need and period and continue to have the incentive to do so in order to avoid hire charges, or reduce them even further. Alternatively, they have the incentive to reduce

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24 Paragraph 2.52, PDR.

25 Paragraph 5.6, AX's response to the PDR.

consumers' legal entitlements by utilising direct hire providers who consistently provide a deficient service. See further paragraphs 5.10 to 5.18 of AX's response to the PDR.

3.36 The CMA must analyse all these variables when setting the rate cap and the possible consequences of Remedy 1C Variant before it can consider proposing this as an alternative price control remedy.

3.37 In light of the above, the only way the CMA can avoid this remedy creating a distortion of competition and to ensure that CHCs will remain viable, would be to raise the level of the cap to the level of the BHR.

Definition of the circumstances in which the Remedy 1C Variant should and should not apply

3.38 We note that the CMA recognises one of the problems with the Remedy 1C Variant is that there will be a "*need for a clear definition of the circumstances in which the remedy should and should not apply to vehicle hire transactions*" (paragraph 17(a) of the Notice). The CMA states that,

"*Under this definition, an individual non-fault claimant would still be able to go to a vehicle hire retail outlet, rent a vehicle on a credit or debit card and seek to recover the costs themselves. However, we would not expect this to happen in many cases*."[26]

3.39 Contrary to the CMA's view that consumers would still be able to hire a car on their credit card without the car hire company being subjected to this charge, this definition would in fact cover that situation. In cases such as these, the car rental company has a contractual arrangement with a credit card provider to accept credit cards and so would appear to be capped in what it can charge the customer. This plainly is not the intention behind the CMA's Remedy 1C Variant, and would introduce a number of problems for consumers, who presumably would have to discuss the purpose of hiring a car with the car hire provider (i.e. whether it is intended to be used as a TRV or not?).

3.40 It could also result in CHCs being obliged to charge less than traditional car hire companies and as such CHCs would have to introduce a new layer of customer verification to ensure that they were not being used as a cheaper source of car hire by a consumer that had not, in fact, been involved in an accident and was sourcing a TRV.

26 Paragraph 19, Notice of Further Consultation.

3.41 This serves to highlight the practical difficulties inherent in defining the transactions the CMA is seeking to cap. It is not clear how such transactions could be defined in a way that did not involve an additional cost for the car hire company or which could not be circumvented.

3.42 Moreover, it is not clear how the CMA could easily monitor compliance with the remedy.

4. THE CMA'S SPECIFIC QUESTIONS

4.1 At paragraph 21 of the Notice, the CMA sets out a number of questions for parties. AX's responses to these points are as follows:

(a) Is the alternative approach an effective way in which to implement Remedy 1C?

4.1.1 As set out at paragraphs 3.2 to 3.23 above, AX considers all of the concerns and problems in relation to effectiveness which applied to Remedy 1C (and set out in AX's response to the PDRs) equally apply to the CMA's alternative approach.

4.1.2 The Remedy 1C Variant would be wholly ineffective if the ability to recover the BHR via subrogated claims remained; the CHC's business models will adapt accordingly. Mobility insurance policies would be issued (possibly through FCA regulated CHCs themselves) in order to ensure that hire claims were (true) subrogated claims. Some CHCs (including AX) already operate similar policies within their businesses. These would become the norm, replacing traditional credit hire arrangements where there is no subrogation. Because in these subrogated claims, mitigation defences are more difficult to run, insurers may even end up paying more under this model. Consumers often do not pay for these mobility policies, and it is likely that they would be provided free of charge in a world in which the Remedy 1C Variant existed, as a mechanism to enable TRV providers recover hire charges at the BHR rather than the rate cap.

(b) Would the remedy create distortions between the provision of temporary replacement vehicles to non-fault claimants and the provision of hire vehicles to retail customers?

4.1.3 Assuming the CMA could draw a defining line between CHCs and traditional hire companies (which would be very difficult in itself), there would clearly be a distortion in the provision of hire vehicles. This would result in a scenario where it would be cheaper to hire a car from a "CHC" rather than a "traditional" hire company. It could even encourage some consumers to attempt to hire a car from

a CHC where there has in fact been no accident (in order to benefit from the CMA's capped rate) rather than go to a traditional hire company.

(c) Whether the definition in paragraph 18 would capture effectively the provision of credit hire vehicles to non-fault claimants or whether there are any further circumvention risks from the proposed wording?

4.1.4 See paragraphs 3.38 to 3.42 above. The CMA's definition might encompass "normal" car hire.

4.1.5 It is also perverse that the CMA is attempting to apply a cap to hire companies, simply by virtue of the fact that they provide, in addition to a hire vehicle, (a) credit and (b) assistance (see paragraphs 18 (a) and (b) of the CMA's Notice. In other words, the CMA would be requiring buisnesses that offer a greater level of service to consumers at the same time to charge less.

(d) Whether the remedy would create distortions between CHC/CMC provisions and non-fault insurer provision of temporary replacement vehicles?

4.1.6 As set out above, AX considers that the Remedy 1C Variant would create distortions because it would allow (and even encourage) insurers to "earn a rent" from the provision of hire (i.e. the original premise of the CC's ToH 1), whilst subjecting one particular business model to an arbitrary cap that does not reflect its own costs of provision, or the additional benefit of credit that it provides to its customers.

(e) Whether the Courts would be likely to limit the sums recoverable in subrogated claims to the rate cap set by the CMA on the basis that this indicates the reasonable cost, or, if not, whether the cap for CHC/CMC provision would have to be set at a level which aligned with that currently allowed by the courts for subrogated claims for temporary replacement vehicles; and whether a dual-rate cap would create greater ambiguity for the courts in these circumstances?

4.1.7 As set out at paragraph 3.27 to 3.37 above, the effect of the CMA's approach would be to create a two tier system whereby CHCs would be limited to the rate cap on the one hand, and insurers would able to recover the BHR on the other. This plainly creates a distortion of competition, and there is no reason to suppose the Courts would or should depart from previous decisional practice and start

applying the CMA's rate cap: the Courts are seeking to ensure that drivers recover the full measure of tortious damages.

4.1.8 Moreover, capping the rate to the present BHR would be utterly nonsensical and ineffective as a remedy. It would be entirely disproportionate for the CMA to implement a remedy which is as extreme and costly as a price cap, at the same rate that is being enforced by the Courts.

(f) Whether the remedy might be expected to lead to greater provision of temporary replacement vehicles by non-fault insurers under the terms of individual's insurance policies, and the benefits and costs of this greater provision if it occurred?

4.1.9 As set out above, the Remedy 1C Variant is likely to result in credit hire disappearing from the market leaving consumers without the necessary assistance that credit hire gives in order for consumers to be in a position to realise their full legal entitlement. The CMA has not properly recognised this (and in fact appears indifferent about this being the outcome in the PDR)[27].

4.1.10 AX's primary view is that insurers would not have an incentive to provide consumer with their full legal entitlement and would only provide TRVs so primarily to earn the rent which subrogation would allow. Whether or not consumers would in reality have access to a TRV post-accident would depend entirely on whether their insurer wanted to operate in that market or not.

(g) Whether the Remedy 1C Variant creates any other unintended consequences, costs or benefits from those already expressed?

4.1.11 AX has already set out above its concerns about the impact of a rate cap on the ability of CHCs to continue to provide consumers with their full legal entitlement; let alone exist at all.

4.1.12 In addition any dual rate cap would be impossible to document (in a way that was compliant with the FCA's Treat Customers Fairly regime and the consumer protection / unfair contract regimes). See further paragraph 6.46.5 and 6.106 to 6.107 of AX's response to the PDR.

27 See paragraph 2.99, PDR.

4.1.13 Moreover, to the extent the Remedy 1C Variant is to apply in a dual way this would increase the complexity of the dual rate cap because it has to be clearly set out in the contractual documentation with the consumer. Alternatively, the rate set out in the hire agreement would have to be the highest rate that might apply – which could be current BHR plus penalties. In which case, the remedy is not achieving any reduction in price (let alone any obvious reduction in alleged excessive frictional costs).

4.1.14 As set out at paragraphs 3.24 to 3.26 above, the Remedy 1C Variant will also unfairly benefit at-fault insurers with all obligations and restrictions being placed on CHCs and the innocent victims of road accidents.

5. MARKET PRACTICES AIMED AT REDUCING FRICTION

Encouraging the GTA to adopt aspects of Remedy 1C (and 1F)

5.1 The Notice states that should the CMA decide not to pursue Original Remedy 1C, it would be keen to encourage market practices which reduce friction between at-fault insurers and parties representing non-fault claimants. In line with this outcome, the CMA suggests that it might, for example, encourage the GTA to adopt aspects of Original Remedy 1C (and 1F) not already part of the GTA (such as a dual-rate system, the Mitigation Declaration Statement, and an online portal) to deliver quicker and cheaper administration of claims and rates which are more in line with those which some insurers and CHCs have agreed through bilateral agreements.

5.2 AX would support the CMA's decision to encourage market practices which reduce friction. However, AX would strongly disagree with encouraging the GTA to adopt aspects of the Original Remedy 1C which are not already part of the GTA (in particular the dual-rate system), on the basis that the CMA has not been able to show that such aspects of Original Remedy 1C were capable of removing disputes over liability, need or duration. The introduction of these measures will not reduce friction and will, in fact, be more likely to increase friction.

5.3 AX recognises the benefits of the GTA in its current form, it provides flexibility in the settlement of claims and provides a framework for setting hire rates according to the circumstances of individual cases. Moreover, the GTA's online portal, which was conceived ahead of the CMA's current investigation will likely reduce frictional costs.

5.4 As set out in full in Section 8 of AX's response to the PDR, AX considers that strengthening the GTA, together with opening up a dialogue with insurers will be far less onerous, and a much more effective, simpler and transparent way of reducing friction. Most importantly, this would ensure the preservation of consumers' full legal entitlement.

5.5 Moreover, encouraging the GTA to implement remedies that it is already in the process of implementing, in particular the developing of an online portal (indeed the progress of such developments are being impeded by the CMA's investigation) though not objectionable as a remedy on its face, it would be entirely unnecessary in relation to an AEC finding that ought to relate to inefficiencies that are not being addressed in the status quo.

Encourage insurers to take action themselves to reduce frictional costs

5.6 The CMA also suggests encouraging bilateral agreements amongst insurers (as an alternative to the Remedy 1C Variant), despite itself recognising the aligned incentives of insurers to minimise TRV provision in denial of victims' legal entitlement and moreover despite not having published any consultation on the scope of bilateral. It would be an utterly perverse outcome for the CMA to advocate an instrument that actually or at least readily can be used to undermine victims' rights. AX has urged the CMA to properly investigate bilateral agreements on the basis that, based on tender documents which AX had declined to tender against, there was a conflict between competing insurers seeking to reduce their own costs by limiting the legal entitlement of a not at fault driver where it suited their commercial interests but opting to increase the charge where they could earn a rent from a non-participating insurer[28]. AX is seriously concerned that this behaviour is akin to cartel behaviour and that evidence of this behaviour (clearly aimed at curtailing consumer's legal entitlement) has not been investigated by the CMA nor taken account of in the CMA's Notice. Rather, the CMA (without any justification or explanation) treats insurers' incentives in this regard as completely legitimate and benign. The CMA has not acknowledged these concerns (and it does not appear the CMA has investigated them either). It now seems reckless for the CMA to seek to consider encouraging insurers to engage with each other on a bilateral basis, which will clearly increase the risk of collusion.

5.7 AX also notes the CMA's other suggestion of encouraging insurers to take action amongst themselves to reduce frictional costs, "*in situations where insurance policies are extended so as to provide a like-for-like temporary replacement vehicle to a non-fault claimant under the*

[28] See paragraph 3.2.2 of AX's response to the Statement of Issues, dated 11 January, paragraph 6.9 to 6.10 of AX's response to the PFs and section 3 of Compass Lexecon's report of the PF's.

terms of the insurance policy; and extending a non-fault claimant's insurance cover to their temporary replacement vehicle so removing the need for the CHC to incur costs in providing this insurance".

5.8 AX understands this to mean the CMA would seek to encourage not at fault insurers to transfer the insurance cover from a non-fault victims own car to the CHCs hire car, as a means of reducing cost. This suggestion only serves to highlight the CMA's lack of understanding of the key issues. If a not at fault driver suffers an accident, and mitigates his loss by hiring a car, then he is entitled to a fully insured hire car without any excess applicable. This is his legal entitlement.[29] Essentially, the CMA would be encouraging not at fault insurers to mislead not at fault drivers to transfer their own insurance at their cost (or miss-sell to them on this basis), when this is a cost which they are entitled to recover by law.

5.9 Requiring the not at fault driver to transfer his own insurance cover would create a multitude of problems (in addition to denying his full legal entitlement) such as:

5.9.1 Any hire company that seeks to claim for any damage to the rental car (even when the hirer may not accept the veracity of the claim) will give rise to a cost to the innocent motorist's insurer, which will ultimately increase the innocent motorist's premium.

5.9.2 Any claims for damage to the hire car brought by the not at fault driver will arise without the consent of the hirer.[30] Where not-at-fault drivers are forced to use the services of a hire company, they have no control over the consequences of what might be minor damage caused to the hire vehicle: it may be the case that if a customer, for example, scuffed their own vehicle's alloy wheels, they would choose not to incur the costs of what might be a relatively expensive repair. They do not have that option if they cause similar damage to a hire vehicle: the hire company will charge them the full cost of repair (which they might not even undertake) and this might be below the level of the customer's excess on their own policy. However, the law entitles them to recover the costs of hiring a vehicle with a zero excess, the law recognising the fact that not-at fault drivers who hire a TRV in mitigation of their loss should not be required to bear the same level of risk they might in connection with their own vehicle when they cannot control the decision whether or not to have any damaged repaired. A not at fault

29 See *Marcic v Davies*, [1985] C.L.Y. 12 (unreported), Court of Appeal (Civil Division)

30 See *Marcic v Davies*, [1985] C.L.Y. 12 (unreported), Court of Appeal (Civil Division)

driver should not be forced to risk a claim against his own policy, and an increase in his premiums as a result of such a claim and a reduction in his no claims bonus; all to reduce the costs which should rightly be borne by the at fault driver or his insurer.

5.9.3 More fundamentally, the CMA would be reducing costs for insurers at the expense of eroding the rights and undermining the financial security of the innocent motorist.

5.9.4 The CMA has also not considered the significant new friction that would arise with increased claims being made against insurers of not at fault drivers by the hire company keen to ensure its rental fleet stays in perfect condition at the end of every hire, even if the insurance industry was prepared to expose itself to that risk. The CMA has not considered this material impact on the wider insurance market.

5.9.5 Even if insurers and innocent motorists were prepared to forget the legal protection they currently have not to transfer their own insurance cover to a hire car, to reduce the claim against a tortfeasor, it is not clear on what basis the CMA believe the rental industry will be able to avoid insuring its fleet. It is highly unlikely that TRV providers could operate an 'uninsured' fleet at all when their financing / loan obligations almost always require the fleet to be fully insured by the hire company. As such, it is unlikley that this would result in any costs reduction for TRV providers.

6. CONCLUSION

6.1 Whilst AX agrees with the CMA's views that Original Remedy 1C cannot be implemented, it is deeply concerned that the CMA has not recognised that the Remedy 1C Variant will have many of the same fundamental problems.

6.2 Moreover, it will introduce new problems that the CMA has not acknowledged the seriousness of.

6.3 Fundamentally, the Remedy 1C Variant is not possible within the CMA's statutory powers and will:

6.3.1 Not be effective in remedying the alleged AEC;

6.3.2 Lead to not at fault drivers not receiving their full legal entitlement;

6.3.3 Give rise to a serious distortion of competition between insurers and CHCs and lead to a closed system that will facilitate collusion between insurers; and

6.3.4 Will be highly prone to circumvention.

6.4 For all these reasons (as set out fully above) the CMA should not proceed with the Remedy 1C Variant. Furthermore, it should not proceed to recommend that the GTA adopt aspect of the Original Remedy 1C that would only serve to increase friction; or to encourage insurers to "collude" more under bilateral agreements.

DLA Piper UK LLP

For and on behalf of Accident Exchange